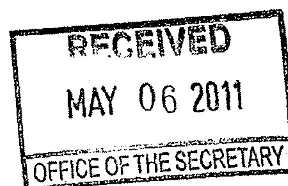
UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of:	)	
	)	ADMINISTRATIVE PROCEEDING
JOHN P. FLANNERY and	)	FILE NO. 3-14081
JAMES D. HOPKINS	)	
	)	



JOHN PATRICK ("SEAN") FLANNERY'S POST-HEARING REPLY BRIEF

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I. INTRODUCTION

John Patrick ("Sean") Flannery submits this Reply Brief[1]. In the face of overwhelming evidence, the Division of Enforcement (the "Division") has conceded that SSgA Global Advisors ("SSgA") dedicated tremendous time and resources to the client letters at issue; that the letter-drafting process was inclusive and key members of the Relationship Management, Legal, and the Fixed Income team reviewed the letters; and that multiple meetings were held to discuss and refine each of the letters. Division of Enforcement's Post-Hearing Brief ("Div. Post-Hearing Br.") at 56. The Division has also conceded that the information they claim should have been included in the letters was available to SSgA's sophisticated investors upon request (Order Instituting Proceeding ("OIP") ¶ 36), consistent with SSgA's business model and industry practice for unregistered funds such as LDBF (Peavy Tr. at 3022:4-13), and that Relationship Management and Legal knew that this was how information was being communicated to investors (*e.g.,* Carlson Tr. at 2734:9-2735:7; Duggan Test. Stip. 322:6-323-16, 326:11-17 (regarding FAQs)). Moreover, there is no dispute that the letters accurately reflected the Fixed Income team's and Mr. Flannery's honestly held opinion of the market (*e.g.*, Flannery Tr. at 1049:9-18, 1173:22-1175:11; Pickett Tr. at 1731:25-1732:4; Flannery Exs. 86, 133), the steps being taken by the Fixed Income team in response to market conditions, and the Fixed Income team's and Mr. Flannery's honestly held belief that those steps reduced risk in LDBF's portfolio (Flannery Tr. at 1049:19-1050:8; Wands Tr. at 2865:15-2866:5 (regarding steps taken to reduce risk); *see* Pickett Tr. at 1743:23-1745:5; *see also* Division's Proposed Findings of Fact ("Div. PFOF") at ¶ 368). Indeed, expert witness Ezra Zask testified without contradiction that the transactions did, in fact, reduce risk. Zask Tr. at 2357:2-16.

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[1] Mr. Flannery will not repeat the arguments set forth in his main brief, and will instead seek to respond to the arguments as set forth by the Division of Enforcement in its Post-Hearing Brief.

Rather than evaluating its claims against Mr. Flannery in light of that and the other evidence actually adduced at trial, the Division has continued to isolate discrete portions of the client letters to try to point out supposed deficiencies. In so doing, the Division has ignored key evidence, mischaracterized other evidence, and advanced arguments wholly unsupported by the evidentiary record and flatly contradicted by even the witnesses they called at trial, including their own experts. For example, the Division claims that:

- The cash from the AAA bond sale had exited LDBF by August 2nd, four days after the sale proceeds were received. Div. Post-Hearing Br. at 40. This assertion is incorrect; in fact, hundreds of millions of dollars in cash remained in the fund on August 2. *See* Section II.A.1, *infra*.

- OFA received "privileged information" which caused it to recommend that its clients redeem. Div. Post-Hearing Br. at 28-30. However, Martha Donovan, whose testimony is unrebutted, testified that OFA's recommendation to its clients was based solely on the underperformance and volatility in the fund—information that was known to all LDBF investors. Donovan Tr. at 1809:4-19.

- The so-called "Related Funds"—SSgA funds invested in LDBF—received "privileged" information and also left the fund by August 2nd. Div. Post-Hearing Mem. at 28-29. However, there is simply no evidence that they received information not available to other investors and, in any event, the information that they received caused the related funds to maintain nearly 900 million dollars of exposure to the LDBF strategy through in-kind redemptions. *See* Sections II.A.3.a and III.A.1, *infra*.

- SSgA's Deputy General Counsel, Mark Duggan, was not provided with facts about LDBF by Mr. Flannery. Div. Post-Hearing Br. at 46. However, as Mr. Flannery well-knew, Mr. Duggan and Legal were heavily involved in LDBF-related issues during the Summer of 2007, and reasonably believed that Mr. Duggan and Legal were fully aware of LDBF's issues, including the facts disclosed in the FAQs, a process that Mr. Duggan supervised. Moreover, Mr. Flannery invited Mr. Duggan to attend the July 25 Investment Committee meeting, which focused almost exclusively on LDBF-related issues, and met with Mr. Duggan separately on more than one occasion prior to that meeting to give Mr. Duggan an overview of the issues that LDBF was facing and that would be discussed at the Investment Committee meeting. Flannery Tr. at 1269:25-1272:9, 1281:10-1282:2, 1361:17-1362:2.

The Division also ignores highly exculpatory evidence, such as the August 6 letter, which disclosed that SSgA was anticipating redemptions from LDBF, and announced the creation of LDBF II, a fund conceived by Mr. Flannery that was intended to minimize the impact of any

redemptions on investors who wished to remain exposed to the LDBF strategy. *Id.* at 1293:23-1294:6, 1295:1-3. To the extent they wanted to do so, LDBF clients would be permitted to transfer their investments in kind to LDBF II, and LDBF II, unlike LDBF, would not allow daily withdrawals. *Id.* at 1293:22-1294:6. Rather than freezing LDBF, LDBF II provided investors with three options: stay in LDBF, move to LDBF II, or redeem their investments altogether. *Id.* at 1294:7-1295:13, 1357:4-1358:4[2]. The Division also ignores the uncontroverted evidence that it was Mr. Flannery who requested that lawyers review and approve every letter. The creation of LDBF II and his insistence on legal review evidences Mr. Flannery's good faith, and is simply inconsistent with the notion that he acted unreasonably, let alone that he acted negligently or with *scienter*.

What the Division's claims against Mr. Flannery lack in substance, they seek to compensate for in rhetoric that is contradicted by the letters and other evidence. For example, the Division alleges that Mr. Flannery was "responsible for characterizing the subprime problem to investors as a small problem that SSgA had already dealt with," and misled investors because he hoped to "buy time." However, the text of the letters refute the allegations, because the letters did not soft-pedal the situation. *E.g.*, Div. Ex. 176 ("The level of this underperformance and the degree of market turmoil are unprecedented in our 30-year history as a fixed income manager;" "Against this backdrop of weakening fundamentals;" and "This market situation is extreme and challenging to manage").[3] The Division also makes the inflammatory and wholly unsupported allegation that the Investment Committee decided to "loot LDBF." This is a new and genuinely bizarre allegation that finds no support whatsoever in the record.

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[2] LDBF II and the August 6 letter made clear to investors that redemptions might be so high that a limited liability fund was needed to protect investors from the redemption requests of others.

[3] There is similarly blunt language in the July 26 and August 2 letters, discussed in Sections II.D.2.a and IV.C.2.f, *infra.*

Although this is not a control person liability case, the Division apparently seeks to hold Mr. Flannery liable for the decisions of others. For example, as this Court and the Chair of the Investment Committee stated at trial, Mr. Flannery was not responsible for the fact that Jie Qin of the Office of Fiduciary Advisor ("OFA") chose to stay at the July 25 Investment Committee meeting after Ali Lowe of Global Asset Allocation ("GAA") left. Flannery Tr. at 995:9-998:4; Johnson Tr. at 2396:25-2397:22; *see also* Lowe Tr. at 2005:17-2010:21 (the Court reiterating its prior ruling).[4] Additionally, it is undisputed that Mr. Flannery was not responsible for determining which clients received what information and in what form—these decisions were made by Relationship Management, which reported to Marc Brown, Larry Carlson, and Staci Reardon. Incredibly, the Division attacks Mr. Flannery for not distributing the FAQs to all investors (*e.g.*, "If [Mr. Flannery] 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?" Div. Post-Hearing Br. at 57),[5] but he was not even consulted about the manner of communicating FAQ information, a decision made by the Legal department.

The shortcomings in the Division's claims with respect to Mr. Flannery and the August 2 and August 14 letters are reflected by the extent to which it makes claims not supported by the evidence. Consider, for example, the Division's claims with respect to the August 2 letter. In an effort to rebut the evidence that only five innocuous words of Mr. Flannery's suggested edits ended up in the letter, the Division has asked the Court to "infer" that Mr. Flannery requested

[4] Of course, there is also no evidence that OFA's decision to recommend withdrawal from LDBF had anything to do with the Investment Committee meeting. Donovan Tr. at 1809:4-19 (testifying that OFA's redemption recommendation was based on LDBF's underperformance and volatility, not actual or anticipated redemptions).

[5] Still, the Division has ignored the evidence in this regard. It is undisputed that hundreds of client calls took place during this period. *See, e.g.*, Flannery Ex. 270. The volume of calls was so great that SSgA created a "SWAT Team" and brought in client relations personnel from Europe. Flannery Ex. 215; Carlson Tr. at 2740:11-16.

that the following statement concerning the credit quality of LDBF be inserted in that letter: "Throughout this period, the Strategy has maintained and continues to be AA in average credit quality according to SSgA's internal portfolio analytics." Div. Ex. 159 at SS-SEC 116944-45. The Division claims:

> It is also likely that the sentence first added to the letter during that two hour window was drafted by Flannery . . . .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.
>
> . . . .
>
> 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.

Div. Post-Hearing Br. at 41 (citing to Div. PFOF ¶¶ 373-77); Div. Post-Hearing Br. at 43 (citing to Div. PFOF ¶¶ 377-82).

The Division's claims, however, are not supported by the evidence upon which it relies. Among other things, the Division failed to prove that Mr. Flannery reviewed the letter during the two hour window, and the Division ignores evidence that Mr. Carlson showed the letter to people other than the "four senior officials" to during that period. In fact, Mr. Carlson could have received that information from anyone on the Fixed Income team, with whom he testified he was meeting with on a daily basis, as discussed below. Moreover, the question about who is responsible for this sentence amounts to nothing. The Division has already conceded that the statement was accurate, that the credit quality was AA (Division's Pre-Hearing Brief ("Div. Pre-Hearing Br.") at 18), and that Mr. Flannery, who did not calculate credit quality or know how SSgA calculated it, believed the credit quality was AA throughout the entire period (Div. PFOF ¶ 379; *see also* Flannery Tr. at 1076:2-18 (though it appears in the testimony cited by the Division, the Division omitted from its Proposed Findings of Fact that Mr. Flannery testified he did not

know how SSgA calculated average credit quality)). In short, the Division is asking that Mr. Flannery's career and reputation be destroyed based on speculation that Mr. Flannery might be responsible for inserting a sentence containing information he believed was accurate, and which the Division concedes was accurate. Attached as **Appendix A** is a chart setting forth Mr. Flannery's Response to the Division's Proposed Findings of Fact, which contains numerous other examples where the evidence cited by the Division fails to support the claims it has made.

To try and overcome the evidence it lacks with respect to the August 2 and August 14 letters, the Division has, for the first time, made claims against Mr. Flannery in connection with the July 25 Investment Committee meeting and July 26 letter. Nowhere in its OIP or Pre-Hearing Brief did the Division make any allegations of wrongdoing against Mr. Flannery with respect to the Investment Committee meeting or the July 26 letter, and fairness demands that the Division not be permitted to unveil its new theories after the hearing has concluded and Mr. Flannery has produced evidence in response to the known allegations. In any event, the Division's claims fail because (1) the Investment Committee did not instruct LDBF's portfolio managers to "loot" LDBF of its highest-rated and most liquid assets and allow the cash raised to fund the redemptions of purportedly "better-informed" investors; and (2) the client letters were not misleading.

In the end, the Division's case is that a man with a twenty-seven year track record for honesty, integrity, charitable works, and professionalism somehow lost his moral compass during the first two weeks of August 2007. This case was investigated for years. Testimony was taken from many witnesses, and millions of pages of documents were reviewed by the Division. There is no evidence that Mr. Flannery concealed information, misled anyone, or did anything other than act in a manner entirely consistent with how he has carried himself throughout his career

and his core values as a person. Mr. Flannery acted reasonably, did not seek to mislead investors, and no investors were misled. Mr. Flannery asks that the Court rule in his favor on each of the Division's claims.

II. THE DIVISION'S CLAIMS BASED ON THE AUGUST 2 LETTER ARE NOT SUPPORTED BY THE EVIDENCE.

A. The Division's Assertions Regarding the Cash in LDBF, and How it Was Used, Are Wrong.

The Division contends that the cash raised from the AAA bond sale was entirely depleted by August 2, and that purportedly "better-informed" investors who redeemed before August 2 were advantaged over others who redeemed after that date. The Division evidently contends that Mr. Flannery is responsible for the allegedly less-informed investors staying in LDBF due to his single round of suggested edits to the August 2 letter. As discussed below, the Division's contentions are wrong in every respect, and stand in direct conflict with the evidence.

1. There Was $200,000,000 Cash in LDBF on August 2.

The Division claims that all of the cash raised from the AAA bond sale was gone from the LDBF portfolio within four days, and, in any event, prior to the August 2 letter. Div. Post-Hearing Br. at 26. The Division further posits that "[h]ad the cash generated by the AAA 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." Div. Post-Hearing Br. at 26. While the Division is correct that cash is less risky than securities, the Division is otherwise wrong, as there was ample cash in LDBF on August 2.

The AAA bond sale raised $423,531,480 of net cash proceeds,[6] most of which was received by LDBF on July 30 and 31st, 2007. *See* Div. Exs. 217, 218. While the cash available in LDBF had been reduced by redemptions, there was still a substantial amount of cash available in LDBF on August 2. In fact, on August 2, there was nearly $200,000,000 of cash and cash equivalents in the LDBF portfolio. *See* Div. Ex. 230 ($176 million in cash equivalent securities) and Flannery Ex. 288 ($21 million in bank accounts).

The chart in Fig. 1 on the following page shows the amount of cash paid out for redemptions and the remaining cash balance available at the end of each day, including any cash received from additional sales transactions from July 26 through August 3, 2007.

[6] This figure represents the net proceeds after repayment of financing on the AAA bonds in the amount of approximately $1.1 million, which reduced LDBF's leverage. Div. Exs. 217 and 218; Flannery Exs. 299 and 300.

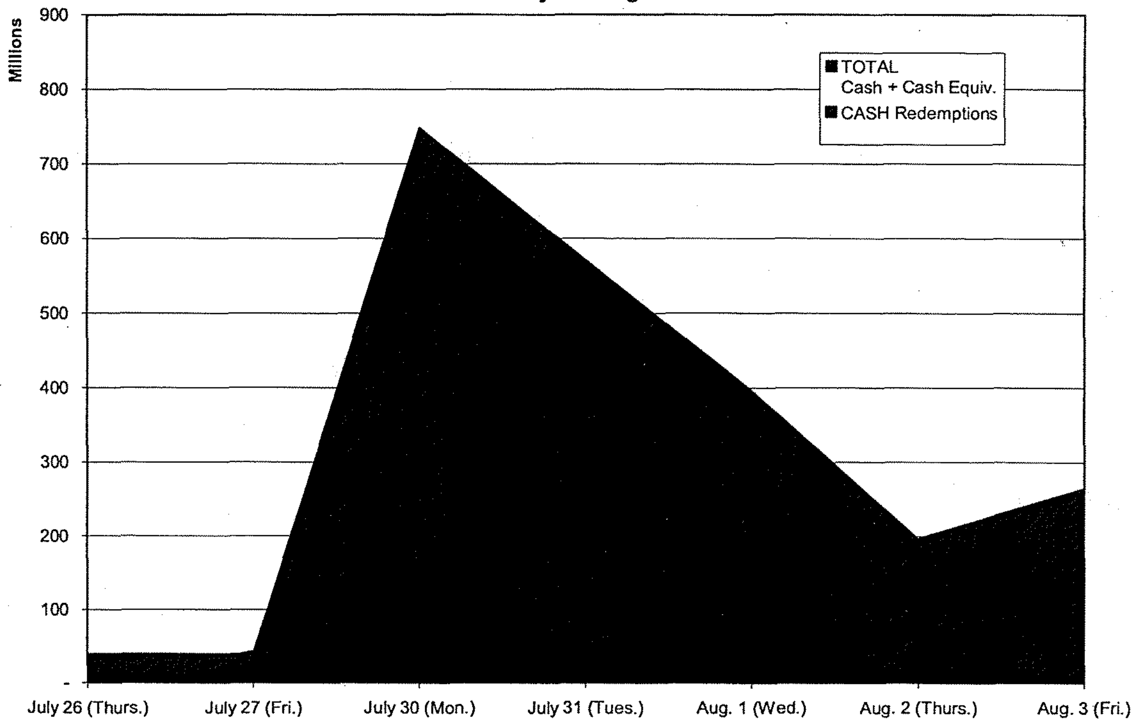

Fig. 1[7]

As Fig. 1 and the evidence underlying it demonstrates, even after paying out cash redemptions from July 27 through August 2, LDBF still maintained a substantial cash balance in excess of the cash redemptions paid. And because LDBF had almost $200 million in cash as of the date of the August 2 letter, LDBF was less risky than it had been prior to the sale of leveraged AAA bonds on July 26, and LDBF had the capacity to fund additional redemptions — a capacity that grew even further on August 3, following additional sales of AAA and AA bonds. *See* Div. Exs. 217 and 218 (CMY1 and CMZ5 transaction data showing sales); Div. Ex. 230 (showing cash and cash equivalents on August 2); Flannery Ex. 288 (same).

[7] Figure 1 is based on end of day cash balances, from SSgA Navigator reports (for cash-equivalent securities) and Daily Trial Balance reports (for cash and cash equivalents held in bank accounts), and cash redemptions paid each day. *See* Div. Ex. 230 (Navigator Reports), Flannery Ex. 288 (Daily Trial Balance), Div. Exs. 229 and 231 (daily redemptions).

The Division relies on its expert, Professor Wermers, for the proposition that that the cash from the AAA sale was drained out of LDBF by August 2. But, (1) even the data on which Professor Wermers relied showed that there was approximately $176 million in cash on August 2; and (2) Professor Wermers failed to include all of LDBF's cash holdings in his analysis, thus missing additional cash held in LDBF.

Professor Wermers admitted that he relied on SSgA's Navigator reports to determine the amount of cash held in LDBF. Wermers Tr. at 714:18-715:1 (explaining that the "light blue 'Cash Equivalents' line" in Wermers' Exhibit III.B only reflects amounts held in cash equivalent accounts as reflected on SSgA's Navigator reports); Div. Ex. 230. The Navigator reports themselves show that there was substantial cash in LDBF — more than *$176 million* — on August 2. Div. Ex. 230. Thus, even the data that Professor Wermers relied on refutes his, and the Division's, contentions that there was "virtually no cash" available to pay redemptions as of August 2, 2007. Moreover, the cash equivalent accounts reflected in the Navigator reports are only *part* of the total cash available in the LDBF portfolio at any given time. SSgA's Daily Trial Balance reports indicate the amount of actual cash in bank accounts and other cash equivalents, including U.S. Treasury bills, held by LDBF at the end of each day. Flannery Ex. 288. Professor Wermers did not consider any of the cash that LDBF held in bank accounts, or other cash equivalents, such as U.S. Treasury Bills. Wermers Tr. at 714:18-715:5.

The amounts shown in blue in Fig. 2, below, represent the substantial cash in LDBF as set forth in the Navigator reports; the amounts shown in green reflect the additional cash held in LDBF that Professor Wermers ignored:

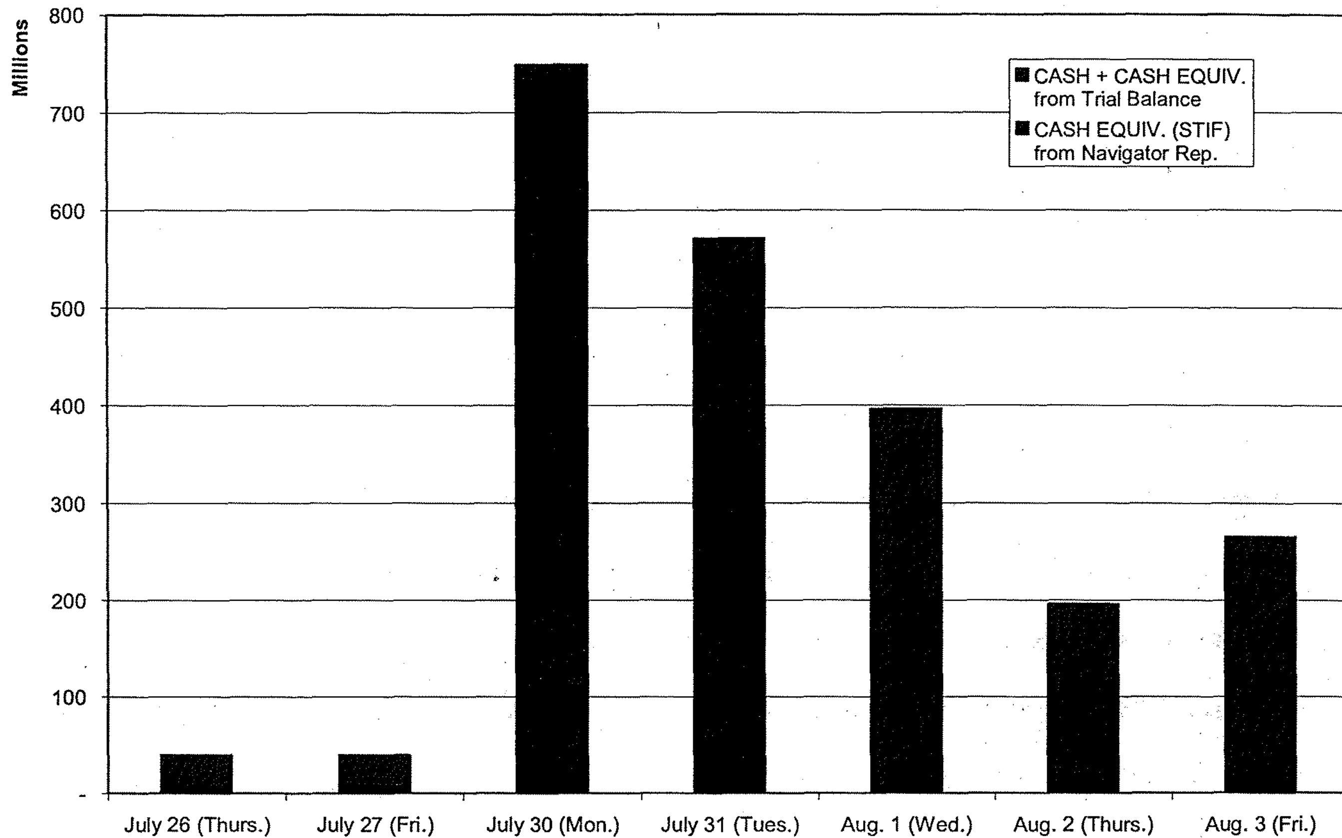

Fig. 2[8]

As Fig. 2 shows, there was ample cash in LDBF on August 2, based both on the data Professor Wermers relied on, as well as the data he failed to consider.[9]

Finally, while the Division relies on Professor Wermers' analysis for the proposition that the cash generated by the AAA sale was drained by August 2 as a result of redemptions (a

[8] Fig. 2 is based on Division Exhibits 217, 218, 230 and Flannery Exhibit 288.

[9] As discussed in Section II.3.A, *infra*, Professor Wermers' entire analysis is also fundamentally flawed because he missed the fact that the majority of redemptions that occurred in LDBF between late July through the first half of August — in particular those of the Related Funds — were in kind, not for cash.

demonstrably incorrect assertion, as shown above), Professor Wermers actually engaged in no such analysis. The Division asserts that a chart prepared by Professor Wermers, entitled "Exhibit III.B," shows the amount of cash received by LDBF from the AAA sale. Div. Post-Hearing Br. at 26-27. However, as Professor Wermers testified, Exhibit III.B. shows neither the cash proceeds from the AAA sale, nor any cash received into or paid out of LDBF at all. Wermers Tr. at 704:24-705:24. Moreover, Exhibit III.B. does not "indicate the timing of any redemptions" nor does it "indicate the amount of cash that was paid out from the sale of [the AAA] bonds to pay redemptions." Wermers Tr. at 705:11-24. In fact, Professor Wermers never even calculated the amount of cash received from the AAA sale. Wermers' Tr. at 706:17-20 ("Q: Did you calculate the amount of cash that LDBF received as a result of the sale of the triple A cash bonds or the triple A bonds? A: Not -- not directly, no."). And no part of Professor Wermers' analysis includes tracking when cash was received from selling securities or when it was paid out for redemptions. Wermers Tr. at 705:11-24 (regarding proceeds from AAA sale); 710:24-711:18 (regarding proceeds from A and AA bond sales). In all events, LDBF had more than adequate cash to fund anticipated redemptions on August 2, as demonstrated above. The presence of that cash rendered LDBF less risky than it had been prior to the AAA bond sale.

2. There is No Evidence That Mr. Flannery Knew that "Virtually All" of the AAA-Rated Bonds Had Been Sold or How The Proceeds Were Used.

In addition to the flaws in the Division's theory regarding the proceeds of the AAA sale and the cash that existed in LDBF on August 2, the Division has failed to prove any relationship between its faulty theory and Mr. Flannery's suggested edits to the August 2 letter. The Division contends that Mr. Flannery knew that "LBDF had sold virtually all of its AAA-rated cash bonds" as of August 2. Div. Post-Hearing Br. at 40. As an initial matter, this fact is irrelevant because the AAA bond sale was actually disclosed in the August 2 letter: "we have sold a significant

amount of our AAA-rated cash positions." Flannery Ex. 144. The letter itself thus informed investors that a substantial portion of AAA bonds had been sold. However, while Mr. Flannery learned that a large AAA sale had occurred, there is no evidence that Mr. Flannery knew that LDBF had sold "virtually all" of its AAA-rated bonds. Indeed, the Division cites to no evidence at all when it baldly states: "Flannery's edits made it clear that he knew that LDBF had sold virtually all of its AAA-rated subprime bonds." Div. PFOF ¶ 367. Mr. Flannery also did not know how the proceeds of the AAA sale were going to be used, and when. Indeed, nobody could have known the magnitude of future redemptions, and the discussion at the July 25 Investment Committee meeting made clear that the volume of anticipated redemptions was based on mere estimates provided by Relationship Management. *See* Section II.D.3.a, *infra*; Flannery's Post-Hearing Memorandum ("Flannery Post-Hearing Mem.") at 29-35.

The Division's further claim that Mr. Flannery knew there was no cash in LDBF when he made his suggested edits is simply wrong. Div. Post-Hearing Br. at 40-41. There is no evidence that Mr. Flannery had been apprised of the levels of cash in LDBF when he made his suggested edits, and the Division points to nothing that would warrant even an attenuated inference that he knew how much cash LDBF held. Furthermore, as discussed above, there was, in fact, substantial cash in LDBF as of August 1 (and on August 2 when others further edited the letter without Mr. Flannery's involvement). *See* Section II.A.1, *supra*; *see also* Flannery Post-Hearing Mem. at 46-54, 77-79.

3. There is No Evidence That Funds "Controlled by SSgA" Were Better-Informed or That They Redeemed On the Basis of Better Information.

The Division further contends that various funds "controlled by SSgA" were privy to information that was unavailable to other investors, and that those funds were therefore able to

redeem before the cash was, according to the Division's erroneous theory, drained from LDBF by August 2. Div. Post-Hearing Br. at 27-28. The Division's contention is unsupported by the evidence.

a. There is No Evidence That The Related Funds Were "Better-Informed," And Such Funds Largely Redeemed In-Kind, Not For Cash.

As an initial matter, the Division offers no evidence for its claim that the redemption decisions of the Related Funds were based on "privileged" information not available to other investors. Div. Post-Hearing Br. at 29. Specifically, the Division cites to paragraphs 278-88, 307-08, and 420-36 from its Proposed Findings of Fact in support of this proposition, but none of the evidence actually relates to what the Related Funds knew or why they made their decisions; indeed, these paragraphs do not concern the Related Funds at all. *See* Div. PFOF ¶¶ 278-88 (setting forth the Division's version of what transpired at the July 25 Investment Committee meeting), 307-08 (discussing when Mr. Flannery and Mr. Wands purportedly learned of the AAA bond sale), 426-36 (containing allegations regarding OFA and GAA only).

In addition to the Division's failure to demonstrate that any Related Fund received more information than other clients, the vast majority of the redemptions by the Related Funds occurred on and after August 3 — which was after the August 2 letter had been circulated and, according to the Division's erroneous theory, after the cash from the AAA bond sale was allegedly gone. *See* Div. Exs. 229 and 231. Accordingly, the Division's contention that the Related Funds were somehow advantaged, while other investors were lulled into a false sense of security by the August 2 letter, makes little sense. And, in any event, the Division offered no evidence that Mr. Flannery knew about the future redemptions of the Related Funds when he edited the August 2 letter.

Moreover, even if the Division could show (and it cannot) that the Related Funds received information that other investors did not and redeemed as a result, the Division and its expert, Professor Wermers, completely ignored the fact that the overwhelming majority of the Related Funds' redemption activity was in-kind, ***not for cash***. *See id.*; Wermers Tr. at 674:1-6. An in-kind redemption does not involve a payment of cash to the redeeming investor, but instead consists of a transfer of shares from one account to another. Wermers Tr. at 672:24-673:14-25; Flannery Post-Hearing Mem. at 79. The Related Funds' in-kind redemption activity, which totaled almost $900 million, reflected decisions by those funds to remain exposed to the LDBF strategy, and was disclosed to investors when LDBF II was announced on August 6, just two business days after the August 2 letter. Flannery Post-Hearing Mem. at 54-57.

The failure of the Division's expert to consider the fact that the Related Funds redeemed in-kind is striking, and undermines his entire analysis (particularly given his additional failure to consider all of the sources of cash held in LDBF, as discussed above). In attempting to show the amount of cash purportedly exiting LDBF as a result of redemptions, Professor Wermers admitted that he failed to differentiate between cash and in-kind redemptions, ***and failed even to consider the fact that in-kind redemptions had occurred at all***. Wermers Tr. at 674:1-6; 675:10-18. This is a fatal flaw. As Professor Wermers admitted, effectively recanting the contrary statements in his report, in-kind redemptions do not require any sale of securities, let alone a "fire sale" to raise cash. Wermers Tr. at 673:11-19 (agreeing that in-kind redemptions "don't require the sale of any of the securities" in the LDBF portfolio, and that "there's no cash that's leaving the fund as a result of those in-kind redemptions."); *id.* at 689:6-9 ("Q: We've already made clear that the fire sales and forced liquidations don't apply to the in-kind redemptions, correct? A: Correct."); *id.* at 673:20-25 ("The only thing that's going on with an in-

kind redemption...is a pro rata distribution and it's an accounting entry indicating that shares of LDBF have been transferred to a different account.").[10]

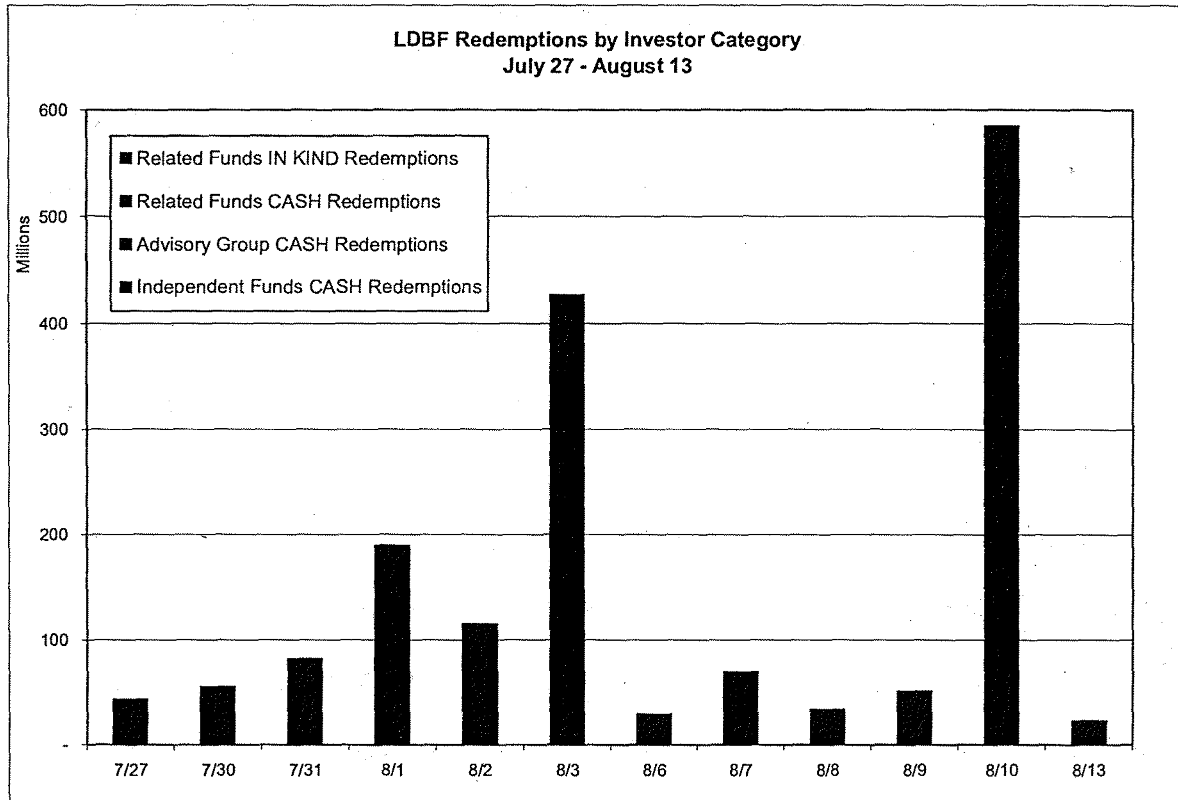

Fig. 3[11]

Fig. 3, above, depicts the redemption activity in LDBF from July 27 until mid-August, and shows that the largest number of redemptions occurred after August 2 and that the majority

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[10] Furthermore, while the Division claims that the Related Funds "redeemed about half" of their investments in LDBF by August 3, this is incorrect and again, a misinterpretation of their own expert's exhibit. Professor Wermers' Exhibit II.B. does not show redemption amounts as a proportion of any investors original investment, but in fact only shows redemptions as a proportion of net trading from an arbitrary (and completely irrelevant) time period of June 1, 2007 through March 25, 2008. (Mr. Wermers admitted in his testimony that he had no basis for selecting this time period, and that this represented the extent of the data that he was provided. He also offered no explanation for why redemptions should be shown as a proportion of "net trading" at all. Wermers Tr. at 695:4-12.) Furthermore, the chart at Exhibit II.B. shows the cumulative amount of both in-kind and cash redemptions, as a percentage of an arbitrary amount of trading over a much longer time period. Wermers Tr. at 695:1-3. In fact, the Related Funds redeemed just over 20% of their shares in LDBF on August 3, and more than a third on August 10. Div. Exs. 229 and 231. Even after these substantial redemptions on August 3 and 10th, 2007, the Related Funds still owned over half of LDBF's outstanding shares. *Id.*

[11] Figure 3 is based on data from Division Exhibits 229 and 231, which show redemption activity and indicate whether the redemption is in-kind or cash. These are the same exhibits on which Professor Wermers relied.

of the redemptions (those of the Related Funds) were primarily in kind, not for cash as Professor Wermers and the Division contend.

b. GAA and OFA Did Not Make Their Decisions Based On Information That Was Not Available to Other Investors.

The Division claims that, in addition to the Related Funds, the advisory groups OFA and GAA decided to recommend that their clients redeem based on LDBF-related information that was not available to other investors. The Division's claim with respect to OFA and GAA, like its claim with respect to the Related Funds, is flawed: the information on which OFA and GAA based their redemption recommendations was available to all investors, as the evidence at trial demonstrated.

In July 2007, OFA was considering whether to place LDBF on its watch list (a list OFA maintained for underperforming funds) or recommend to its clients that they redeem their investments in LDBF. Donovan Tr. at 1779:7-13, 1796:7-16. OFA undertook this evaluation because it was concerned about LDBF's significant underperformance, a fact disclosed to investors in performance information, the July 26 letter, and even the MML article published on July 25. *Id.* at 1779:7013; *see also* Carlson Tr. at 2668:13-2671:6 (noting that investors received detailed fund performance updates on a monthly basis). OFA also requested a meeting with the Fixed Income team. Anyone invested in LDBF could request such a meeting. Donovan Tr. at 1789:12-19. OFA met with the Fixed Income team on July 25th. *Id.* at 1789:12-19. Not only was the Fixed Income team late to the meeting because they were conducting similar meetings with other clients and consultants, but it took OFA a week to schedule a meeting with the Fixed Income team because the members of the team were meeting with other investors and consultants about LDBF. *Id.* at 1789:20-1790:4; 1805:20-1806:11. At the meeting, OFA and the Fixed Income team discussed LDBF's performance and volatility. *Id.* at 1789:20-1790:13. They

did not discuss redemption activity, or what other clients were doing with respect to LDBF. *Id.* at 1806:12-15; *see also* Donovan Tr. at 1788:20-1794:15 (discussing Donovan's recollection of the meeting, which did not include redemption activity), Div. Ex. 138 (Jack Moore's notes on the meeting, which Donovan testified were accurate and also do not include a discussion of redemption activity). Subsequently, OFA decided to recommend to investors that they redeem their investments in LDBF. *Id.* at 1796:17-25, 1809:12-19. The reason for its decision was the "[s]ignificant underperformance of LDBF due to [its] holdings in securities related to sub-prime mortgage market." Div. PFOF ¶ 422.

In its Brief, the Division notes that Jie Qin, a member of OFA's advisory team, chose to participate in the July 25 Investment Committee meeting—the same day OFA was meeting to evaluate LDBF. Div. Post-Hearing Br. at 30. As both the Court and the Chair of the Investment Committee stated at trial, and as the Division conceded, Mr. Flannery was not responsible for policing the ethics of SSgA personnel. Flannery Tr. at 995:9-998:4; Johnson Tr. at 2396:25-2397:22; *see also* Lowe Tr. at 2005:17-2010:21 (the Court reiterating its prior ruling).[12] Mr. Flannery also did not determine who sat on the Investment Committee; that determination, including the decision to include representatives from OFA and GAA on the Committee, was made by the Chair of the Investment Committee. Johnson Tr. at 2365:21-2366:14. There is also no evidence that Mr. Flannery was aware as of July 25 that OFA was evaluating LDBF as a strategy. Donovan Tr. at 1800:5-19 (testifying she notified Mr. Flannery of OFA's recommendation on July 27); Flannery Tr. at 877:2-878:3 (same); Div. Ex. 222 at SSgA-SEC 000380698.

[12] There is also no evidence that Mr. Flannery even knew Mr. Qin (he did not) or would recognize him if he saw him. Flannery Tr. at 865:22-866:3.

Tellingly, the Division did not call Mr. Qin as a witness. As noted above, the only OFA witness who did testify, Ms. Donovan, testified that OFA's decision with respect to recommending redemption in LDBF was based solely on underperformance and volatility, and had nothing to do with any anticipated or actual redemption activity. Donovan Tr. at 1809:4-11; *see also* Div. PFOF ¶ 422; Div. Post-Hearing Br. at 30 (conceding OFA's decision to redeem was based on underperformance and volatility). Indeed, there is simply no evidence that Mr. Qin conveyed or used ***any*** information that he learned at the Investment Committee meeting in contravention of his ethical duties.

While it is unclear how the Division believes it relates to its claims, the Division highlights in its Brief that one of OFA's clients invested in LDBF was SSgA's pension plan, and the Division also makes much of the fact that Mr. Flannery spoke to Ms. Donovan on July 27. As to the pension plan, there is no evidence Mr. Flannery even knew that the pension plan was an OFA client, let alone that it was invested in LDBF. Flannery Tr. at 883:7-884:21. As to Mr. Flannery's conversation with Ms. Donovan on July 27, that conversation occurred *after* OFA had determined that it was going to recommend to clients that they redeem their investments. Div. Ex. 222 at SSgA-SEC 000380698. Thus, anything Mr. Flannery told Ms. Donovan had no bearing on OFA's recommendation, and OFA did not alter its course of action based on Ms. Donovan's discussion with Mr. Flannery. In any event, Ms. Donovan testified that she did not believe Mr. Flannery was trying to provide OFA with any informational advantage over other investors during their conversation, and that he simply conveyed to her that LDBF was a daily liquidity fund and, like any client, OFA was under no obligation to wait until month-end (as she had told him they were planning to do) to redeem their client's investments in LDBF. Donovan Tr. at 1809:23-1810:21. And, as set forth above, Mr. Flannery never knew how much cash was

in LDBF. Flannery Tr. at 1342:17-19, 1353:19-24. Accordingly, there is simply no basis for the Division's claim that OFA redeemed early because of access to information not available to other investors.

The Division's claims are similarly flawed with respect to GAA. No one from GAA participated in the Investment Committee meeting, and it is uncontroverted (and the Division concedes) that GAA's recommendation to its clients was "not at all" based on the redemption activity of other clients. Lowe Tr. at 2034:16-20, 2036:11-2038:6. In fact, the only argument advanced by the Division with respect to GAA is that GAA knew that LDBF was heavily concentrated in subprime investments. Div. Post-Hearing Br. at 30-31. But, the fact that LDBF was heavily concentrated in subprime investments was public knowledge, and Mr. Flannery knew that it was public knowledge as of July 26. Flannery Ex. 108 at SS 003837015 (July 25 MML article stating LDBF was invested "mostly in subprime" and used leverage). Mr. Flannery was also aware of the many other disclosures to investors regarding LDBF's subprime exposure, such as the February 28, 2007 CAR Alert, which had been provided to the Relationship Management team and which discussed LDBF's subprime exposure and underperformance. *See* Flannery Tr. at 1466:23-1467:4; Div. Ex. 45. Mr. Flannery knew that this information was also available in the FAQs being used by Relationship Management and Consultant Relations to answer client and consultant questions. Flannery Tr. at 1310:4-1311:1; *see also* Flannery Post-Hearing Mem. at 39-40. Mr. Flannery was also aware that investors had access to extensive information concerning the composition of the portfolio including, but not limited to, audited financial statements. Flannery Tr. at 1216:20-1217:1.[13] As with OFA, GAA's recommendation

[13] *See also* Flannery Exs. 17 (Mr. Flannery detailing subprime and leverage exposure to, among others, Marc Brown, to whom both Relationship Management and Consultant Relations reported) and 58 (same; Mr. Brown was a member of the EMG, which was included on the e-mail).

to its clients was ultimately based on LDBF's underperformance and GAA's view that the "downside risk was not reasonable relative to the outperformance potential." Div. Ex. 129 at SSgA-SEC 371543.

While irrelevant, the Division's assertion that Mr. Lowe "knew" the subprime market was blowing up, and "knew" subprime investments were highly correlated similarly falls flat. In fact, Mr. Lowe, the head of GAA, testified that the decision to recommend redemption was a difficult one because GAA was concerned that, if the market rebounded, as it had done after the February dislocation, GAA's clients would have locked in losses and missed out on the upside they would have realized had they remained invested. Flannery Post-Hearing Mem. at 38 (citing Lowe Tr. at 2016:7-2017:3, 2019:19-2020:5). Mr. Lowe and GAA were "terrified" that they were making the wrong recommendation. *Id.* (citing Lowe Tr. at 2049:18-2050:12).[14]

Ultimately, Mr. Flannery was not responsible for determining which investors received what information, and in what form. *See e.g.* Flannery Tr. at 1461:4-6, 1453:2-3 ("[A]gain, [client communication] is way out of my realm of responsibility"), 1223:6-10 (Mr. Flannery wasn't "responsible for client communications regarding LDBF"), 1303:4-8 (Mr. Flannery did not play a role in determining how the relationship management team and the consultant management team interacted with outside entities). The Division cannot and does not dispute that all of the information they posit should have been disclosed to investors was available to them through the FAQs. Ultimately, if SSgA's unregistered fund communications model — which was neither Mr. Flannery's creation or responsibility, and which was customary for unregistered funds at the time — resulted in insufficient disclosure because investors had to request certain information in order to receive it, it would be both unfair and bizarre to conclude

[14] As to the third advisory group, Charitable Asset Management ("CAM"), the Division did not put on any evidence reflecting, nor have they argued, that CAM received "privileged" information.

that Mr. Flannery somehow bore responsibility for decisions made by others with respect to client communications.

B. The Division Admits That Mr. Flannery Believed The Risk Reduction Statements in the August 2 Letter, and the Evidence Demonstrates That Those Statements Were True.

The Division's *scienter*-based charges against Mr. Flannery are premised solely on the August 2 letter. The Division takes issue with the August 2 letter's statements that SSgA had taken "steps to seek to reduce risk across the affected portfolios. To date, in [LDBF], we have reduced a significant portion of our BBB-rated securities and we have sold a significant amount of our AAA-rated cash positions. Additionally, AAA-rated exposure has been reduced as some total return swaps rolled off at month end." Div. Ex. 159. In the Division's discussion of this language in its Proposed Findings of Fact, the Division states:

> When he edited Kohler's Draft, ***Flannery did not change the sentence concerning risk reduction <u>because he believed that risk had been reduced</u>*** when leverage was reduced as a result of some AAA swaps rolling off and the reduction of reverse repurchase financing on LDBF's AAA-rated bonds.

Div. PFOF ¶ 368 (emphasis added) (citing Flannery Tr. at 1049:19-1052:3). Based on this striking concession, this Court must conclude that Mr. Flannery lacked *scienter,* and that the Division's claims based on this language fail. *See United States v. Dowlin*, 408 F.3d 647, 667 (10th Cir. 2005) ("[a]n honest belief or 'good faith' belief by the defendants that the statements or representations made were true is a complete and total defense to the charge of securities fraud."); *see also* Flannery Post-Hearing Mem. at 90.

Mr. Flannery's belief in the truth of the risk reduction statements in the August 2 letter was reasonable: the unrebutted evidence proves that such statements were true, as each of the transactions described in the letter — the AAA bond sale, the offset of BBB ABX Index swaps, and the rolling off of total return swaps — reduced risk in LDBF. *See* Section II.A.1, *supra*;

Flannery Post-Hearing Mem. at 24, 33-36, 75-79. First, the Division's claim that the AAA bond sale made the portfolio more risky is, according to the Division's own argument, dependent on there having been no cash proceeds remaining by August 2. As explained above, however, nearly $200,000,000 in cash remained in LDBF as of that date. As the Division concedes, cash is the least risky form of investment, and is even less risky than AAA-rated bonds. *See* Section II.A.1, *supra*.

Moreover, the unrebutted testimony of Respondents' expert, Ezra Zask, demonstrated that each of the three transactions – the AAA bond sale, the offset of the BBB ABX Index swaps, and allowing the total return swaps to roll off – reduced risk in the LDBF portfolio as measured by several different metrics. Flannery Post-Hearing Mem. at 75-78. Each of these transactions reduced exposure to subprime, which had become an increasingly risky investment in the Summer of 2007. Zask Tr. at 2356:6-2357:16; *see also* Zask Direct Test. at A.61, A.38, A.39-A.43. Exs. 3, 4; Flannery Post-Hearing Mem. at 76. Each of the transactions also reduced leverage. Flannery Post-Hearing Mem. at 76-77; Zask Direct Test. at A.46-49. As discussed above, the AAA sale reduced risk by raising cash. Flannery Post-Hearing Mem. at 77-79; Zask Direct Test. at A.62. Each of the transactions reduced market risk as measured by CVaR. Zask Direct Test. at A.40, A.47, A.49, A.57, A.58. The Division did not present any evidence to rebut Mr. Zask's risk analysis, and admitted that the Division's own expert, Mr. Wermers, had conducted no risk analysis whatsoever. Wermers Tr. at 716:5-718:12.

The Division attempts a misguided attack on Mr. Zask's analysis by pointing out that the overall CVaR of the LDBF portfolio increased between July 26 and August 2, 2007. Div. Post-Hearing Br. at 44. However, neither Mr. Zask's analysis nor the August 2 letter made any claim that the overall CVaR of the LDBF portfolio was decreasing during this time period. Rather, the

point made in the August 2 letter, and verified by Mr. Zask, is that the three transactions reduced risk, that is, each of them resulted in lower risk in the portfolio than there would have been in the absence of the transactions. Flannery Post-Hearing Mem. at 75-78. The increased CVaR in the portfolio was a function of the dramatically high and growing levels of volatility in the market; as witnesses called by the Division explained, while a transaction or transactions can reduce CVaR, overall CVaR for a portfolio can increase, due to conditions in the market. Lindner Tr. at 1960:14-1961:18; Pickett Tr. at 1754:6-11. That the overall CVaR of the LDBF portfolio increased, despite the risk-reducing impact of these three transactions, does not change the fact that the transactions were intended to reduce risk, had that effect, and ***risk would have been higher had they not occurred.*** Pickett Tr. at 1701:18-1702:15, 1745:14-24; Lindner Tr. at 1963:19-1964:20.

C. While There Is No Evidence Mr. Flannery Added The Credit Quality Language, The Division Admits The Language Was Accurate and That Mr. Flannery Believed It Was True.

The other portion of the August 2 letter with which the Division takes issue is the statement that "the Strategy has maintained and continues to be AA in average credit quality according to SSgA's internal portfolio analytics." Div. Ex. 159. In its Post-Hearing Brief, the Division states:

> ***Flannery believed at the time that the average quality of LDBF was AA . . . .***

Div. Post-Hearing Br. at 43 (emphasis added). Again, this concession forecloses the Division's *scienter*-based claim against Mr. Flannery. His belief was reasonable, inasmuch as the same credit quality information had been inserted by the FAQ team into the FAQs by August 1 when he made his suggested edits. Div. Ex. 153 (FAQ #8); Flannery Ex. 135 (July 26 FAQs containing credit quality language). Moreover, the Division has further conceded that the credit

quality statement in the letter was true. Div. Pre-Hearing Br. at 18 (admitting that the statement was "**technically accurate**").

In light of the Division's two crucial concessions — (1) that Mr. Flannery believed that the average credit quality language was true, and (2) that it was, in fact, true — the Division's claim based on this language fails. Notwithstanding these concessions, the Division goes to great lengths seeking to establish that Mr. Flannery added the credit quality language to the letter. The Division's concessions are dispositive: the addition of a truthful statement believed by Mr. Flannery to be accurate cannot form the basis for an enforcement action. Moreover, the Division's assertion that Mr. Flannery added the language to the letter is unsupported by the evidence. The Division has failed to meet its burden of proof on this issue.

First, not a single witness testified that Mr. Flannery added the language to the letter, and there are no exhibits showing that he added the language. The Division claims that the "evidence is clear" that Mr. Carlson, Mr. Brown, Mr. Shames and Mr. Flannery reviewed the August 2 letter during the two-hour window during which the Division claims the sentence was drafted and added to the letter. Div. Post-Hearing Br. at 41-42. The evidence regarding this purported meeting is, however, anything but clear. Mr. Flannery did not recall whether he met with Mr. Carlson or Mr. Shames on August 2. Flannery Tr. at 1064:10-13. Mr. Carlson also did not recall such a meeting, and did not recall the source of the credit quality language. Carlson Tr. at 2756:25-2757:2, 2701:16-2702:22. Similarly, Mr. Shames did not testify regarding the alleged meeting, and, like Mr. Carlson, did not recall the source of the credit quality language. *See generally* Shames Test. Stip.; Div. PFOF ¶ 376. Furthermore, the e-mail from Mr. Carlson to SSgA attorney Jodi Luster and others, on which the Division relies to establish that the meeting occurred (and which does not discuss the credit quality language at all), states, "I had

shown the letter to Sean, Mitch ***et al*** . . . ." Div. Ex. 163 (emphasis added). This exhibit itself demonstrated that Carlson showed the letter to other people during the period when the language was added.

Moreover, whether or not Mr. Flannery participated in a meeting does not prove that he added the credit quality language. There are multiple sources from which that language could have derived, including the lawyer-approved FAQs. The August 1 FAQs contained the very same credit quality language as that which appeared in the August 2 letter. *See* Div. Ex. 153. Almost anyone could have copied the language from those FAQs, and inserted it into the letter. The language could have come from a number of other sources, as well. Mr. Carlson testified that beginning in late July, he met daily with the LDBF investment team, who clearly possessed more granular knowledge of LDBF than Mr. Flannery. Carlson Tr. at 2725:1-15. The investment team easily could have provided the information about LDBF's average credit quality; in any event, the Division failed to prove that Mr. Flannery was the source of the sentence. Many people knew about the average credit quality including recipients of the August 1 FAQs, product engineers and members of the Fixed Income team. *See, e.g.*, Flannery Ex. 137 at SSP 003875765 (August 2, 2007 e-mail from Michael O'Hara to Mr. Flannery, Matthew Steinaway, James Hopkins, Patrick Armstrong, Michael Wands and Paul Greff attaching a memo stating LDBF's average credit quality has always been AA to AA+).

In the end, the purportedly "reasonable inferences" that the Division would have this Court draw (*see* Div. Post-Hearing Br. at 42) regarding the (accurate) average credit quality language derive entirely from an e-mail mentioning a meeting that nobody remembers.

D. Mr. Flannery's Limited Role in the August 2 Letter is Fatal to the Division's Claims.

1. Mr. Flannery's Role In The Letter Was Minimal.

As detailed in Mr. Flannery's Post-Hearing Memorandum, Mr. Flannery's role in the August 2 letter was minimal, and was limited to one round of "suggested edits." Mr. Flannery had no further involvement in the August 2 letter, which was heavily vetted by others with knowledge of the facts after Mr. Flannery made his edits, and before it was circulated to clients. *See* Flannery Post-Hearing Mem. at 46-54.

Mr. Flannery's changes were mere word-smithing, consisting principally of grammatical, stylistic and verb tense corrections. Moreover, Mr. Flannery's suggested edits made the letter more accurate, not less. *See id.* at 48-49. The Division failed to prove that Mr. Flannery ever saw the letter again once he made his suggested edits, after which the letter was heavily revised by others. *Id.* at 49-54. The only five words added by Mr. Flannery in his suggested edits that survived the subsequent editing process, in which he was not involved, are as follows:

"Additionally"

"prompting us to"

"some"

There can be no serious contention that these five words are deceptive or misleading. Nonetheless, on the basis of Mr. Flannery's benign and limited suggestions, the Division accuses Mr. Flannery of misleading investors, and doing so with *scienter*. The Division's claims fail.

2. Mr. Flannery Did Not Edit The August 2 Letter To "Soothe Clients' Fears."

The Division claims that Mr. Flannery made his single round of suggested edits to the August 2 letter to "soothe" clients' fears so that they would remain invested in LDBF.[15] The Division's claims are in direct conflict with the evidence, as well as with its own admissions that Mr. Flannery believed the truth of the letter as discussed above.

a. The August 2 Letter Portrayed A Negative Situation.

If the August 2 letter was intended to "soothe clients' fears," it did so in a peculiar manner, for it depicted a serious and deteriorating situation. For example, it stated:

- "Most notably, the Limited Duration Bond Strategy has experienced significant negative performance due to its exposure to the ABX Indices." Flannery Ex. 144 at SS-SEC 000120103.
- "The Limited Duration Bond Strategy experienced even more pronounced negative performance in the second quarter of 2007 which continued in July as spread widening moved up the capital structure to AAA and AA-rated securities secured by subprime mortgages." *Id.*
- "The Enhanced Dow Jones-AIG Commodities Futures Strategy has experienced significant negative performance primarily due to the performance of the underlying collateral pool which is invested in the Limited Duration Bond Strategy." *Id.* at SS-SEC 000120104.

The Division's claim that the letter was "soothing" strains credulity, and the Division failed to produce even one investor to testify that their fears were purportedly soothed by the letter.

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[15] *See, e.g.*, Div. Post-Hearing Br. at 40 (claiming that "[h]is edits display his intent to soothe clients' fears by claiming that the [AAA] sale reduced investors' risk"); *id.* at 41 ("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.").

Furthermore, the risk reduction statements in the "Actions Taken" paragraph that are challenged by the Division were already in the draft at the time Mr. Flannery made his suggested edits, as the Division concedes. *See* Div. Post-Hearing Br. at 40; Div. Ex. 151. Nothing about Mr. Flannery's minor edits to that language are remotely suggestive of an intent to lull clients into a false sense of security. Indeed, Mr. Flannery's testimony regarding his edits to the letter shows that he had no intention to sugarcoat the situation. For example, Mr. Flannery suggested adding language to the "Actions Taken" paragraph stating that recent events "indicate some deterioration in longer-term fundamentals" because he believed that what was happening was not a mere technical issue in the market, and that some fundamental weakening was occurring. Flannery Tr. at 1321:15-1322:14; Division Ex. 155 (Mr. Flannery's suggested edits). "[A]t this point ***we had to acknowledge that we, in fact, had seen some signs of fundamental deterioration. I didn't want to be misleading*** . . . I wanted it to be accurate." Flannery Tr. at 1322:16-25 (emphasis added). While others decided not to include this language in the final draft of the letter, Mr. Flannery was not consulted regarding that decision. Div. Ex. 159; Flannery Tr. at 1339:19-23. The evidence is plain that Mr. Flannery's suggested edits were intended to be accurate, not "soothing."

b. Nobody Sought to Hide Redemption Activity.

The Division boldly suggests that Mr. Flannery sought to hide anticipated redemptions from investors when he made his suggested edits to the letter, but the evidence shows that neither Mr. Flannery nor anybody else was seeking to keep information about actual or anticipated redemptions a secret from investors. As to anticipated redemptions, the Division did not prove that Mr. Flannery knew whether the Related Funds intended to redeem. As to actual redemptions, the August 1 FAQs disclosed to investors that GAA had recommended redemption to its clients. Div. Ex. 153 (FAQ # 31). LDBF II, an alternative to LDBF that was Mr.

Flannery's idea, was being created during the time period that the August 2 letter was being prepared, as a way for investors to shield themselves from the redemption activity of other investors while remaining exposed to the LDBF investment strategy; the ***entire premise*** of LDBF II was the possibility of significant redemption activity. Flannery Post-Hearing Mem. at 54-55. The August 6 letter announcing LDBF II, sent just two business days after the August 2 letter, clearly discussed redemption activity, including the in-kind redemption activity of the Related Funds invested in LDBF. *Id.* at 55-57. The August 6 FAQs disclosed the level of redemption activity at the end of July (20-25%), and contained the same information regarding GAA's redemption recommendation that had been in the August 1 FAQs. Flannery Ex. 167 (FAQ # 31, 36). The notion that Mr. Flannery or SSgA sought to hide anticipated redemptions is inconsistent with the evidence.

3. The Letter Was Heavily Edited By Others In Possession of the Facts Before It Was Finalized.

a. Mr. Flannery's Knowledge Was Not "Unique."

The Division contends that of those who reviewed and edited the August 2 letter, Mr. Flannery possessed "unique" knowledge regarding anticipated redemptions, but failed to share his knowledge in order sooth clients' fears. Div. Post-Hearing Br. at 41. This contention is in direct conflict with the evidence. Those principally responsible for reviewing and approving the letter knew what the Division claims was only known to Mr. Flannery.

Michael Wands, who was much more intimately familiar with LDBF than Mr. Flannery, was present at the July 25 Investment Committee meeting where anticipated redemptions were discussed at length. Flannery Tr. at 1273:11-22; Flannery Ex. 92. Mr. Wands edited the August 2 letter after Mr. Flannery provided his suggested edits, but did not change the "Actions Taken" paragraph. Flannery Ex. 126. The Division implicitly concedes that others involved in

reviewing the letter possessed the relevant knowledge. *See* Div. Post-Hearing Br. at 45 (alleging that "***most***" others who reviewed the letter did not understand the facts, and that they relied on Mr. Flannery "***and the other members of the investment team*** . . . .") (emphasis added).

The Division's further contention that the lawyers and Relationship Management executives who were heavily involved in reviewing and editing the August 2 letter "relied completely" on Mr. Flannery and other members of the investment team for the accuracy of the letter (Div. Post-Hearing Br. at 45) is also false. Relationship Management executives such as Larry Carlson and Staci Reardon were heavily involved in reviewing and editing the letter, and their teams were the ***source*** of the anticipated redemption estimates. Flannery Tr. at 1279:9-1280:22; Flannery Ex. 92 at SSgA-SEC000252910. Relationship Management and Consultant Relations also knew by the time of the August 2 letter that GAA and OFA had recommended redemption to its clients. *See* Flannery Post-Hearing Mem. at 39-41.

SSgA's lawyers were similarly well-equipped to assess the letter's accuracy, and there is no evidence that Mr. Flannery or anyone else sought to conceal information from them. For example, Mr. Shames' direct report, Deputy General Counsel Mark Duggan, relayed what had been discussed at the July 25 Investment Committee meeting to Mr. Shames, as Mr. Flannery expected Mr. Duggan to do when he invited him to the meeting. Duggan Test. Stip. at 210:10-211:15; Flannery Post-Hearing Mem. at 28-29. At that meeting, anticipated redemptions and liquidity were discussed extensively, and the Investment Committee directed the Fixed Income team to take measures to increase the fund's liquidity, in part to meet anticipated, but uncertain, redemptions. Flannery Post-Hearing Mem. at 29-35. General Counsel Mitchell Shames, who, among other SSgA lawyers, was substantially involved in editing the August 2 letter, participated in the EMG Meeting which took place on July 30, four days after the AAA sale. *Id.*

at 36. Mr. Flannery also attended the July 30 EMG meeting. *Id.* At that meeting, Mr. Shames and other members of the EMG considered whether to freeze LDBF, because of possibly high levels of future redemptions. *Id.* Mr. Flannery understood that Mr. Shames knew about a potentially high level of redemptions when he edited the August 2 letter, further evidence that Mr. Flannery lacked *scienter* and instead acted reasonably in connection with the letter. *Id.* at 86-88. Actual and anticipated redemption information was also available to SSgA's lawyers through a number of other sources, including the FAQs, which Legal had to approve. Flannery Tr. at 1361:17-1362:2; Carlson Tr. at 2743:2-11; Shames Test. Stip. at 169:1-3; Duggan Test Stip. at 330:12-19; Div. Ex. 153; *see also* Flannery Post-Hearing Mem. at 40-41, 86-87.

b. The Involvement of Knowledgeable Lawyers Is Highly Relevant.

As is detailed in Mr. Flannery's Post-Hearing Memorandum, a number of SSgA lawyers reviewed and edited the August 2 letter multiple times, including Mitchell Shames, Jodi Luster, Charles Cullinane, Glenn Ciotti, and outside counsel Elizabeth Fries. Flannery Post-Hearing Mem. at 47-52. The Division claims that the lawyers involved in editing the letter, and in particular Mr. Shames, did not know LDBF's risk had purportedly been increased as a result of the AAA sale because the cash proceeds were used to fund redemptions (Div. Post-Hearing Br. at 45, 65-66) but, as discussed previously, the premise for this theory is flawed because the AAA sale did reduce risk in LDBF, and there was ample cash in LDBF on and before August 2. Moreover, the evidence shows that Mr. Shames and the other SSgA lawyers had all of the relevant information, and that Mr. Flannery reasonably believed that these lawyers possessed the relevant information, when he edited the letter. *See* Section II.D.3.A, *supra* (for example, Mr. Shames knew about liquidity issues anticipated redemptions so significant that the possibility of

freezing the fund was considered; the AAA bond sale was disclosed in the August 2 letter itself, as well as the FAQs); *see also* Flannery Post-Hearing Mem. at 28-36.

The Division argues that Mr. Flannery cannot rely on the substantial involvement of SSgA's lawyers without proving that he satisfies a four-pronged test, regardless of whether the lawyers were fully informed, and regardless of whether Mr. Flannery believed they were fully informed. Specifically, the Division asserts that Mr. Flannery cannot point to his reliance on the involvement of counsel as evidence of his good faith and the reasonableness of his conduct without demonstrating that he (1) made a complete disclosure to counsel; (2) sought advice from counsel regarding the legality of his conduct; (3) received advice from counsel that the conduct was legal; and (4) relied on that advice in good faith. Div. Pre-Hearing Br. at 28. But, the Division's four-pronged test is designed for situations where a defendant interposes the "advice of counsel" defense; as, for example, where a person consults his lawyer with respect to a course of action, follows the lawyer's advice, and is later alleged to have violated the law by doing what the lawyer advised. This is not such a case; SSgA's lawyers represented the company, not Mr. Flannery, who is not constrained from pointing to the heavy involvement of the company's lawyers to show that he acted reasonably and without *scienter*. These lawyers acted for SSgA, and had access to multiple sources of information within SSgA about LDBF, as Mr. Flannery understood. Where, as here, Mr. Flannery reasonably believed that the lawyers knew the facts, he was not required personally to convey those same facts to the lawyers, notwithstanding the Division's contentions to the contrary.

Reliance on the involvement of counsel — just like reliance on others with knowledge — need not be asserted as a separate and distinct "advice of counsel" defense. *See, e.g.*, *S.E.C. v. Selden*, 632 F. Supp. 2d 91, 98-99 (D. Mass. 2009) (recognizing that advice of counsel can

mitigate *scienter*) (quoting *Howard v. S.E.C.*, 376 F.3d 1136, 1147 (D.C. Cir. 2004)). As the D.C. Circuit held:

> [R]eliance on the advice of counsel need not be a formal defense; it is simply evidence of good faith, a relevant consideration in evaluating a defendant's *scienter*.

Howard, 376 F.3d at 1147. As one court recently explained, "reliance on counsel's advice . . . 'is simply ***a means of demonstrating good faith and represents possible evidence of an absence of any intent to defraud***.'" *United States v. Stevens*, 2011 U.S. Dist. LEXIS 30107, at *21 (D. Md. Mar. 23, 2011) (emphasis added) (quoting *United States v. Peterson*, 101 F.3d 375, 381 (5th Cir. 1996)); *see also Oakley, Inc. v. Bugaboos*, 2010 U.S. Dist. LEXIS 123976, at *11-12 (S.D. Cal. Nov. 23, 2010) (good faith reliance on advice of counsel is "not an affirmative defense" but rather "'is relevant to determining whether [defendant] acted with intent to deceive") (quoting *Pequignot v. Solo Cup Co.*, 608 F.3d 1356, 1364 (Fed. Cir. 2010)); *see also S.E.C. v. Snyder*, 292 F. App'x 391, 406 (5th Cir. 2008) (reliance on counsel's advice is . . . "a means of demonstrating good faith and represents possible evidence of an absence of any intent to defraud") (citation and internal quotation marks omitted).

In its Brief, the Division provides a string citation to a number of cases (largely without providing explanatory parentheticals) purportedly supporting the Division's theory that Mr. Flannery must satisfy a four-part test before evidence of the lawyers' involvement can even be considered by the Court, but these cases do not support the Division, and some of them have nothing to do with the issue at all. Most significantly, none of these cases supports or even mentions the proposition advanced by the Division — *i.e.*, that where the evidence shows that a lawyer was fully informed about the facts, and the respondent reasonably believed the lawyer

was fully informed, the respondent nonetheless cannot rely on such evidence without proving that the respondent personally delivered or transmitted the facts to the lawyer.[16]

In *Howard*, the SEC argued that the respondent failed to qualify for an advice of counsel defense because someone else within the company had made the disclosure to counsel. 376 F.3d at 1148. In rejecting the argument, the D.C. Circuit held that "[t]he facts that Rogers & Wells oversaw the closing of the first offering at its law offices, that it drafted the documents for the second offering and that Matcovsky conveyed to Howard his and the law firm's approval of the Capel Group's purchases and the IDG Development Corporation transaction constituted powerful evidence that Howard's actions did not amount to 'an extreme departure from the standards of ordinary care' 'so obvious that the actor must have been aware of it.'" *Id.* (internal quotations omitted). The *Howard* court concluded that were the SEC's theory correct, every employee

[16] *See United States v. Wenger*, 427 F.3d 840, 853-54 (10th Cir. 2005) (holding simply that a reasonable jury could have rejected the reliance on counsel defense if lawyer did not know all relevant facts), *cert. denied*, 548 U.S. 913 (2006); *Markowski v. S.E.C.*, 34 F.3d 99, 104-05 (2d Cir. 1994) (no discussion of applicability of the defense when lawyers are in possession of all of the relevant facts); *C.E. Carlson v. S.E.C.*, 859 F.2d 1429, 1436 (10th Cir. 1988) (affirming lower court's conclusion that there was a lack of full disclosure; no discussion of whether evidence could be considered if lawyer knew all the relevant facts); *S.E.C. v. Savoy Industries, Inc.*, 665 F.2d 1310, 1314 n.28 (D.C. Cir. 1981) (defendant did not even assert advice of counsel defense; no discussion of applicability of the defense when lawyers are in possession of all of the relevant facts); *S.E.C. v. Manor Nursing Ctrs., Inc.*, 458 F.2d 1082, 1101-02 (2d Cir. 1972) (holding that "good faith reliance on advice of counsel may be a factor to consider in deciding whether to grant injunctive relief," but evidence demonstrated that defendant-appellants lacked good faith); *United States v. Custer Channel Wing Corp.*, 376 F.2d 675, 683 (4th Cir. 1967) (holding that "reliance on legal counsel may be considered in determining the question of good faith" but affirming District Court's finding that appellants could not rely on counsel's advice because they did not follow lawyer's advice in selling stock to more persons than the lawyer had advised), *cert. denied*, 389 US. 850 (1967); *In the Matter of Charles F. Kirby et al.*, Exchange Act Release No. 177, 2000 WL 1787908, at *19 (ALJ Dec. 7, 2000) (initial decision) (holding, in the context of an advice of counsel defense, that one respondent could not claim he relied on a legal opinion he never saw, especially given that he knowingly provided false information to the lawyer; other respondent could not rely on advice of counsel because he was not even sure if legal opinion existed); *In the Matter of WHX Corp.*, Exchange Act Release No. 173, 2000 WL 1482921, at *20 (ALJ Oct. 6, 2000) (initial decision) (holding that "[i]t was not unreasonable for WHX to follow advice of counsel"); *In the Matter of William H. Gerhauser, Sr. and William C. Gerhauser, Jr.*, Exchange Act Release No. 34-40639, 1998 WL 767091, at *6 n.25 (Comm'n Op. Nov. 4, 1998) (stating that advice of counsel defense would not succeed because relevant issue was not raised with attorneys); *In the Matter of John Thomas Gabriel*, Exchange Act Release No. 34661, 1994 WL 512479, at *6 (Comm'n Op. Sept. 13, 1994) (holding that advice of counsel defense failed where respondent did not identify the lawyers, what was disclosed to them, or what counsel instructed), *aff'd*, 60 F.3d 812 (2d Cir. 1995).

would have to speak directly with the lawyer advising the company, which would be both impractical and highly inefficient. *See id.* at 1148-49.

In this case, the substantial involvement of the numerous SSgA in-house and outside lawyers who Mr. Flannery reasonably believed possessed the relevant facts when they drafted and edited the letter is strong evidence that Mr. Flannery lacked *scienter* and instead behaved reasonably. Indeed, to limit consideration of the corporate lawyers' involvement to instances where Mr. Flannery personally provided the information to the lawyers, when he reasonably believed that those lawyers possessed the information, would not only be illogical, but would also limit consideration of their knowledge and involvement in a way not applicable to others involved in the letter, including Relationship Management executives and members of the Fixed Income team. The knowledge and input of these groups bears upon the reasonableness of Mr. Flannery's actions, and the lawyers' involvement certainly bears on this too.

Finally, even if, contrary to law, the four-pronged test were a prerequisite to Mr. Flannery's ability to point to the involvement of knowledgeable lawyers in the August 2 letter, Mr. Flannery satisfies that test:

(1) Mr. Flannery made a complete disclosure to counsel. For example:

- Mr. Flannery invited Mark Duggan, SSgA's Deputy General Counsel and the securities law expert in the organization, to the July 25 Investment Committee meeting, at which liquidity issues, and potentially significant anticipated redemptions — so large that the Committee considered the possibility of freezing the fund from redemptions — were discussed at length. Mr. Duggan was Mr. Shames' direct report, and Mr. Flannery reasonably believed that Mr. Duggan would share what had transpired at the meeting with his boss and, as Mr. Duggan testified, he did so. Flannery Post-Hearing Mem. at 27-32.

- Mr. Flannery also met with Mr. Duggan before the July 25 Investment Committee meeting to inform him of the issues that were going to be discussed. *Id.* at 27 (citing Flannery Tr. at 1269:25-1271:22; Duggan Tr. at 80:8-15).

- On July 30, the Executive Management Group, including Mr. Shames and Mr. Flannery, discussed the potentially high levels of redemptions from LDBF, and the possibility of freezing the fund as a result. *Id.* at 36 (citing Flannery Tr. at 1314:2-4, 1315:1-15).
- Mr. Flannery developed the idea for LDBF II, which was being considered by the Legal Department at the same time the August 2 letter was being prepared; the entire premise for LDBF II was anticipated redemptions and reduced liquidity. *Id* at 54-56.
- The very draft of the August 2 letter containing Mr. Flannery's suggested edits, which the Division concedes Mr. Flannery edited and circulated to Mr. Shames and others for review, disclosed the AAA bond sale, and contained substantial information regarding LDBF's negative performance and subprime exposure. Flannery Ex. 144.

(2) Mr. Flannery sought advice from counsel regarding the letter. It is undisputed that Mr. Flannery sent his single round of "suggested edits" to the August 2 letter to Mr. Shames, among others. Flannery Post-Hearing Mem. at 47, 49.

(3) The lawyers approved the August 2 letter (and, in fact, were required to approve each of the letters sent to clients during the Summer of 2007, a fact which Mr. Flannery understood. Flannery Post-Hearing Mem. at 43-45). Indeed, Legal had to confirm that the August 2 letter was "good to send," and Mr. Shames made clear that the letter could not be changed without his approval. *Id.* at 43, 50, 51; Flannery Ex. 127. Mr. Shames approved the final version of the letter, and involved a number of other in-house and outside lawyers in the approval process. *See, e.g.*, Flannery Exs. 127, 123, 142, 144, 149; Flannery Post-Hearing Mem. at 50-54.

(4) Mr. Flannery relied on the many experienced lawyers who reviewed and approved the letter, and believed they would make any necessary changes, and there is no contrary evidence.[17]

As more fully set forth in Mr. Flannery's Post-Hearing Memorandum, the evidence establishes that SSgA's lawyers were fully informed when they edited the letters; that Mr. Flannery reasonably believed they were fully informed; and that Mr. Flannery took steps to ensure they were aware of the relevant facts. Flannery Post-Hearing Mem. at 86-88. Mr. Flannery lacked *scienter* and instead behaved reasonably.

E. The August 2 Letter Was Not The Only Source of Information For Investors.

The Division contends that the August 2 letter was the only communication to explain to investors "how the performance of their investments was affected by the subprime crisis." Div. Post-Hearing Br. at 39. This contention is demonstrably false.

The August 2 letter was one communication among many other sources of information regarding the effect of the subprime crisis on LDBF that Mr. Flannery believed were available to investors, and that were available both publicly and from SSgA, by August 2. SSgA instituted a broad communications initiative in the Summer of 2007 in order to respond to the high volume of investor questions regarding the subprime crisis, and even imported personnel from Europe to assist in handling the deluge of calls. Flannery Post-Hearing Mem. at 39. SSgA also developed a series of FAQs, the answers to which were used in responding to client inquiries. *Id.* at 39-40. By August 1, the FAQs contained detailed information about LDBF's exposure to subprime through the use of leverage (total return swaps), and the deterioration in LDBF's performance.

[17] Notably, Mr. Flannery never saw the letter again after he circulated his suggested edits to Mr. Shames and others. To the extent the Division claims that Mr. Flannery's conduct does not fit neatly within its inapplicable four-pronged test, it is because of Mr. Flannery's limited involvement in the letter, which itself belies the notion that he acted with *scienter*. *See* Flannery Post-Hearing Mem. at 85-86.

Div. Ex. 153 (FAQs # 1-2); Flannery Post-Hearing Mem. at 39-41. In addition to the FAQs, SSgA set up a SWAT team to assist in responding to client inquiries regarding the effect of the subprime crisis on their investments. *See* Flannery Post-Hearing Mem. at 41-42. Indeed, information about subprime exposure and LDBF's underperformance had also appeared in the February 2007 Car alert. Div. Ex. 45.

Information regarding the effect of the subprime crisis on LDBF was also publicly available. For example, an article in the July 25 Money Management letter, which Mr. Flannery read, bore the title, "SSgA Bond Fund Whacked by Subprime Losses." Flannery Ex. 108. The article described the losses suffered by LDBF, and explained, among other things, that the fund was "mostly invested in subprime mortgage-backed securities." *Id.* LDBF's subprime losses were well known by August 2, and the contention that the August 2 letter was the only information available to investors on the subject is false.

Moreover, as expert witness John Peavy testified, no sophisticated investor or investment consultant would have relied on a single letter in determining whether to remain invested in LDBF. Peavy Direct Test. at A.65, A.73. SSgA's model for communicating with investors, for which Mr. Flannery was not responsible, was both appropriate and standard in the industry, and sophisticated investors and consultants knew that if they wanted more information about their investments, they could ask. Peavy Direct Test. at A.40(c), A.46, A.47, A.55, A.69, A.70; *see also* Carlson Tr. at 2734:16-2735:7. In the July 26 letter to investors, for example, SSgA urged investors to contact their SSgA Relationship Managers with questions. Hopkins Ex. 98. That investors knew they could ask for information from SSgA is itself evidenced by the undisputed

fact that there was an extraordinarily high volume of client and consultant inquiries during the Summer of 2007.[18]

F. The Court Should Rule in Mr. Flannery's Favor In Connection With The August 2 Letter.

For all of the reasons set forth above and in Mr. Flannery's Post-Hearing Brief, the Division's claims arising out of the August 2 letter fail because:

- Mr. Flannery's contribution to the letter was limited to a single set of suggested edits, only five words of which survived, and as such, he did not "make a statement" under any applicable test. *See* Flannery Post-Hearing Mem. at 46-49, 72-75.
- The challenged statements in the letter were accurate, because the transactions described in the letter all reduced risk, as demonstrated by the unrebutted testimony of a number of fact and expert witnesses. Moreover, as the Division concedes, LDBF's average credit quality was AA. *Id.* at 75-79; Section II.C., *supra.*
- There were no material omissions from the letter; the Related Funds and advisory groups were not provided with superior information; and Mr. Flannery did not have a duty to speak. Flannery Post-Hearing Mem. at 80-84.
- Mr. Flannery lacked *scienter* and was not negligent. *Id.* at 48-53, 84-92; Subsection A, *supra.*:
    - His involvement in the letter was minimal, which itself negates *scienter*;
    - His suggested edits made the letter more accurate;
    - He knew that fully informed investment professionals, lawyers, and Relationship Management executives were heavily involved in reviewing and editing the letter;
    - He reasonably believed the letter was true, as the Division itself concedes; and

[18] To the extent the Division asserts that SSgA's model for communicating with investors was inadequate, or that SSgA's communications efforts during the Summer of 2007 were insufficient, that is a dispute between the Division and SSgA, not Mr. Flannery, who was aware of the communications efforts described above, but, as Chief Investment Officer, did not oversee them and was not responsible for them. *See* Flannery Post-Hearing Mem. at 14-18. SSgA had two large departments that were specifically devoted to investor communications — Relationship Management and Consultant Relations — both of which reported to Chief Marketing Officer Marc Brown, who was no less senior to Mr. Flannery and who, like Mr. Flannery, reported to SSgA's CEO. *See id.*; *see also* Flannery Tr. at 1150:4-23. The Division's efforts to lay at Mr. Flannery's feet everything that it contends went wrong at SSgA as a result of the 2007 subprime crisis is unwarranted and fundamentally unfair.

  - He conceived of and advocated for LDBF II before the August 2 letter was sent (as a means of protecting investors from the redemption decisions of others), despite the fact that such a limited liquidity vehicle would be harmful to his reputation as a Chief Investment Officer, as the Division's own expert, William Lyons, testified.

- Mr. Flannery did not receive money or property as a result of the letter as required by Section 17(a)(2). *See* Flannery Post-Hearing Mem. at 93.

- The Letter was not part of a deceptive course of conduct, as there was no such course of conduct. *Id.* at 93-94; *see also* Section IV.C., *infra.*

III. THE DIVISION FAILED TO PROVE ITS CLAIMS BASED ON THE AUGUST 14 LETTER.

The Division's claims arising out of the August 14 letter — the only one of the Summer 2007 letters that Mr. Flannery actually wrote to investors — are described in what can only be characterized as a less than 3-page afterthought in a 76-page post-hearing brief. Div. Post-Hearing Br. at 45-48. The Division asserts that the "many judicious investors" statement in the letter was misleading because (1) "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 (2) "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." Div. Post-Hearing Br. at 47. The Division is wrong on the facts, and has failed to prove these claims.

A. The August 14 Letter Was Accurate, and Was Not Misleading.

1. The Majority of Related Funds Chose to Stay Exposed to LDBF.

With respect to the Division's first assertion, the Division is simply wrong. As discussed above, the vast majority of "LDBF's shareholders controlled by SSgA" chose to remain exposed to the LDBF strategy, by taking their redemptions in-kind, primarily between August 3 and August 10. *See* Section II.A.3.a, *supra*. These investors — the so-called "Related Funds" — did

not cash out of LDBF; their in-kind redemptions demonstrated that they believed that holding on was the right strategy, a position consistent with the letter's statement that "we believe that many judicious investors will hold the positions in anticipation of greater liquidity in the months to come." As discussed previously, the letter announcing LDBF II to clients clearly explained the in-kind redemption activity of the Related Funds to all other investors in LDBF, and also contained substantial information regarding liquidity concerns. Flannery Ex. 161 at SS 004325369 (emphasis added) ("you may wish to be sheltered from these technical and liquidity issues"); ("Certain SSgA commingled funds . . . intend to redeem in-kind their respective proportionate interests" because of their desire "***not to be negatively impacted by the liquidity decisions of others.***"). The very premise of LDBF II was anticipated redemptions by other clients.

With respect to the redemption recommendations of advisory groups GAA, OFA and CAM, the redemption activity of these groups' clients were dwarfed by the in kind redemptions of the Related Funds, as the chart below demonstrates:

	OFA	GAA	CAM	Total Advisory
CMY1	69,829,848.69	4,406,394.49	3,681,476.88	77,917,720.06
CMZ5	11,439,723.06	24,172,517.35	12,048,512.48	47,660,752.89
			Total OFA, GAA, and CAM redemptions combined:	**125,578,472.95**
			Total in-kind redemptions:	**$869,214,196.40**

Fig. 4[19]

[19] Figure 4 shows cash redemptions by Advisory Groups and in-kind redemptions by Related Funds from July 27 through August 14, based on Div. Exs. 229, 231, 130; Flannery Exs. 291, 292, 294. The total amounts of cash and in-kind redemptions by investor category are also shown in Fig. 3.

The in-kind redemptions of the Related Funds were worth over $869 million dollars, nearly seven times the amount of the redemptions by the three advisory groups. The August 14 letter did not represent to investors that "all" judicious investors would stay invested in LDBF. Indeed, the actions of the Related Funds illustrate Mr. Flannery's belief: even accounting for OFA, GAA and CAM, nearly two-thirds of the SSgA-managed assets invested in LDBF remained exposed to the strategy. *See* Div. Ex. 229 and 231 (showing redemptions and remaining holdings by investor for CMY1 and CMZ5, respectively).

2. The August 14 Letter Made No Secret of Liquidity Problems.

The Division's further assertion that "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" is also unsupported by the evidence. Indeed, the letter itself informed investors of Mr. Flannery's belief that the market was "chaotic and illiquid." *Id.* at SS-SEC 000087632 (discussing "downside of forced selling in ***this chaotic and illiquid market***"). Similarly, the very sentence of the August 14 letter that the Division challenges disclosed that redemption activity was ongoing and expected, and that liquidity was a source of concern:

> 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.***

Div. Ex. 176 at SS-SEC000087633 (emphasis added). The challenged sentence itself thus informed investors of redemptions, and that liquidity was less than it was anticipated to be in the future. Mr. Flannery knew that multiple other sources of information available to investors by August 14 disclosed to investors information about liquidity problems, including the August 1 FAQs, the August 6 FAQs, and the August 6 letter announcing LDBF II. Div. Ex. 153 (August 1 FAQs), Flannery Ex. 167 (August 6 FAQs); Flannery Ex. 161 (LDBF II letter). The remainder

of the August 14 letter is also replete with information about the problems faced by LDBF investors. *See, e.g.*, Div. Ex. 176. at SS-SEC000087631 (describing the fact that LDBF had "sharply underperformed" and that the level of underperformance was "unprecedented"); *id.* (describing the situation as "disappointing and unsettling"); *id.* (describing a "backdrop of weakening fundamentals"); *id.* at SS-SEC000087632 (describing situation as "extreme and challenging to manage"); *id.* (stating that "the market segment faces a magnitude of risk not previously anticipated").

Moreover, on August 14, highly publicized events such as BNP Paribas freezing redemptions, and the historic intervention of the Federal Reserve and European Central Bank, *see* Flannery Post-Hearing Mem. at 59, ensured that illiquidity in the subprime market — and in the subprime assets held in LDBF — was well known to sophisticated investors and investment consultants, and the Division failed to call even one witness to testify otherwise.

B. Mr. Flannery Had No Motive To Deceive Investors.

The Division's suggestion that Mr. Flannery was motivated to deceive investors in order to "buy time" for LDBF to recover is totally unsupported by the evidence. The August 14 letter clearly described a very serious, negative situation, as discussed above. Many people, including Mr. Flannery and other investment professionals, believed that selling into an illiquid market was unwise, and that the market would eventually retrace; the market did, in fact, partially recover in September. Flannery Post-Hearing Mem. at 59, 64. In any event, Mr. Flannery had no reason to conceal information from investors. By August 14, only two investors remained in CMY1 (LDBF ERISA) (Div. Ex. 229, showing redemptions and shares by investor in CMY1), and the assets of CMY1 and CMZ5 combined had been reduced to less than $500 million, approximately 1/6 of the LDBF's assets as of July 1, 2007. Flannery Post-Hearing Mem. at 100; Flannery Ex. 288. Indeed, to the extent that Mr. Flannery's reputation was tied to LDBF, Mr. Flannery had

already sacrificed his reputation by August 14. As the Division's expert, William Lyons, testified, the very concept of LDBF II would have been harmful to Mr. Flannery's reputation: "[D]oing this would be harmful to the reputation of a person such as Mr. Flannery because I believe that this is a truly extraordinary event in the life of a fund . . . ." Lyons Tr. at 1867:7-1868:18; Flannery Post-Hearing Mem. at 55. Nonetheless, Mr. Flannery was an advocate of LDBF II because it was a good option for investors, irrespective of its effect on his reputation, and the alternative fund was offered to investors by a letter dated August 6, well before the August 14 letter was sent.

Finally, Mr. Flannery testified credibly about the purpose of the August 14 letter, which was to offer a CIO's perspective on the unprecedented events in the market, and to acknowledge the seriousness of the situation, as the letter, in fact, did. Flannery Tr. at 1377:25-1378:3, 1378:25-1380:5; *see also* Flannery Post-Hearing Mem. at 60-62. Mr. Flannery's intent in writing the letter — something which he volunteered to do over the initial objections of his boss (Flannery Tr. at 1370:6-25; *see also* Flannery Post-Hearing Memo at 60-61) — was not to paint a rosy picture of the situation or deceive investors.

C. Mr. Duggan Was Armed with the Relevant Information When He Reviewed and Edited the Letter Multiple Times.

While the Division concedes that the challenged language was drafted by the number two person in SSgA's Legal Department, Deputy General Counsel Mark Duggan, the Division asserts that "there is no evidence that Flannery provided the reviewing lawyers with any factual information to assist in their review." Div. Post-Hearing Br. at 46. This statement is wholly without merit. As discussed more fully in Mr. Flannery's Post-Hearing Memorandum and above, by the time Mr. Duggan — an experienced securities lawyer and the securities law expert within SSgA — drafted and inserted the "many judicious investors" language into the August 14

letter, he had attended the July 25 Investment Committee meeting, at Mr. Flannery's invitation, where anticipated redemption activity and liquidity concerns, among other items, were discussed at length by Mr. Duggan and the other meeting participants. Flannery Post-Hearing Mem. at 27-32. Mr. Flannery spoke with Mr. Duggan in advance of the July 25 Investment Committee meeting to advise him of what was going to be discussed. *Id.* at 27 (citing Flannery Tr. at 1269:25-1271:22, Duggan Tr. at 80:8-15). Moreover, Mr. Duggan also attended the August 8 Investment Committee meeting in the midst of the review and editing process for the August 14 letter; indeed, Mr. Duggan reviewed and commented on the letter a number of times after the August 8 Investment Committee Meeting. *Id.* at 68-69, 103. At that meeting, redemptions, illiquidity, the AAA sale, and other subjects were discussed. *Id.* at 103; Flannery Ex. 231.

It also is undisputed that Mr. Flannery was aware that Mr. Duggan, along with other members of the Legal Department, had received the August 6 FAQs on that date, which contained information on actual redemption activity, including the recommendation by GAA, and liquidity problems. *Id.* at 40-41, 57-58.[20] Mr. Flannery understood that the Legal Department had to review and approve both the contents of the FAQs and the manner in which they were used by client-facing personnel (i.e., in response to the voluminous client inquiries in the Summer of 2007). *Id.* at 39-41. It was entirely reasonable for Mr. Flannery to believe that

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[20] As discussed above, it is a misstatement of the law to suggest that Mr. Flannery cannot point to Mr. Duggan's wealth of knowledge and information without showing that he physically provided information to the lawyer, and the evidence is clear that Mr. Duggan was fully informed. *See* Section III.C, *supra.* However, Mr. Flannery would satisfy the Division's four-pronged test in any event: (1) Mr. Flannery invited Mr. Duggan to the Investment Committee meeting and consulted with him in advance; Mr. Flannery and Mr. Duggan were both present at the August 8 Investment Committee meeting; Mr. Flannery conceived of LDBF II, which was approved by the Legal Department and released to investors on August 6 (Flannery Post-Hearing Mem. at 27-32, 54-58, 103); (2) Mr. Flannery consulted Mr. Shames before writing the August 14 letter regarding what he could and could not say, and heavily involved Mr. Duggan in every step of the drafting process (*id.* at 60, 63-69); (3) Mr. Duggan approved the letter even down to the smallest changes, writing, "[h]how many times to we have to sign off???" (*id.* at 68-69; Flannery Ex. 207); and (4) Mr. Flannery relied on Mr. Duggan' s expertise and advice with respect to the letter (*id.* at 63-69).

disclosure of information on redemptions and illiquidity in the FAQs, to Mr. Duggan and others in the Legal Department, well prior to the August 14 letter, was sufficient, and that sale information did not need to be repeated by Mr. Flannery to Mr. Duggan.

Finally, Ali Lowe of GAA personally informed Mr. Duggan of its redemption decision in late July, and the information was repeated in the August 6 FAQs. Lowe Tr. at 2041:24-2044:6. Mr. Duggan had ample information to assess the accuracy of his "many judicious investors" language, even if he did not personally know about OFA's redemption recommendation — something that is very unlikely given the fact that at least one of Mr. Duggan's subordinates in the Legal Department was informed of OFA's recommendation on July 27, long before the August 14 letter was sent. Lowe Tr. at 2041:24-2044:6; Donovan Tr. at 1804:20-1805:19; Div. Ex. 222 at SSgA-SEC 000380698.

Mr. Duggan's review and approval of the August 14 letter evidences the reasonableness of Mr. Flannery's conduct in connection that that letter.

D. The Court Should Rule in Mr. Flannery's Favor In Connection With The August 14 Letter.

For all of the reasons set forth in Mr. Flannery's Post-Hearing Memorandum and in this Reply Memorandum, the Division failed to prove its claims against Mr. Flannery based on the August 14 letter:

- The "many judicious investors" language was a statement of opinion honestly held by Mr. Flannery (and many others), and therefore does not provide a basis for a claim. Flannery Post-Hearing Mem. at 95-96;

- The language was accurate, as many investors — including the vast majority of the SSgA entities that had invested in LDBF — remained exposed to the LDBF strategy. *Id.* at 96-98; Section I.A.3.a, *supra*;

- Mr. Flannery acted reasonably in connection with the letter by ensuring that it was broadly circulated for review by numerous lawyers, client-facing executives, and other senior executives who were armed with the relevant facts. Flannery Post-Hearing Mem. at 99-105;

- Even in October, the Legal Department continued to believe the "many judicious investors" language was accurate, approving its inclusion in a letter from CEO Hunt to investors. *Id.* at 69-70;
- Mr. Flannery did not receive money or property as a result of the letter for purposes of Section 17(a)(2). *Id.* at 93;
- The Letter was not part of a deceptive course of conduct, as there was no such course of conduct. *Id.* at 93-94; *see also* Section IV.C., *infra.*

IV. THE DIVISION'S NEW CLAIMS AGAINST MR. FLANNERY SHOULD BE REJECTED AS A MATTER OF LAW AND FAIL AS A MATTER OF FACT

A. The Division Failed to Provide Mr. Flannery With Sufficient Notice That It Was Charging Him In Connection With the July 25 Investment Committee Meeting and July 26 Letter.

Rule 200(b)(3) of the Commission's Rule of Practice requires that, where the order instituting proceedings directs that an answer be filed, the order "shall set forth the factual and legal basis alleged therefor ***in such detail as will permit a specific response thereto***." Rule 200(b) (emphasis added). In *Jaffe & Co. v. S.E.C.*, the Second Circuit Court of Appeals vacated an order of the Commission where the underlying order instituting proceeding failed to provide the respondent with fair notice of the claims against him and the grounds upon which those claims were being made. 446 F.2d 387, 394 (2d Cir. 1971). As the Court of Appeals observed:

> The Commission argues that notice is always sufficient whenever an order for hearing includes somewhere within its four corners a reference, however veiled and indistinct, to the facts and law which together would support the liability ultimately imposed . . . . [A] primary purpose of the notice requirement in this case is to permit the respondent a reasonable opportunity to prepare a defense against the theory of liability by those who initiate the proceedings against it. A respondent may not be reasonably be expected to defend itself against every theory of liability or punishment that might theoretically be extrapolated from a complaint or order if one were to explore every permutation of fact and law there alluded to or asserted. The Commission's proposed test would make a guessing-game of proceedings that the notice and hearing requirement are designed to rationalize.

Id. As this Court has similarly observed, "the Commission case law has established that a respondent is entitled to be sufficiently informed of the charges so that he or she may adequately

prepare a defense . . . ." *In the Matter of MGSI Securities, Inc., et al.*, Exchange Act Release No. 570, 1998 WL 758113, at *1 (Oct. 21, 1998) (J. Murray). Mr. Flannery should not be required to extrapolate that the Division's scheme liability claim against him included the July 25 Investment Committee meeting and July 26 letter from the veiled and indistinct references to them in the Division's OIP and Pre-Hearing Brief.

In its OIP, the Division made specific factual allegations concerning the purported misstatements and omissions Mr. Flannery allegedly made in the August 2 and August 14 letters. OIP ¶¶ 37-41. The Division also made specific factual allegations against Mr. Hopkins in connection with his involvement with the July 26 letter, as well as the fact sheets and presentations purportedly made to investors. OIP ¶¶ 13-35. While the July 26 letter is discussed in the OIP in connection with the Division's claims against Mr. Hopkins, there are no factual allegations of any wrongdoing by Mr. Flannery in connection with that letter. OIP ¶¶ 32-36. The only statement that could even purport to connect Mr. Flannery to the July 26 letter is decidedly unspecific. *See* OIP ¶ 31 ("Hopkins and Flannery played an instrumental role in the misrepresentations in these letters. . . ."). But this statement did not put the respondents on notice that they were being charged in connection with all three letters. Indeed, it is undisputed that, with respect to the Summer 2007 letters, the Division is only seeking to hold Mr. Hopkins responsible for the July 26 letter, the only letter as to which the Division makes allegations against Mr. Hopkins. Similarly, paragraph 31 of the OIP did not put Mr. Flannery on notice that his conduct was being challenged beyond the August 2 and August 14 letters. And, with respect to the July 25 Investment Committee meeting, the OIP contains no allegations of any wrongdoing.

Shortly after the OIP was filed, on October 12, 2010, Mr. Flannery's lead counsel, Mark Pearlstein, participated in a telephone conference with Division Counsel (Ms. Bernstein, Mr. Baker, and Ms. Shields) to discuss scheduling. Affidavit of Mark W. Pearlstein ("Pearlstein Aff.") ¶ 3.[21] During that call, Mr. Pearlstein asked the Division to confirm that Mr. Flannery was not being charged in connection with the July 26 letter. *Id.* Ms. Bernstein confirmed that the Division was not charging Mr. Flannery in connection with that letter, and that he was only being charged in connection with the August 2 and August 14 letters. *Id.* Peter Acton and Joshua Munn, also attorneys representing Mr. Flannery, spoke with Ms. Bernstein and Mr. Baker concerning the scope of the Division's claims against Mr. Flannery. Affidavit of Peter M. Acton, Jr. ("Acton Aff.") ¶ 3. Ms. Bernstein and Mr. Baker confirmed, again, that Mr. Flannery was not being charged in connection with the July 26 letter. *Id.*

On February 7, 2011, the Division filed its Pre-Hearing Brief. As with the OIP, the Division's Pre-Hearing Brief made specific factual allegations concerning the purported misstatements and omissions Mr. Flannery allegedly made in the August 2 and August 14 letters only (Div. Pre-Hearing Br. at 17-21), and specific factual allegations of wrongdoing by Mr. Hopkins in connection with the July 26 letter, the fact sheets, and the client presentations (Div. Pre Hearing Br. at 6-10, 14-16). As with the OIP, the Division's Prehearing Brief made no factual allegations of wrongdoing by Mr. Flannery in connection with the July 26 letter or the July 25 Investment Committee meeting. Div. Pre-Hearing Br. at 14-16; *see generally* Div. Pre-Hearing Br. During the hearing, counsel for Mr. Flannery ***repeatedly*** raised the lack of notice on the Division's purported scheme liability claim. *See, e.g.*, Flannery Tr. at 215:2-4, 217:3-5,

[21] Copies of these affidavits are attached as Appendix B.

289:14-16, 381:17-19, 814:11-16, 838:17-840:19, 961:8-962:2. Even then, the Division never explained what its claim might entail beyond the August 2 and 14 letters.

In its Post-Hearing Brief, for the first time the Division described its purported scheme liability claim. Specifically, it argued Mr. Flannery engaged in a fraudulent scheme and course of conduct based on (1) his involvement in the July 26, August 2, and August 14 letters; and (2) allegedly "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." Div. Post-Hearing Br. at 67-68 (emphasis added).

In *United States v. Schiff*, the Court granted the defendant's motion to exclude legal theories where the Government failed to provide the defendant with proper notice of the factual and legal bases for its claims. 538 F. Supp. 2d 818, 840-41 (D.N.J. 2008), *aff'd* 602 F.3d 152 (3d Cir. 2010) ("To the extent that the Government seeks to raise new arguments, to make a new factual proffer, or to advance a new legal theory in the post-hearing submission, such portions are beyond the scope of the ordered briefing. ***A post-hearing brief is not the place for new theories. This is not arbitrary, but rather essential for a fair hearing process.***") (emphasis added); *see also Jaffe*, 446 F.2d at 394 ("A respondent may not reasonably be expected to defend itself against every theory of liability or punishment that might theoretically be extrapolated from a complaint or order if one were to explore every permutation of fact and law there alluded to or asserted."). As is reflected by the Division's representations to Mr. Flannery's counsel, the OIP, and its Pre-Hearing Brief, the Division's case against Mr. Flannery is a misstatements and omissions case concerning the August 2 and August 14 letters. It is not a case about the July 26 letter or the Investment Committee. It is also not a control person liability case. Div. Post-

Hearing Br. at 39 (Mr. 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.") (emphasis added).[22] As a matter of fundamental fairness, the Division should not be allowed after the hearing to introduce entirely new theories of liability. Mr. Flannery presented evidence in response to the charges actually raised against him in the OIP, and confirmed in the Division's pre-hearing brief. This Court should exclude the Division's scheme liability claim to the extent it purports to expand liability beyond the August 2 and August 14 letters.[23]

B. Scheme Liability Is Unavailable As a Matter of Law In a Case Premised On Alleged Misstatements and Omissions.

A claim for "scheme liability" is legally untenable in a case, such as this, that is premised entirely on alleged misstatements and omissions. As discussed above, the Division has never before made any allegations against Mr. Flannery other than in connection with the purported misstatements and omissions in the two August letters. The Division's "scheme liability" allegations in its Post-Hearing Brief are nothing other than belated attempts by the Division to resuscitate its deficient misstatements and omissions claims by disguising them as something else, but such attempts fail.

[22] The Division has not even pled that Mr. Flannery is liable pursuant to Section 20(a) of the Securities Exchange Act of 1934, 15 U.S.C § 78t(a). *See generally* OIP.

[23] By way of analogy, Rule 9(b) of the Federal Rules of Civil Procedure also requires that the factual circumstances constituting fraud be stated with specificity. FED. R. CIV. P. 9(b). The purpose of this pleading requirement is to provide detailed notice of a fraud claim to the defendant. *See, e.g.*, *Harrison v. Westinghouse Savannah River Co.*, 176 F.3d 776, 784 (4th Cir. 1999) (rule ensures that defendant has sufficient information to formulate defense by putting it on notice of conduct in dispute). While the facts supporting an alleged fraud may vary, courts universally require the plaintiff to be precise and specific in detailing their allegations. *See, e.g.*, *United States ex rel. Karvelas v. Melrose-Wakefield Hosp.*, 360 F.3d 220, 226 (1st Cir. 2004) (must specify time, place, and content of alleged fraudulent misrepresentations); *In re Rockefeller Ctr. Props. Sec. Litig.*, 311 F.3d 198, 217 (3d Cir. 2003) (plaintiffs must support allegations of securities fraud with essential factual background—that is, the "who, what, when, where and how" of events at issue); *see also* 2 JAMES WM. MOORE ET AL., MOORE'S FEDERAL PRACTICE ¶ 9.03[1][b] (3d ed. 2011) (compiling cases from Circuit Courts reflecting high degree of specificity required).

To prevail on a "scheme to defraud" claim pursuant to Rule 10b-5(a) or (c), the Division must prove that Mr. Flannery engaged in a "manipulative device or contrivance." *S.E.C. v. Tambone*, 417 F. Supp. 2d 127, 135 (D. Mass. 2006) (citing *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 199 nn.20-21 (1976)). Here, the Division failed to establish that any of Mr. Flannery's actions fell into that category. Courts have typically applied Rule 10b-5(a) and (c) when allegations involve market manipulation, such as "wash sales, matched orders, or rigged prices," *see Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 476-77 (1977), and not to typical misstatement/omissions cases such as this one. *See In re Alstom SA Sec. Litig.*, 406 F. Supp. 2d 433, 475 (S.D.N.Y. 2005) ("a plaintiff may not seek to hold a defendant liable for misleading statements under subsections (a) and (c) by alleging that the defendant is liable for the misleading statements because he or she was a participant in a scheme through which the statements were made"); *Swack v. Credit Suisse First Boston*, 383 F. Supp. 2d 223, 239 (D. Mass. 2004) ("If the claimed fraudulent schemes or practices consisted simply of misleading statements and omissions, then they would fall entirely within the ambit of Rule 10b-5(b), and no separate (a) or (c) actions would lie."); *S.E.C. v. Brown*, 2010 U.S. Dist. LEXIS 101403, at *56-57 (D.D.C. Sept. 27, 2010) (the alleged conduct must be more than a reiteration of the misrepresentations underlying the claim). The same is true for cases alleging a fraudulent course of conduct under Section 17(a)(1) and (3). *United States v. Naftalin*, 441 U.S. 768, 774 (1979) ("each subsection [of § 17(a)] proscribes a distinct category of misconduct").

As noted above, the Division now claims Mr. Flannery engaged in a fraudulent scheme based on (1) his involvement in the July 26, August 2, and August 14 letters; and (2) allegedly "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." Div. Post-Hearing Br. at 67-68 (emphasis added). While these inflammatory allegations are wholly unsupported by the evidence (*see* Section IV.C., *infra*), in any event, they are nothing more than allegations of misstatements and omissions.

With respect to the three letters, the Division claims are based on alleged misrepresentations and omissions. As such, the letters provide no basis for liability on a fraudulent scheme or course of conduct theory. *See Lentell v. Merrill Lynch & Co., Inc.*, 396 F.3d 161, 177 (2d Cir. 2005) (plaintiffs failed to make out claim under Rule 10b-5(a) and (c) where the sole basis for such claims were alleged misrepresentations or omissions) (citing *Schnell v. Conseco, Inc.*, 43 F. Supp. 2d 438, 447-48 (S.D.N.Y. 1999) (refusing to characterize allegations as market manipulation claims where alleged "schemes to defraud" consisted largely of an aggregation of material misrepresentations to inflate stock). With respect to the Investment Committee's instructions, the evidence demonstrates that those instructions, including the directive given to the Fixed Income team to raise liquidity in order to reduce risk and prepare for anticipated redemptions, were not illegal or improper (*see S.E.C. v. Durgarian*, 477 F. Supp. 2d 342, 352 (D. Mass. 2007) ("The legality of a particular device is obviously an important factor to consider when determining whether a deceptive practice was implemented . . . .")), and it is reckless for the Division to claim that LDBF was looted, as there is absolutely no evidence of a decision to "loot" LDBF. *See, e.g.*, Flannery Tr. at 1232:18-1233:2; Div. Pre-Hearing Br. at 39-40. Rather, the Division contends that a scheme to defraud occurred because Mr. Flannery allegedly "***concealed*** what had happened" from investors. While this allegation is simply not true, again, it is merely an omissions allegation and provides no basis for a fraudulent scheme or course of conduct claim. *See In re Parmalat Sec. Litig.*, 376 F. Supp. 2d 472, 505 (S.D.N.Y

2005) (rejecting claims where the identified transactions "were not shams" and finding that the arrangements "therefore were not intentions, projects, or schemes with the tendency to deceive. Any deceptiveness resulted from the manner in which Parmalat or its auditors described the transactions on Parmalat's balance sheets and elsewhere.").

Alstom, a case cited by the Division in its Post-Hearing Brief, demonstrates this point. *See generally* 406 F. Supp. 2d 433. In *Alstom*, plaintiff investors alleged, in part, that defendants intentionally underbid a contract which resulted in an understatement of losses in the parent company's financial statements. In addition to claiming that the defendants were liable pursuant to Rule 10b-5(b), plaintiffs posited an alternate theory of liability based on the defendants' alleged use of a manipulative or deceptive device or participation in a scheme to defraud. *See generally id.* The court concluded that plaintiffs failed to state a claim for relief pursuant to 10b-5(a) or (c), where the allegations related to the fraud concerned the non-disclosure of the cost overruns. *See id.* at 476. Even where the defendants were alleged to have intentionally underbid a contract, the court found that plaintiffs did not allege a scheme to defraud that went beyond the misrepresentations themselves. *See id.*; *see also S.E.C. v. KPMG LLP*, 412 F. Supp. 2d 349, 378 (S.D.N.Y. 2006) ("Because the core misconduct alleged is in fact a misstatement, it would be improper to impose primary [Rule 10b-5(a) and (c)] liability ... by designating the alleged fraud a 'manipulative device' rather than a 'misstatement.'").[24] Similarly, the Division has never alleged anything more than alleged misrepresentations and omissions against Mr. Flannery, and its newly articulated scheme/course of conduct theory set forth in its post-hearing brief is also

[24] *See, e.g., In re Pfizer Inc. Sec. Litig.*, 584 F. Supp. 2d 621, 640 (S.D.N.Y. 2008) ("because Plaintiffs allege no deceptive course of conduct going beyond misrepresentations or omissions, their market manipulation claims must be dismissed"); *In re Nat'l Century Fin. Enters., Inc., Inv. Litig.*, 2006 WL 469468, at *21 (S.D. Ohio Feb. 27, 2006) (granting motion to dismiss 10b-5(a) and (c) claims because the scheme allegations merely repeated the allegations made in support of plaintiff's 10b-5(b) misrepresentation and omission claim).

comprised of nothing more than allegations of purported misrepresentations and omissions. As such, the Division's "scheme liability" and "course of conduct" claims fail.

C. There Was No Scheme to Defraud.

The Division claims that Mr. Flannery's involvement with the client letters was designed to mislead investors about the true risks of the funds in which they were invested. Div. Post-Hearing Br. at 67. As has been described in considerable detail above and in Mr. Flannery's Post-Hearing Memorandum, the evidence demonstrates that Mr. Flannery's conduct in connection with the August 2 and August 14 letters was careful and reasonable, and that he sought to make the letters accurate. Involving lawyers in meetings, requesting that they vet the letters, observing that they revised the letters multiple times, and following the advice that they gave is inconsistent with a scheme to defraud. Mr. Flannery's ***repeated*** escalation of the subprime issues facing LDBF within SSgA to the highest levels within SSgA—to the Investment Committee, the Impaired Asset Valuation Committee, the Executive Management Group, and the Chief Executive Officer of the Company is also inconsistent with a scheme to defraud. The following conduct is also fundamentally inconsistent with the assertion that there was a fraud scheme:

- The Division has conceded that all of the relevant groups within SSgA were involved in the review of the client letters and that extensive resources were expended in their preparation. Div. Post-Hearing Br. at 32-33.
- The one time Mr. Flannery did edit the August 2 letter, he revised it to make it more negative. Flannery Ex. 124; Flannery Tr. at 1322:1-25 (substituting in "events over the past several months indicate some deterioration in longer term fundamentals").
- Rather than hiding the fact that they were anticipating redemptions, two business days after the August 2 letter was sent LDBF II was launched. Flannery Tr. at 1293:23-1294:6, 1295:1-3. LDBF II was Mr. Flannery's idea. Flannery Tr. at 1293:19-1295:25, 1358:19-1359:11. The Division's "motive" expert testified that the creation of LDBF II was "the acknowledgment of a serious issue within" LDBF that was damaging to Mr. Flannery's reputation. Lyons Tr. at 1865:25-1869:18.

- Mr. Flannery volunteered to write the August 14 letter, over the objection of his boss, because he believed it was the right thing to do. Flannery Tr. at 1370:1-1371:6.

- Rather than hiding the information the Division claims was omitted from the client letters, SSgA put such information in an FAQ document for ***every*** client-facing person within the Company to see and use with all investors. *See* Flannery Ex. 133.

- Though it was not his job to do so, Mr. Flannery worked to streamline the process for getting information to clients to ensure clients got answers to their questions within 24-hours without exception. Flannery Ex. 163. Additional resources were even imported from Europe to deal with the deluge of investor questions. Carlson Tr. at 2740:11-13.

Central to the Division's fraud scheme is the claim that the Investment Committee instructed Mr. Pickett to "loot" LDBF of its highest-rated and most liquid assets to fund the redemptions of better-informed investors. As was explained above, there is no evidence supporting this inflammatory claim; there was more than ample cash from the AAA bond sale in the fund well past August 2nd, and there is no evidence that "better-informed" investors redeemed early. *See* Section II.A.3, *supra*. The Division's claims with respect to what happened at the July 25 Investment Committee meeting, and with respect to the July 26 letter to clients, are similarly baseless.

1. The Division's Characterization of What Happened at the July 25 Investment Committee Meeting is Not Supported by the Evidence.

As was discussed at length in Mr. Flannery's Post-Hearing Memorandum, and contrary to the Division's claim, the evidence reflects that Mr. Flannery's conduct in connection with the July 25 Investment Committee meeting was careful, reasonable, and reflective of his efforts to ensure that SSgA was acting in the best interests of ***all*** clients. Flannery Post-Hearing Mem. at 27-36. Specifically, Mr. Flannery:

- ***Raised LDBF's performance issues to the attention of the Investment Committee.*** Mr. Flannery did this, even though he was under no obligation to do so, because he wanted to keep the Committee informed of the issues and, ultimately, receive direction from the Committee. *Id.* at 27-28.

- ***Invited key subject matter experts to attend and participate in the meeting.*** As discussed above, Mr. Flannery requested that SSgA's Deputy General Counsel and the securities disclosure expert within the Company, attend the meeting. *Id.* at 27. Mr. Flannery also invited other subject matter experts within the organization to the meeting, including key members from the Fixed Income team (Michael Wands, Paul Greff, Bob Pickett) and Risk Management (Patrick Armstrong). *Id.*

- ***Expressly encouraged debate regarding the issues facing LDBF among all who were present at the meeting.*** *Id.* at 28. The minutes from that meeting reflect that the subject matter experts all actively participated in a full discussion of the issues and options, and that Mr. Flannery encouraged them all to participate and express their views as to what should be done. Including Mr. Duggan. *Id.* at 28 (citing Flannery Ex. 92); *see also* Pickett Tr. at 1736:12-1737:5.

- ***Ensured key issues were discussed at that meeting.*** Potential redemptions, freezing the fund, LDBF's risk profile, and reducing risk were all discussed at the meeting so that the Investment Committee could make informed decisions. Flannery Post-Hearing Mem. at 29-31.

- ***Recommended review by the Impaired Asset Valuation Committee ("IAVC").*** In an attempt to ensure accurate pricing, Mr. Flannery recommended that the IAVC be engaged to deal with the pricing and liquidity issues being caused by market conditions. That Committee met and Mr. Duggan participated in those meetings. *See, e.g.*, Flannery Exs. 102, 113; *see also* Flannery Ex. 170. The only reason to engage the IAVC was if there was a need to price and sell securities with an eye toward ensuring all clients—those staying in the fund and those redeeming—received the benefit of accurate pricing.

It is implausible to think Mr. Flannery would (a) unilaterally raise the issues LDBF was facing to the Investment Committee; (b) invite the Company's disclosure expert, Mark Duggan, to attend that meeting; (c) meet with Mr. Duggan in advance to discuss the meeting; (d) invite the relevant subject matter experts, and (d) involve yet another committee (the IAVC) if his intention was to conceal information or engage in a course of action designed at defrauding certain investors in favor of others. Rather than serving as a launching pad for a fraud scheme as the Division now contends, the July 25th Investment Committee meeting should be viewed for what it was: a sincere effort by Mr. Flannery to do what was in the best interests of all clients in the midst of the worst market conditions he had seen in 27 years in the business. Flannery Tr. at 1267:23-1278:2 ("our job is to do our best for our clients").

In its Post-Hearing Brief, the Division quotes portions of the draft minutes of that meeting and concludes that 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." Div. Post-Hearing Br. at 23 (quoting Flannery Ex. 92). But that simply mischaracterizes the discussion at the meeting. The purpose of the meeting was to discuss the issues facing LDBF, and determine the best way to achieve the objectives of reducing risk and preparing for anticipated but uncertain redemptions. The draft minutes reflect that what transpired was a healthy, deliberative discussion of ***various*** ways in which those objectives could be achieved, including the possibility of freezing LDBF. The draft minutes also reflect that the options discussed were evaluated for their potential impact, real and theoretical, good and bad. *See* Flannery Post-Hearing Mem. at 29-31. For example:

> 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.

In the foregoing excerpt quoted by the Division, Mr. Greff discussed an option and, in evaluating that option, stated that SSgA could not take actions that would injure clients remaining in the fund—i.e., SSgA "can't leave the clients with riskier lower grade in portfolio." Mr. Flannery echoed that sentiment:

> 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.

Flannery Ex. 92 at SSgA-SEC 000252910.

The debate at the meeting was how best to be fair to ***all*** investors. Later in the meeting, Mr. Flannery summarized the salient points from the discussion up to that point:

> Sean Flannery: there are 2 points:
> 1) raise money selling AAA (liquid), but if liquidity is siphoned, we are stuck with a lower quality portfolio
> 2) raise liquidity by selling pro-rata share of portfolio, which leaves the remaining portfolio more like a pro-rata share

Flannery Ex. 92 at SSgA-SEC 000252911.

Again, Mr. Flannery's comment was aimed at ensuring that all investors were treated equally—i.e., "if liquidity is siphoned [by redemptions], we are stuck with a lower quality portfolio [for investors remaining in the fund]." Mr. Flannery did not want a result that "stuck" remaining investors with a lower quality portfolio. After further discussions, Mr. Flannery summarized the group consensus:

> 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. at SSgA-SEC 000252912.

The Division maintains that this statement reflects Mr. Flannery's "educated guess" that LDBF would have to sell about 40% of its assets to satisfy the redeeming clients' demands for liquidity. Div. Post-Hearing Br. at 23. While Mr. Flannery did use that figure, it was neither his guess, nor did it ultimately prove to be accurate. In fact, the 40% figure came from Relationship Management, the only SSgA group in a position to assess potential redemption activity. Flannery Ex. 92 at SSgA-SEC 000252909 ("Discussions have suggested we build 40% liquidity . . . ."); *see, e.g.*, Flannery Tr. at 1000:10-1001:19, 1279:9-1280:22. Notwithstanding its statements in its Post-Hearing Brief, the Division concedes that the figure came from Relationship Management in its Proposed Findings of Fact. Div. PFOF ¶ 280 (citing Mr.

Flannery's testimony that the estimate came from the client-facing teams). The 40% figure actually represented a guess that anticipated redemption activity would be within the range of 25 to 50%. *Id.* at SSgA-SEC 000252912; Flannery Tr. at 1004:16-1006:7. The speculative nature of those guesses is reflected in the comments of Messrs. Wands and Greff:

> Mike Wands: It's hard to predict if the market will to hold on or if there will be a large number of withdrawals by clients. We need to have liquidity should the clients decide to withdraw.

. . . .

> Paul Greff: We can't control redemptions

Flannery Ex. 92 at SSgA-SEC 000252909, SSgA-SEC 000252911.

As was discussed in greater detail in Mr. Flannery's Post-Hearing Memorandum at 27-35, armed with complete and accurate information, and following a thorough discussion of the relevant issues, the Committee unanimously concluded that ***both*** steps needed to be taken in order to achieve the collective goal of doing what was best for ***all*** clients invested in LDBF, instructing as follows:

> After further discussion, upon motion duly made and seconded, the Investment Committee passed the following motions unanimously, instructing the portfolio management team to:
> 1) Increase the liquidity in the Limited Duration Bond portfolios, per consultation with the Relationship Management team, by the end of the month.
> 2) Seek to sell a pro-rata share of securities within the funds to meet any withdrawals.
> 3) Reduce the AA exposure, in the target amount of 5%, by the end of the week.

Flannery Ex. 91 at SSgA-SEC 000252901.

The Division contends that the foregoing instructions should be read to mean that the Investment Committee instructed Mr. Pickett (the LDBF portfolio manager) to sell the AAA bonds to meet early redemptions and sell remaining assets proportionally in order to satisfy later redemption requests. Div. Post-Hearing Br. at 24-25. This interpretation, however, is not supported by the evidence:

- ***The first instruction given by the Investment Committee was more general in nature.*** While Mr. Pickett interpreted the Investment Committee's instruction to mean that he needed to sell the AAA bonds (Pickett Tr. at 1665:3-1666:9), the actual instruction given by the Investment Committee was general in nature. *See* Flannery Ex. 91 at SSgA-SEC 000252901; Flannery Tr. at 1028:2-1030:4 (noting that the Investment Committee instructions were not trade specific; it was left to the discretion of the Portfolio Manager to follow the letter and spirit of those instructions to the best of his ability in a challenging market); Wands Tr. at 2875:21-24 (stating he does not remember the Investment Committee giving a specific instruction to sell the AAA cash bonds).

- ***The purpose of the first instruction was to raise liquidity and reduce risk.*** Pickett Tr. at 1743:17-1745:5; Flannery Tr. at 1035:7-11; Zask Direct Test. at A.44, A.46, A.50; *see* Flannery Post-Hearing Mem. at 32-35 (discussing the purpose of the first instruction at length).

- ***<u>All</u> redemption requests were to be met pro rata.*** The plain language of the second instruction itself states that the Portfolio Manager should seek to sell a pro rata share of securities to meet "any" withdrawals, not just later redemption requests. The purpose of this instruction was to keep the risk profile of the fund as consistent as possible while meeting any redemption activity. Pickett Tr. at 1747:10-18.

- ***It follows that <u>some</u> of the cash from the AAA bond sale would be used to fund redemptions.*** Consistent with the instruction[25] that "any" withdrawals were to be met by selling a pro rata share, and given that a pro rata share would include AAA-rated bonds, it follows that as redemption requests were made, ***some*** of the cash from the AAA sale would be used to fund those redemptions. Although he did not know how much cash was in the fund or how redemption requests were being met at any point, Mr. Flannery understood that as redemptions came in, ***some*** of the liquidity that was raised would be used to fund investor redemptions. Flannery Tr. at 1053:23-1054:24. This is in stark contrast to the Division's characterization that the cash from the AAA bond sale was to be used to pay early redemption requests only.

- ***The cash proceeds from the AAA cash bonds were not exhausted by meeting early redemption requests.*** *See* section II.A.1, *supra*. The Division's theory is based on the erroneous conclusion that the cash proceeds from the AAA bond sale were gone by August 2 such that there was no longer any cash in LDBF. This theory is simply wrong.

- ***The Investment Committee instructions were followed.*** *See* Flannery Post-Hearing Mem. at 32-35.

[25] This is also consistent with the discussion at the meeting, discussed *supra*. *See generally* Flannery Ex. 92.

To support its erroneous conclusion that the AAA bond sale was intended to meet the redemption requests of earlier redeemers only, the Division mischaracterizes Mr. Pickett's testimony in its Proposed Findings of Fact:

> Pickett explained the Investment Committee's directive at the July 25 meeting as a two-step process: 1) raise liquidity by month end by selling LDBF's AAA-rated bonds, and 2) after LDBF was repositioned following the AAA sale, and the fund held mostly AA-rated bonds, sell remaining assets proportionally to meet ***further*** demands for liquidity. (Tr. 1666:15-1667:15).

Div. PFOF ¶ 288 (emphasis added).

Mr. Pickett's testimony, however, was different than the Division described it:

> Q. Now, that specific instruction, did that apply – did you have to satisfy that at the same moment in time that you sold the AAA, or was it a multi-step process?
>
> A. It was largely a two-step process. The liquidity was one thing, but thereafter – so the liquidity's been raised by the end of the month, ***and then going into August,[[26]] as those redemptions came in, is doing our best to do this pro rata across what was largely***, I believe, AA left, but there were some AAA swaps . . . .
>
> Q. Okay. So I want to break this down so it's as clear as possible. Your first step, to fulfill the instructions, sell the AAA?
>
> A. Correct.
>
> Q. Then at that moment in time that the AAA is sold, the portfolio is repositioned; is that right?
>
> A. That's right.
>
> Q. And then the second step after repositioning is to sell pro rata going forward post repositioning; is that right?
>
> A. That's right. ***I would say pro rata as redemptions came in.*** That would cause you to do that sale.
>
> Q. But that's after the portfolios repositioned?
>
> A. Correct.

[26] Mr. Pickett testified that the redemption activity was not anticipated until August. Pickett Tr. at 1739:15-1740:3.

> Q. And generally speaking, for the post-repositioning period, after the AAAs are sold, is it your recollection that you did that? That you generally kept the fund –
>
> A. Generally speaking, but I can't say -- I don't have the numbers in front of me, but it was a goal of that unwind process.

Pickett Tr. at 1666:15-1667:22 (emphasis added). The Division also omits the fact that later in his testimony, Mr. Pickett explained that the AAA bond sale accomplished three things: increased liquidity, decreased risk, and reduced leverage in the portfolio. Pickett Tr. at 1744:19-1745:5. With respect to anticipated redemptions, Mr. Pickett explained that the AAA bond sale repositioned the portfolio and that, subsequently, pro rata sales were made when redemptions requests were made in accordance with the Investment Committee's instructions. Pickett Tr. at 1749:6-1752:25. Ultimately, and contrary to the Division's theory, Mr. Pickett—a witness called by the Division—testified as follows:

> Q. Well, for clarification, did you take it that a goal of the investment committee -- of the investment committee of instructing that there be pro rata sales was so that investors who remained in the fund, let's say in mid to late August after redemptions, would have a similar portfolio as investors who were invested in LDBF prior to redemptions?
>
> A. I think ***the goal was to treat all shareholders as equal as possible.***
>
> Q. And so besides treating them as equal as possible, it's also to have a portfolio that has the same type of risk characteristics as much as possible?
>
> A. As much as possible, correct.
>
> Q. And so that meant that you were trying through the pro rata sales to keep the spread duration the same; is that correct?
>
> A. Correct.
>
> Q. And you were trying to keep the average credit rating of the portfolio similar to the extent possible?
>
> A. To[*sic*] less so, because of the makeup of the bonds versus the swaps, but there was an attempt there as well.
>
> Q. But that was the goal at least?

A. Yes.

Q. And you think that your portfolio management team under the circumstances, I take it, performed pretty well, don't you?

A. Yes.

Pickett Tr. at 1751:24-1752:25 (emphasis added). Mr. Pickett's testimony corroborates the testimony of the other witnesses that participated in the July 25 Investment Committee meeting. *See* Flannery Tr. at 1020:22-1021:3; Wands Tr. at 2875:21-24.

As the most knowledgeable person concerning the LDBF portfolio, Mr. Pickett was responsible for carrying out the Investment Committee instructions, and the evidence reflects he acted in a manner consistent with those instructions. Mr. Pickett testified that he rarely interacted with Mr. Flannery and that Mr. Flannery was not overseeing the day-to-day trades made in the portfolio during this period. Pickett Tr. at 1730:8-15. There is no evidence that Mr. Flannery was ever told, by Mr. Pickett or otherwise, that the Investment Committee instructions were not followed, or that the risk profile of the portfolio had changed to the detriment of the investors remaining in the fund. To the contrary. On August 8, 2007, Paul Greff, the Head of Global Fixed Income, reported to Mr. Flannery and the entire Investment Committee that the "portfolio management team has met all the redemption requests while maintaining the same risk profile." Flannery Ex. 180 at SSgA-SEC 000252968; *see also* Div. Ex. 248 at SSP 000105535-36; Flannery Post-Hearing Mem. at 34-35. Thus, even if the Division's theory was correct (it is not) and all of the cash from the AAA cash bond sale been used to meet redemptions (it had not), from Mr. Flannery's perspective all investors had been treated equally and the risk profile had been maintained in the fund. *See* Div. Post-Hearing Br. at 43 ("Flannery believed at the time that the average quality of LDBF was AA"). There is no evidence supporting the Division's theory that Mr. Flannery knew that the Investment Committee initiatives were not followed.

2. The Client Letters Were Accurate, Not Misleading, and Reflected the Fixed Income Team's Good Faith View of the Market.

Mr. Flannery has already addressed the Division's claims with respect to the August 2 and August 14 letters at length. With respect to the July 26 letter, the Division's new claims against Mr. Flannery are confusing and contradictory. The Division alleges that 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." Div. Post-Hearing Br. at 37-38. The Division also alleges the letter was misleading because it omitted that (a) LDBF was concentrated in subprime and employed leverage, and (b) LDBF's highest rated assets were being sold to fund redemptions by the Related Funds and OFA and GAA clients. Div. Post-Hearing Br. at 33. Though the Division claims it is not charging Mr. Flannery with respect to those alleged misstatements and omissions (Div. PFOF ¶ 311) and there is no control person liability claim here, the Division now claims for the first time Mr. Flannery "played an oversight role in crafting" the letter and is thus "responsible for" the misstatements and omissions. Div. Post-Hearing Br. at 39. According to the Division, it was Mr. Flannery's "job to ensure that [the client letters] were factually accurate . . . No one else was checking the letters' factual accuracy." *Id.* The Division further claims that Mr. Flannery believed investors would have wanted to know about their subprime exposure through LDBF, that the fund's AA subprime bonds were valued less than securities of other types with comparable ratings, and that Mr. Flannery knew about the ongoing sale of LDBF's AAA rated bonds. Div. Post-Hearing Br. at 39. The Division's allegations are without merit.

a. Mr. Flannery Neither Drafted the July 26 Letter Nor Requested That It be Drafted.

Immediately following LDBF's underperformance in June 2007, Adele Kohler asked James Hopkins to draft a CAR alert to explain the underperformance. Div. Ex. 100; Hopkins Tr. at 365:10-18. On July 2, 2007, Mr. Hopkins circulated a draft CAR alert. Div. Ex. 100. The purpose of the alert was to explain that the underperformance in many of SSgA's active fixed income funds in June was because of their exposure to the BBB-ABX index and the volatility resulting from the Bear Stearns collapse. *Id.* ("Again, the cause [of the underperformance] was our exposure to the subprime mortgage market, specifically our exposure to the triple B ABX . . . what precipitated the most recent declines had to do with Bear Stearns repricing their holdings in two of their hedge funds."). Upon circulating his CAR alert, Mr. Hopkins asked Patricia Hudson, a writer for SSgA, to take his alert and turn it into a client-friendly letter. Hopkins Tr. at 367:5-368:4.

b. Mr. Flannery's Involvement With the July 26 Letter Was Limited.

As with the August 2 and August 14 letters, the July 26 letter underwent an extensive review process. Hopkins Post-Hearing Br. at 25-35; Div. Post-Hearing Br. at 56 (acknowledging the extensive review process of all the letters). Though SSgA's review of the letter was extensive, Mr. Flannery's role was limited. On July 11, 2007, Mr. Flannery sent an e-mail to Ms. Hudson making a "couple of edits" to the draft letter she had previously circulated. Div. Ex. 103. Mr. Flannery's edits made the letter more accurate, and consistent with the investment team's view of the long-term fundamentals. Flannery Tr. at 937:9-23 (testifying he revised language from "downgradings" to "actions" to make it more accurate). That is the only time Mr. Flannery edited the letter. In addition to distributing the draft letter to the investment team to

ensure its accuracy, Mr. Flannery also made clear that he wanted the July 26 Letter vetted by Legal. Shames Test. Stip. at 87:16-21; Flannery Tr. at 1299:11-22; Flannery Exs. 52, 54; Hopkins Ex. 77.

Mr. Flannery included Frank Gianatasio, the Head of the Structured Products Group (and part of the LDBF portfolio management team), and Mr. Wands on the e-mail he sent with his "couple of edits." *Id.*; *see also* Hopkins Tr. at 369:4-8; 471:20-22. Mr. Flannery considered Mr. Gianatasio to be an expert on the housing-related asset-backed securities market who was deeply knowledgeable about LDBF and the facts described in the draft letter. *E.g.*, Flannery Tr. at 1249:7-19; *see also* Flannery Ex. 4 (prepared by Mr. Gianatasio). Mr. Wands also had a more "granular" knowledge of LDBF and the underlying facts than Mr. Flannery. Flannery Tr. at 943:18-24. Mr. Gianatasio and Mr. Wands also both reviewed and commented on the draft letter. Hopkins Exs. 72, 74, 77.

In addition to distributing the draft letter to the investment team to ensure its accuracy, Mr. Flannery also made clear that he wanted the July 26 Letter vetted by Legal. Shames Test Stip at 87:16-21; Flannery Tr. at 1299:11-22; Flannery Exs. 52, 54; Hopkins Ex. 77. Thereafter, Mr. Flannery's involvement with the letter was limited to several brief meetings regarding the letter, and forwarding a subsequent draft of the letter reflecting Legal's comments to Mr. Wands, Mr. Greff, and Michael O'Hara to ensure that the revisions that had been made by Legal were factually accurate. Div. Ex. 113; Flannery Tr. at 944:10-13. Like Mr. Wands, Messrs. Greff and O'Hara had a deeper knowledge of the portfolio and the market than Mr. Flannery. Flannery Tr. at 943:13-944:13. Hopkins Exs. 71, 72, and 74. Messrs. Wands, Greff, and O'Hara received subsequent iterations of the draft letter. Hopkins Exs. 77, 78, 84, 85, 88, 89, 93, 96. Messrs. Wands and Greff specifically received a draft of the letter including the "risk reduction"

language the Division has claimed is misleading, and participated in a meeting with Mr. Flannery and others to discuss that version of the draft letter. Hopkins Ex. 96.

Mr. Flannery was not copied on the final letter sent to clients. Flannery Ex. 111.

c. The Lawyers Had a Substantial Role in Reviewing, Editing, and Approving the July 26 Letter.

While Mr. Flannery is not required to satisfy the four-part advice of counsel test to demonstrate his good faith (*see* Section II.D.3.b, *supra*), Mr. Flannery can do so here:

(1) Mr. Flannery made a complete disclosure to counsel:

- Mr. Duggan participated in the July 25 Investment Committee and July 26 Impaired Asset Valuation Committee meetings. The discussion of subprime, illiquidity, and pricing issues at that those meetings was extensive. Flannery Exs. 92, 102. Mr. Duggan briefed Mr. Shames on the July 25 Investment Committee meeting promptly after it ended. Duggan Test. Stip. at 210:5-20.

- Mr. Duggan was briefed by Mr. Flannery on the issues facing LDBF on at least two occasions prior to July 26, including one meeting with Paul Greff. Duggan Test Stip. at 80:8-21, 105:15-106:7; Flannery Tr. at 1270:16-1271:22.

- Mr. Shames and Mr. Flannery regularly discussed the market situation. Flannery Tr. at 942:5-14 (testifying he and Mr. Shames had a lot of discussions about what was going on in the market and the direction the market had taken" around that time).

- Mr. Flannery also provided Mr. Shames and others with periodic reports on the amount of subprime exposure in the fund—including a report reflecting SSgA's subprime exposures as of July 10, 2007—and "a breakdown of the allocation of CDOs/SubPrime exposure" held by the various funds, including LDBF. Hopkins Ex. 171 (Mr. Shames was a member of the EMG group); Shames Test. Stip. at 213.

(2) At Mr. Flannery's express request, SSgA lawyers were heavily involved in reviewing and editing the letter. Shames Test Stip. at 155:8-156:5; Flannery Tr. at 904:4-23; Carlson Tr. at 2749:25-2750:1.

(3) The lawyers approved the July 26 letter. *See, e.g.*, Shames Test. Stip. 89:7-90:9; Flannery Ex. 52, Div. Ex. 137; Hopkins Ex. 95.

(4) Mr. Flannery relied on the many experienced lawyers who reviewed and approved the letter, and believed they would make any necessary changes, and there is no contrary evidence. *See* Div. Ex. 112; Hopkins Ex. 79, 81.

d. Other Key Groups Reviewed and Edited the July 26 Letter.

In addition to the review by Legal and the subject matter experts in Fixed Income, numerous other people from key disciplines within SSgA participated in drafting, reviewing, and ultimately approving the letter, including:

- Mr. Hunt, SSgA's Chief Executive Officer. *See* Hopkins Ex. 95.
- Relationship Management, including Marc Brown (Chief Marketing Officer), Larry Carlson and Staci Reardon (Co-Head's of Relationship Management), and Maureen Fitzgerald (Head of Consultant Relations). Flannery Ex. 52; Hopkins Exs. 79, 96.
- Members of the Fixed Income Product Engineering team, including Mr. Hopkins and Michael Thompson, another fixed income product engineer. *E.g.*, Hopkins Exs. 73, 84, 85, 88, 89.
- The SWAT Team, which was charged with ensuring that clear, concise, accurate, and consistent communications were being provided to clients. *E.g.*, Flannery Exs. 56, 68.

e. The July 26 Letter Was a Supplement to SSgA's Communication Action Plan

As with the August 2 and August 14 letters, the July 26 letter was a supplement to a larger communication plan implemented by the Relationship Management and Product Engineering team. Consistent with SSgA's communication model and industry practice, the letter provided general information; more specific, tailored information was available to investors. *E.g.*, Hopkins Ex. 85 (an e-mail not including Mr. Flannery, Michael Thompson noting that the approach was to keep the letter simple and provide more details in the FAQs). The "sub-prime action plan" implemented by SSgA was spearheaded by Staci Reardon, the co-head of Relationship Management, and Nick Mavro, a member of the SWAT Team and part of consultant relations. Flannery Ex. 99. The communication plan had several parts: (1) determine

what to communicate (i.e., the July 26 letter); (2) develop a list of clients with exposure to LDBF/subprime; (3) complete the FAQs already in process; (4) hold a meeting with Fixed Income and Relationship Management to educate client-facing personnel on the market conditions and walk through the FAQs and how they can be used; and (5) send out the letter; and (6) prepare a call log to track calls made to investors and their consultants, and to use the feedback received to update the FAQs. Flannery Ex. 99. Relationship Management participated in over one hundred calls with investors and consultants on July 26, and hundreds of investor/consultant calls were made and tracked by SSgA on a "Subprime Issue Feedback" spreadsheet maintained by Relationship Management. Flannery Exs. 109 (meeting with Fixed Income and Relationship Management to discuss Rules of Road), 114 (e-mail indicating that Relationship Management participated in one hundred calls after letter sent out), 270 (version of spreadsheet showing client calls); Carlson Tr. at 2738:20-2740:16.

f. **The Risk Reduction Language in the July 26 Letter Was Not Misleading.**

The Division's claim that the letter is 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" (Div. Post-Hearing Br. at 37-38; Div. PFOF ¶ 358) is a straw-man. In fact, the letter does not even ***mention***, let alone emphasize, LDBF's BBB-rated ABX investment. Div. Ex. 111. Instead, the letter provided a frank, sobering assessment of the conditions in the market and the impact those conditions were having on valuations:

> The downturn in the US housing market and the shake-out in the subprime mortgage sector are not short-lived events that will be resolved quickly. On the contrary, we expect that we will continue to see reverberations in the credit markets over the next 18 months. Moreover, it is possible that asset price declines could overshoot their fair value levels. In fact, so far in July, the subprime market has continued to deteriorate as Moody's and Standard and Poor's have downgraded a significant number of asset backed securities backed by home equity loans.
>
> . . . .
>
> We believe that what has occurred in June, and thus far in July, has been more driven by liquidity and leverage issues than long term fundamentals. These technical forces have triggered the sudden and sustained unwinding of leverage and forced sales, even as market liquidity has declined. Our experience in previous market dislocations has shown that technical forces can often drive the market to extreme valuations. However in the long term, fundamental factors reassert themselves to create a new equilibrium. Still, we are mindful of technicals in the market, that is, the downdraft in valuations and the impact on the risk profile of our various portfolios. We have been seeking to reduce risk in those portfolios

Div. Ex. 137 at SS-SEC 120177.

Contrary to the Division's claim, phrases such as "extreme valuations" and "downdraft in valuations" and "asset price declines could overshoot their fair values" are broad and simply do not specific to any particular tranche of securities within the portfolio. The plain language of the letter demonstrates that the Fixed Income team was communicating (1) concerns to clients about

all pricing in the market, (2) the impact pricing was having on the risk profile of the portfolios, (3) the Fixed Income team's honestly held view that this was a technical (i.e., liquidity) event, and, (4) as discussed below, how the team was reacting to the situation. *Id.*; *see also* Flannery Ex. 137 (good faith view of the Fixed Income team as of early August continued to be that this was a liquidity-driven, technical event).

In addition to ignoring the plain language of the letter, the Division's claim is really just hindsight bias. The Fixed Income team believed in good faith well into July that the sub-prime issues were largely confined to the lower-rated tranches. *E.g.*, Flannery Exs. 58 at SS 003865282, 86 at SS 008524112, 137 at SS 0038775765-66. So too did many others. *See* Flannery's Post-Hearing Mem. at 26. Indeed, when the February 2007 market underperformance occurred,[27] spreads in BBB "gapped" to +733 basis points over LIBOR while the higher rated tranches remained relatively steady. Flannery Ex. 137 at SS 003875766. As Mr. O'Hara stated in the LDBF chronology he prepared in August 2007, the negative activity in February "was primarily concentrated in the BBB segment of the market." *Id.* Subsequently, the market recovered and the situation was "calm until June and the Bear Stearns hedge fund collapse. *Id.* As had occurred in February, throughout July the BBB spreads widened to historic levels: +2750 basis points over LIBOR. *Id.* On July 10, when Standard & Poor's and Moody's downgraded or placed on downgrade watch an unprecedented number of bonds backed by subprime mortgages, most of the securities being downgraded or reviewed had ratings of A or lower—i.e., BBB. *See* Sirri Report ¶ 58; Flannery Exs. 44 at 2-3, 58 at SS 003865282, ¶ 2, 86 at SS 008524112.

It was not until late July that higher tranches began experiencing liquidity issues. As Mr. Sirri stated, once that happened, a liquidity crisis ensured. Sirri Report ¶ 77. In assessing these

[27] The February 2007 market event is discussed in Mr. Flannery's Post-Hearing Memorandum at 19.

developments, the Fixed Income team concluded that—as in February—the pricing action was driven primarily by technical rather than fundamental factors. As Mr. Gianatasio—who Mr. Flannery testified he relied on for his expertise—stated in a July 24 e-mail to other members of the Fixed Income team:

> Regarding #2 under Future Plans, from a fundamental perspective we remain constructive on 06-2 ABX. Although there have been downgrades on the underlying securities at the A, BBB and BBB- levels, we believe that current pricing at all rating levels is overstating the level of risk embedded in the underlying securities. That being said, the ABX continues to trade in a very technical manner (primarily driven by large hedge funds shorting the index). Although some natural longs with a credit view believe the ABX offers value at current levels, the technical nature of the trade (and resulting mark-to-market volatility) is discouraging longs from entering the market.

Flannery Ex. 86 at SS008524112; Flannery Tr. at 1249:7-19.

The view expressed in Mr. Gianatasio's internal e-mail matches what appears in the July 26 letter and reflected the good faith view of the Fixed Income team. *See* Flannery Ex. 137 (also shows good faith view of Fixed Income team). For the Division to claim that "the greatest risks were then coming from its exposure to higher-rated AA and AAA subprime bonds and derivatives" may now seem clear with the benefit of hindsight, but was not known to the Fixed Income Team as they grappled with a dysfunctional market.

The only sentence in the letter that the Division specifically points to as being misleading is the following:

> profile of our various portfolios. 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.

Div. Ex. 137 at SS-SEC 120177; *see* Div. Post-Hearing Br. at 36-37.

Simply put, that statement was accurate. Specifically, by July 26th, SSgA: (1) had reduced its exposure to BBB-rated securities; (2) was finalizing the sale of AAA bonds to Citigroup (it was finalized that day and occurred a few days later); and (3) had made the decision to allow the total return swaps to roll-off at month end. Those transactions reduced risk.

Flannery Post-Hearing Mem. at 24-26, 30-31, 32-34, 35-36, 75-79; Flannery Ex. 55 (Peter Lindner, Risk Management, e-mails Mr. Flannery on July 13 to tell him that $5 billion in swaps would be rolling off of LDBF on August 1, and September 1, 2007). Given that the risk reducing transactions had occurred or were about to take place, it was accurate to refer to past ("We have") and future ("will continue") events. Further, as noted above and as the Division has conceded, Mr. Flannery believed that risk had been reduced in the portfolio during this period. *See* Section II.B, *supra* (citing Div. PFOF ¶ 368). Mr. Wands also believed that the sentence in the July 26 letter was accurate in light of the foregoing risk-reducing transactions. Wands Tr. at 2865:15-2870:4.

Quite apart from the deficiencies in notice relating to the July 26, letter there is nothing about that letter and Mr. Flannery's role that provides the basis for a claim against him.

g. It Was Public Information that LDBF Was Concentrated in Subprime Securities and Used Leverage.

The Division also alleges the July 26 letter was misleading because it omitted that (a) LDBF was concentrated in subprime and employed leverage, and (b) LDBF's highest rated assets were being sold to fund redemptions by the Related Funds and OFA and GAA clients. Div. Post-Hearing Br. at 33. To support its claim that Mr. Flannery is responsible for failing to disclose that LDBF was concentrated in subprime and employed leverage, the Division makes two statements:

> 362. Flannery thought, in the summer of 2007, that investors needed to know that they were holding subprime investments in order to make an intelligent decision about whether they wanted to be invested in subprime. (Tr. 1458:6-12 (Flannery).) Also by mid to late July 2007, Flannery thought investors in LDBF would want to know the fund was concentrated in subprime. (Tr. 1470:18-1471:1 (Flannery).) ***Flannery did not keep track of whether relationship managers were pushing out information to clients about what was going on in the subprime market and did not talk to relationship managers about whether they were telling clients about what was going on in the subprime market.*** (Tr. 1462:11-23.) Flannery also did not know if clients actually got audited financial statements for LDBF, including

> the December 31, 2006 LDBF CTF audited financial statements. (Hopkins Ex. 23; Tr. 1463:13-16 (Flannery).)

Div. PFOF ¶ 362 (emphasis added).

> 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.***

Div. Post-Hearing Br. at 35.

These statements by the Division are not accurate. First, it was public knowledge by July 26 that LDBF was invested mostly in subprime and used leverage. Flannery Ex. 108 at SS 003837015 (July 25 MML article stating LDBF was invested "mostly in subprime" and used leverage). Second, Mr. Flannery ***knew*** that information was public knowledge by July 26. *Id.*; Flannery Tr. at 1306:21-1308:15. Third, Mr. Flannery was also aware of the other information available to investors concerning LDBF's subprime exposure, including the February 28 CAR alert that discussed LDBF's investments in subprime at length; audited financial statements; and the FAQs. Flannery Tr. 1216:20-1217:1, 1309:9-1310:10; *see also* Flannery Exs. 17 (Mr. Flannery detailing subprime and leverage exposure to, among others, Marc Brown, the Head of Relationship Management) and 58 (same; Mr. Brown was a member of the EMG, which was included on the e-mail); Flannery Ex. 167 at SS 004344158.

More fundamentally, the Division completely ignores Mr. Flannery's role and responsibilities within SSgA. Mr. Flannery was the Chief Investment Officer, responsible for overseeing strategy for all of SSgA's funds. *See* Flannery Post-Hearing Mem. at 6-7. He was not, as the Division's statements assume, responsible for SSgA's compliance, legal, or client and consultant communications functions. *See id.* Mr. Flannery did not "keep track of whether relationship managers were pushing out information to clients about what was going on in the

subprime market and did not talk to relationship managers about whether they were telling clients about what was going on in the subprime market" ***because it was not his responsibility to do so.*** While Mr. Flannery was aware that there was a substantial amount of information available to investors and consultants in the FAQs and elsewhere, there was an entire structure in place—Relationship Management and Consultant Relations—that was expressly responsible for communicating with investors and consultants. Relationship Management personnel and not Mr. Flannery were responsible for tracking whether Relationship Managers and Consultant Relations personnel were using the information provided to them.[28]

The Division's assertion that Mr. Flannery knew that there was a "sensitivity" by the Relationship Management team about what clients knew because he received a revised draft of the letter deleting the phrase "As you know" truly strains credulity. First, as noted above, Mr. Flannery had good reason to believe that investors did know about the use of subprime in the funds. Second, the reason the "as you know" phrase was deleted is unknown—the Division adduced no evidence as to why the revision was made. That revision could have been made for any number of reasons, including stylistic. Third, Mr. Flannery was unsure whether he even read that draft version and believes that he may not have read it. Flannery Tr. at 955:20-956:3. Fourth, if Relationship Managers were "sensitive" as to whether investors knew certain information—***they had the responsibility and knowledge to communicate it to them.*** While Mr. Flannery was aware that there was a substantial amount of information available to investors and consultants, as the Division effectively concedes Mr. Flannery did not know what specific information had been provided to specific investors or consultants. Div. Post-Hearing Br. at 32 (Mr. Hopkins "perhaps alone among the letter's reviewers, knew what clients had not yet been

[28] The evidence establishes that Relationship Managers were providing this information to investors and their consultants. *See* Flannery Ex. 270.

told . . . ."). Relationship Management was included in every iteration of the drafting of this letter and was obviously in the best position to assess the total mix of information provided and available to clients. To claim that Mr. Flannery—as opposed to Relationship Management, the group responsible for communicating with clients—is somehow responsible for remedying any purported "sensitivities" makes no sense.

As is discussed above, the Division's claim that SSgA sold the highest rated assets to fund redemptions by the Related Funds and OFA and GAA clients is simply inaccurate. *See* Section II.A., *supra*. The Division's allegations with respect to the July 26 letter further ignores basic facts the Division admits elsewhere. Mr. Flannery did not learn about OFA's recommendation to its clients until July 27, ***after*** the July 26 letter was sent to investors. Div. Ex. 222 at SSgA-SEC 000380698; Donovan Tr. at 1800:23-1801:4; *see* Div. Post-Hearing Br. at 30 and Div. PFOF ¶ 424. There is no evidence Mr. Flannery had any idea OFA was evaluating whether to make a recommendation to its clients concerning LDBF prior to that. As to GAA, there is no evidence that Mr. Flannery was told about GAA's recommendation before August 1, after the July 26 letter was sent to investors. Div. Post-Hearing Br. at 31; Div. PFOF ¶¶ 435-36. While Mr. Flannery saw Mr. Lowe depart from the July 25 Investment Committee meeting, and did not know that GAA was contemplating withdrawal. Flannery Tr. at 992:12-15; Lowe Tr. at 2013:15-2014:19; 2017:16-2018:13. Notably, the August 1 "internal SSgA document" that the Division highlights as evidence Mr. Flannery knew by that date that GAA had recommended to its clients that they redeem their investments in LDBF (Div. Post-Hearing Br. at 31) was an updated version of the FAQs, a document reviewed and approved for use by Legal, and received by every person in Relationship Management, including Marc Brown, Larry Carlson, and Staci Reardon. Div. Ex. 153 at SS 004379036; Duggan Test. Stip. at 301:6-8. With respect to the so-

called Related Funds, while Mr. Flannery became aware on or about July 25 that SSgA was anticipating some level of unspecified redemption activity in LDBF, and ***may*** have been generally aware of some unspecified level of actual redemption activity, there is no evidence he had any specific knowledge of the amount of activity or which investors—Related Funds versus independent investors—would be redeeming by July 26th. As such, the Division's claim must fail.

V. SANCTIONS SHOULD NOT BE IMPOSED.

If this Court were to conclude, contrary to law and the evidence, that Mr. Flannery is liable, it should decline to impose the relief requested, as the punishment sought by the Division would be unfair and contrary to the public interest. Even viewing the evidence in the light most favorable to the Division, this is a case where *scienter* is absent. *Steadman v. SEC*, 603 F.2d 1126, 1140 (5th Cir. 1979), *aff'd on other grounds*, 450 U.S. 91 (1981) (degree of *scienter* is among the public interest factors to be considered in determining sanctions). The only *scienter*-based charge against Mr. Flannery relates to the August 2 letter, yet ***the Division concedes that Mr. Flannery believed that the statements in that letter were true.*** *See* Section II.B-C, *supra*. In light of that concession, and the abundant evidence of the reasonable basis for Mr. Flannery's belief, *scienter* cannot be found. Flannery Post-Hearing Mem. at 85-89; *see also* Section II.B-C, *supra*.

Mr. Flannery has led an impeccable life, both personally and professionally, as numerous witnesses testified. Consistent with his character, the evidence demonstrates that at all times during the unprecedented market crisis of the Summer of 2007, he had investors' best interests in mind, sought to take responsibility, and strove to be accurate and truthful. It would be contrary to the public interest and notions of justice to impose even a minimal sanction against Mr. Flannery. *See* Flannery Post-Hearing Mem. at 106-108.

A. Civil Monetary Penalties Should Not Be Imposed.

1. The Division Is Not Entitled to Civil Monetary Penalties.

The Division brought this action under Section 8A of the Securities Act of 1933, Section 21C of the Securities Exchange Act of 1934, Section 203(f) of the Investment Advisors Act, and Section 9(b) of the Investment Company Act. OIP at 14. While the Division does not explicitly indicate as much, it appears that in seeking sanctions, the Division is relying, at least in part, on amendments to these Acts contained in the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"). Pub. L. No. 111-203, 124 Stat. 1376 (2010) (codified at 12 U.S.C. § 5301 *et seq*. (2010)). Because the conduct at issue in this case occurred in 2007, the Division is impermissibly seeking retroactive application of the amendments.

Dodd-Frank does not apply to conduct occurring prior to its enactment. Indeed, Dodd-Frank states, "[e]xcept as otherwise specifically provided in this Act or the amendments made by this Act, this Act and such amendments shall take effect 1 day after the date of enactment of this Act," *i.e.*, on July 22, 2010. Pub. L. No. 111-201, 124 Stat. 1390 (2010); *see* 12 U.S.C. § 5301 (note 4). Congress did not provide for Section 929P of Dodd-Frank —regarding penalties — to apply retroactively and, accordingly, it does not. *See AT & T Corp. v. Hulteen*, 129 S. Ct. 1962, 1971 (2009) (there is a general presumption against retroactivity absent indication of a clear intent from Congress); *Lockheed Corp. v. Spink*, 517 U.S. 882, 896 (1996) (language setting forth the date amendments are to take effect "compels the conclusion that the amendments are prospective."); *see also In the Matter of John W. Lawton*, Exchange Act Release No. 419, 2011 WL 1621014, at *4 (ALJ Apr. 29, 2011) (initial decision) (J. Murray) (analyzing new associational bars created by Dodd-Frank, and holding that "because such bars did not exist at

the time of Lawton's conduct, I find that they attach new legal consequences to Lawton's conduct and are impermissibly retroactive.").[29]

For these reasons and the other reasons set forth below, civil monetary penalties are unavailable against Mr. Flannery:

a. Section 8A of the Securities Act

The Division seeks penalties under Section 8A of the Securities Act, but Section 8A did not authorize civil penalties in cease and desist proceedings prior to Dodd-Frank; rather, it only provided for the imposition of cease and desist orders. *See* 15 U.S.C. § 77h-1 (noting that Subsection (g), "Authority to Impose Money Penalties," was added via 2010 amendment, Pub. L. No. 111-203, § 929P(a)(1)). Accordingly, penalties are unavailable under Section 8A. *See* Section V.A.1, *supra*.

b. Section 21(B)(a) of the Exchange Act

Before Dodd-Frank, civil penalties were only available under Section 21(B)(a) against specifically enumerated persons: broker/dealers and persons associated with them (15(b)(4), (6); securities analysts (15D); municipal securities dealers (15B); government securities broker/dealers (15C); credit rating agencies (15E); and clearing agencies (17A). The Division did not allege, much less prove, that Mr. Flannery fell into any of these categories. Rather, the Division seeks to apply Section 21B(a)(2), which was added by Dodd-Frank and expanded the

[29] Even if there were some ambiguity in terms of whether Dodd-Frank had retroactive application (and there is not), resolution of that ambiguity would yield the same result under the test set forth in *Landgraf v. USI Film Prods.*, 511 U.S. 244 (1994). In considering retroactivity, a court must assess "whether applying the statute to the person objecting would have a retroactive consequence in the disfavored sense of affecting substantive rights, liabilities, or duties on the basis of conduct arising before its enactment. If the answer is yes, we then apply the presumption against retroactivity by construing the statute as inapplicable to the event or act in question owing to the absence of a clear indication from Congress that it intended such a result." *Fernandez-Vargas v. Gonzalez*, 548 U.S. 30, 37-38 (2006) (*citing Landgraf*, 511 U.S. at 278, 280) (internal quotation marks and brackets omitted). The allegations in this case do not concern any actions that took place after 2007. Subjecting Mr. Flannery to increased penalties on the basis of statutory provisions enacted in 2010 would be unfair, and affect Mr. Flannery's substantive rights and liabilities.

availability of civil penalties. *See* 15 U.S.C. § 78u-2 (noting that Subsection (a), "Commission Authority to Assess Money Penalties," was rewritten via 2010 amendment, Pub. L. No. 111-203, § 929P(a)(2)). Again, retroactive application of this amendment to conduct pre-dating its enactment would be improper. *See* Section V.A.1, *supra*.

c. Section 203(i) of the Investment Advisors Act

Monetary penalties under Section 203(i) are not available unless the respondent was an investment advisor pursuant to 203(e), or a person associated with an investment advisor pursuant to 203(f).[30] *See* 15 U.S.C. § 80b-3(i)(1); *see also In the Matter of John Francis D'Acquisto*, Exchange Act Release No. 1696, 1998 WL 40225, at *2 (Comm'n Op. Jan. 21, 1998) (order imposing remedial sanction) ("Sections 203(e) and 203(f) of the Advisors Act, as relevant here, permit us to sanction any person who is an "investment advisor" or is "associated with an investment advisor," if we find that the sanctions are in the public interest, and that, among other things, the person has been permanently enjoined from engaging in conduct in connection with the purchase or sale of a security.").

The Division alleges only that Mr. Flannery was associated with an investment advisor pursuant to Section 203(f). In order to establish that Mr. Flannery was associated with an investment advisor, the Division needed to prove that he was a "partner, officer, or director of [an] investment advisor (or any person performing similar functions), or any person directly or indirectly controlling or controlled by such investment advisor, including any employee of such investment advisor." 15 U.S.C. § 80b-2(a)(17). The Division has not established that Mr. Flannery fell into any of these categories. The Division's evidence on this point established only that certain portfolio managers who managed registered funds of SSgA Funds Management, Inc.

[30] This is true regardless of whether Dodd-Frank is applicable.

("SSgA FM") ultimately reported up (though not directly) to Mr. Flannery. Div. PFOF ¶ 7; OIP ¶ 9. There is no evidence that Mr. Flannery was a partner, officer, director or employee of SSgA FM, or that he controlled the investment advisor, SSgA FM, within the meaning of Section 80b-2(1)(17). The issue of control is a factual issue, and, therefore, the Division needed to prove this at trial. It did not do so, failing to even adduce any evidence on the issue of Mr. Flannery's control over SSgA FM. The mere fact the Mr. Flannery was several levels higher in the reporting structure from portfolio managers who managed SSgA FM funds does not prove that Mr. Flannery controlled that entity. The Division failed to prove that he was associated with an investment advisor, and penalties are therefore unavailable under the Investment Advisors Act.

d. Section 9(d) of the Investment Company Act

Similarly, the Division seeks civil penalties pursuant to Section 9(d) of the Investment Company Act. However, prior to Dodd-Frank, Section 9(d) only provided for penalties in a proceeding brought under Section 9(b) against a person associated with a registered investment company at the time of the alleged misconduct. *See* 15 U.S.C. § 80a-9(b) (noting that Subsection (d)(1), "Authority of Commission," was rewritten via 2010 amendment, Pub. L. No. 111-203, § 985(d)(2)). While the Division claims that Mr. Flannery was "performing advisory services for the registered investment companies advised by SSgA FM" (Div. Post-Hearing Br. at 74), there is no evidence whatsoever to support this statement. Indeed, as discussed above, the Division failed to show that Mr. Flannery was even associated with an investment advisor. Moreover, while Section 9(d) authorizes penalties in certain proceedings brought pursuant to Section 9(b) when willfulness is established, penalties are not available here, because the Division failed to prove that Mr. Flannery acted "willfully." 15 U.S.C. § 80a-9(b).

2. Civil Monetary Penalties Would Be Contrary To The Public Interest.

Even if monetary penalties were available, the Division has not shown that they would be appropriate. The crux of the Division's penalties argument is the contention that the alleged conduct of Mr. Flannery "harmed investors in LDBF and the Related Funds." Div. Post-Hearing Br. at 73. However, this has not been demonstrated: the Division never called a witness to testify that they relied on or were harmed by the alleged misstatements or omissions in the August 2 and August 14 letters. While the portfolio managers may have made investment decisions which proved to be incorrect, the risk of such incorrect choices is known to all investors (particularly the sophisticated institutional investors in LDBF), is an inherent feature of investing, and did not result from any misconduct by Mr. Flannery. Moreover, Mr. Flannery received no financial or other gain as a result of the alleged misstatements and omissions — his compensation was not tied to LDBF, and he did not otherwise receive any benefit. Flannery Post-Hearing Mem. at 93.

B. A Bar Should Not Be Imposed.

The Division asks that a bar be imposed under Section 203(f) of the Investment Advisors Act and Section 9(b) of the Investment Company Act. Again, the Division is not entitled to a bar pursuant to these sections, as it has failed to establish that Mr. Flannery was an associated person, as set forth above. *See* Section V.A.1.d, *supra*. Furthermore, a bar would be contrary to the public interest, where the Division has conceded that Mr. Flannery believed in the accuracy of the statements upon which the only *scienter*-based charge against him is founded, where he sought to involve multiple lawyers, Relationship Management personnel and others in the letters and took steps to ensure they were informed, and where Mr. Flannery did not and never had responsibility for investor communications. *See* Section II.B-C, *supra*; *see also* Flannery's Post-Hearing Mem. at 14, 27-28, 42-46, 90. Notably, the cases on which the Division relies are starkly different from this case, and they simply do not provide support for imposing a bar

against Mr. Flannery. *See Seghers v. S.E.C.*, 548 F.3d 129, 131, 134 (D.C. Cir. 2008) (Seghers, who the parties conceded was acting as an investment advisor, repeatedly misstated the value of hedge funds while knowing that the values were incorrect, telling his lawyers the funds were "in the toilet"); *In the matter of Don Warner Reinhard*, Exchange Act Release No. 3139, 2011 WL 121451, at *5-6 (Comm'n Op. Jan. 14, 2011) (bar issued against Reinhard, who did not dispute that he was an "associated person," on the basis of his criminal conviction for conduct including false statements to the government and others and concealing assets; misconduct "involved a high degree of *scienter*"). The Division's suggestion that either of these cases supports a bar against Mr. Flannery is without merit.

C. A Cease and Desist Order Should Not Be Imposed.

Finally, the Division seeks a cease and desist order under Section 8A of the Securities Act and Section 21C(a) of the Exchange Act. The decision whether to issue a cease and desist order is remitted to the Court's discretion. In considering whether a cease and desist order would be appropriate, a number of factors are to be considered, 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 or her conduct, and the respondent's opportunity to commit future violations. In addition, we consider whether the violation is recent, the degree of harm to investors or the marketplace resulting from the violation, and the remedial function to be served by the cease-and-desist order in the context of any other sanctions being sought in the same proceedings." *WHX Corp v. SEC*, 362 F.3d 854, 859 (D.C. Cir. 2004) (reversing imposition of cease and desist order).

Here, the Division claims Mr. Flannery committed "egregious securities violations," "failed to provide assurances against future violations," and "failed to acknowledge that a

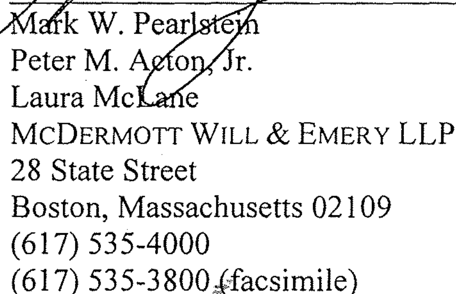
violation had occurred." Div. Post-Hearing Br. at 72. Further, the Division contends that if Mr. Flannery finds future employment in the investment industry, he "will again be placed in circumstances where [he] can violate the securities laws." *Id.* With respect to the Division's latter argument, such a conclusory contention was rejected by the Court in *WHX*: "The 'risk of future violation' cannot be the sole basis for its imposition of the order, as the SEC's standard for finding such a risk is so weak that it would be met in (almost) every case. . . ." 362 F.3d at 861. And, for the reasons discussed previously in this Brief and Mr. Flannery's Post-Hearing Memorandum, the suggestion that Mr. Flannery did anything that was "egregious" during the subprime crisis is completely at odds with the evidence. Finally, it would be truly inappropriate to issue a cease and desist order — while it is true that Mr. Flannery has "failed to acknowledge that a violation had occurred," the evidence demonstrates that he committed no violation, and believed in good faith that he committed no violation.

VI. CONCLUSION

For all the foregoing reasons, and the reasons set forth in Mr. Flannery's Post-Hearing Memorandum, the Court should reject all of the claims against Mr. Flannery.

Dated: May 4, 2011

Respectfully Submitted,



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APPENDIX A

to

John Patrick ("Sean") Flannery's Post-Hearing Reply Brief

Division Proposed Findings of Fact Citations (Substantive Inconsistencies)[1]

FOF #	Division's Proposed Finding of Fact	Flannery Response and Counterstatement
33	"As the CIO of the Americas, the heads of each asset class reported to Flannery, "so I had a team that included equities, passive, active, fundamental, active, quantitative. I had head of bonds, head of cash, global asset allocation, and currency management, the advanced research center, which was where our quantitative modeling and research was done, product engineering, and credit policy and risk management." (Tr. 782:1-783:2 (Flannery).) Division Exhibit 90 accurately reflects the reporting structure that Flannery was part of in 2007. (Tr. 783:3-15 (Flannery); Div. Ex. 90 at SSgA-SEC 60359.) During this time frame, Paul Greff reported to Flannery and was the head of global fixed income; Adele Kohler reported to Flannery and was the director of product engineering; and Patrick Armstrong reported to Flannery and was the head of investment risk management. (Tr. 783:25-784:1, 784:10-15 (Flannery); Div. Ex. 90 at SSgA-SEC 60359; Hopkins Ex. 24; Tr. 38:10-39:7 (Hopkins).) Because both the head of fixed income and the head of the risk management group reported to Flannery, if they could not resolve a dispute it would likely find its way to Flannery as the direct supervisor of both groups. (Tr. 784:16-785 (Flannery).)"	• While Mr. Flannery does not dispute this Proposed Finding of Fact, he was not responsible for SSgA's compliance, legal, or client and consultant communications functions. The Compliance Department reported to Chief Operating Officer Otello Sturino, who did not report to Mr. Flannery. Flannery Tr. at 1149:17-1150:3. The Relationship Management and Consultant Relations groups reported to Marc Brown, the Chief Marketing Officer, who also did not report to Mr. Flannery. *Id.* at 1150:4-23. The Legal Department reported to Mitchell Shames, SSgA's General Counsel. Mr. Shames also did not report to Mr. Flannery. *Id.* at 1150:24-1151:10. Further, Mr. Flannery was not involved in the day-to-day management of any of SSgA's strategies, nor were his direct reports. *Id.* at 1157:23-1158:5. Those tasks were the responsibilities of Portfolio Managers and traders; in the case of LDBF, the Portfolio Manager was Bob Pickett, who was a member of SSgA's Fixed Income team. *Id.* at 1152:10-13, 1158:2-15. Mr. Pickett did not report directly to Mr. Flannery. He reported to Mr. O'Hara, who reported to Mr. Greff, who reported to Mr. Flannery. Pickett Tr. at 1549:16-22; 1747:3-1728:10; Flannery Tr. at 1206:10-22.
35	"In 2006 and 2007, Flannery received a base salary of $450,000 plus a discretionary bonus. (Tr. 787:12-22 (Flannery).) The discretionary bonus pool each year at SSgA was divided among all SSgA employees who received bonuses and the size of the pool depended on SSgA's revenues, which in turn depended on SSgA's assets under management. (Tr. 1437:10-1438:5 (Flannery).) In 2006, Flannery received $2,108,582 in wages,	• Mr. Flannery's salary and bonus were not tied to assets under management in LDBF or the performance of any fund. Flannery Tr. at 1163:5-10.

[1] **Rule 201.340 of the Commission's Rules of Practice does not require a counter-statement to the Division's Proposed Findings of Fact where, as here, simultaneous filings were ordered. Nonetheless, to assist the Court, Mr. Flannery files this counter-statement to highlight his disputes with those proposed findings of fact directed at him. Mr. Flannery does not admit the accuracy of other proposed findings which do not relate to the claims against him, and further notes that he included his own Proposed Findings of Fact in his Post-Hearing Memorandum.**

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	tips, and other compensation from State Street, which included his base salary of $450,000 and certain elements of a discretionary bonus that included prior years' stock awards that had vested. (Div. Ex. 10 at FLAN1609; Tr. 788:3-20 (Flannery).) In 2007, Flannery received $4,337, 314 in wages, tips, and other compensation from State Street, which included his base salary of $450,000 and certain elements of a discretionary bonus that included prior years' stock awards that had vested. (Div. Ex. 10 at FLAN 1613; Tr. 788:21-789:11 (Flannery).)"	
36	"SSgA terminated Flannery's employment on November 16, 2007. (Tr. 782:8-10 (Flannery).) When State Street's CEO, William Hunt, told Flannery his position was being eliminated, Hunt did not offer Flannery another position at State Street. (Tr. 793:13-794:3 (Flannery).)"	• Mr. Flannery was not told that he was being terminated nor does his separation agreement reflect that he was terminated. Flannery Tr. at 790:20-22.
38	"Flannery's Prehearing brief states that Flannery "has never been the subject of a criminal or civil enforcement action…" (Flannery Pre-Hearing Memorandum at 5.) Flannery testified that this sentence was accurate, and he was not aware of being the subject of a criminal enforcement action. (Tr. 764:17-765:4 (Flannery).) However, Flannery [redacted]	• As Mr. Flannery disclosed in the background questionnaire that was provided to the Division and shown to him during the hearing, Mr. Flannery was not convicted of the two referenced and disclosed DUI offenses. Div. Ex. 197. Mr. Flannery further noted that he did not understand that those two allegations made him a "subject of a criminal enforcement action." Flannery Tr. at 764:17-767:2. Mr. Flannery has never been the subject of any enforcement action other than the [redacted] disclosed in the questionnaire.
41	"LIBOR is a relatively low rate of return. (Tr. 128:14-16 (Hopkins).)"	• Mr. Hopkins actually testified that "LIBOR is ***usually*** a relatively low rate of return." Hopkins Tr. at 128:14-16 (emphasis added). • LDBF had a target annual return of LIBOR plus 50 to 75 basis points as it was designed to generate returns well in excess of money market funds. Hopkins Tr. at 45:16-19; Sirri Report at ¶ 21; Zask Direct Test. at A.22. Seeking to achieve those returns required LDBF to take on substantially more risk than a money market fund. Sirri Report at ¶ 21; Zask Direct Test. at A.22. "This risk-return trade-off is a fundamental principle of finance that is well understood by sophisticated investors." Sirri Report at ¶¶ 1-3, 9-10, 12, 15.

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44	"The common trust fund (CMZ5) was open to other non-ERISA qualified institutional investors such as pensions, endowments, and charitable trust. (Tr. 44:18-21 (Hopkins); Tr. 1562:9-15 (Pickett); Div. Ex. 200 ¶12; Stip. ¶ 5.) ***Some of State Street's institutional clients were very small and included charities and colleges.*** (Tr. 2780:16-21 (Carlson).)"	• The clients invested in LDBF were sophisticated institutional investors. Carlson Tr. at 2731:2-9; Peavy Direct Test. at A.40(a), A.42-A.44, A.54, A.67-A.68. While some of these institutional investors may have been small, the majority of them were large in size and investing significant amounts of money. *Id.*; *see also* Carlson Tr. at 2732:1-3. In addition, approximately 70 to 80% of the sophisticated institutional investors employed consultants to assist them with investment decisions. *Id.* at 2731:10-18. The consultants employed by the sophisticated institutional investors invested in LDBF are investment experts who charge a fee for rendering investment advice to their clients. *Id.* at 2731:19-25. Investors in LDBF included large institutions with hundreds of millions of dollars of assets under management. Sirri Direct Test. at ¶ 7, ¶ 21 n.9.
48	"The Division's expert Russ Wermers, an Associate Professor of Finance at the University of Maryland's Robert H. Smith School of Business, is an expert on mutual funds. (Div. Ex. 255.) Wermers testified that LDBF was similar to a mutual fund because: 1) LDBF provided a net asset value of the portfolio every day; 2) LDBF's investment manager, State Street, worried about investors redeeming quickly (a bigger worry for LDBF because LDBF had large investors who could pull large amounts of money on a moment's notice); 3) State Street managed LDBF to a particular strategy; and 4) LDBF avoided excessive trading costs, paid attention to fees, analyzed the risks of the portfolio to make sure it was within risk limits, and followed a stated benchmark as a guideline for risk and performance targets. (Tr. 732:7-733:25 (Wermers).)"	• The Division admits in its Proposed Findings of Fact that LDBF had differences from a mutual fund. Division Proposed Findings of Fact ("Div. PFOF") ¶ 50. "Unlike a mutual fund, LDBF ERISA and LDBF CTF were governed by fund declarations." *Id.* • The Respondents' expert, Erik Sirri, is a Professor of Finance at Babson College who was previously the Director of the Division of Trading and Markets at the SEC, as well as the SEC's Chief Economist. Hopkins Ex. 161 at ¶¶ 1-3. Professor Sirri is an expert on securities market structure, the interaction of securities law and finance, and investment management, with expertise in both mutual funds and unregistered funds. *Id.* ¶ 5; Sirri Tr. at 2091:7-2094:18. Mr. Sirri opined that unregistered funds such as LDBF are exempt from certain SEC rules that apply to mutual funds offered to the general public, including rules that require the funds to file prospectuses and periodic reports disclosing portfolio details with the SEC. Sirri Direct Test. at ¶ 7, ¶ 21. One of the reasons for this exemption is that investors in such funds are sophisticated investors who are sufficiently capable of evaluating the risks, either on their own or by hiring consultants with the necessary expertise. *Id.* • In general, as an unregistered fund, LDBF was subject to much less extensive

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		disclosure requirements than a registered fund such as a mutual fund. Flannery Tr. at 1211:4-11; Sirri Report at ¶ 21.[2] Unlike a mutual fund, LDBF did not issue a prospectus. Sirri Report at ¶ 21. Instead, fund declarations were provided to investors, which spelled out the objectives and limitations of LDBF, including the types of securities in which the fund could invest. Flannery Tr. at 1215:5-20. Audited financial statements were available to investors, which also contained detailed information regarding the types of securities in which LDBF invested, including housing-related ABS and derivatives. *Id.* at 1216:20-1218:23, 1221:1-21; Hopkins Ex. 23 (Audited Financial Statements for CTF version of LDBF as of 12/31/06). Clients received fact sheets, which contained information about LDBF's investment strategy and the types of securities it was invested in, such as "collateralized mortgage obligations, asset-backed securities, futures, options, and swaps." Sirri Report at ¶¶ 23-25 (quoting 2002 LDBF fact sheet); Flannery Tr. at 1225:12-17. Clients also received periodic reporting packages on a monthly or quarterly basis discussing fund performance. Sirri Report at ¶ 22 (citing investigative testimony); Carlson Tr. at 2667:25-2670:21. While Mr. Flannery was aware that the foregoing sources of information were available to investors, as CIO, he was not involved in the preparation or dissemination of these documents. Carlson Tr. at 2667:25-2670:21; Flannery Tr. at 1083:6-1084:20, 1211:12-1212:5, 1213:11-20. • The Fund's "disclosure and marketing materials described the LDBF strategy as a strategy that sought to provide '[e]nhanced performance over traditional money

[2] Common trust funds and collective investment trusts such as LDBF are excluded from the definition of "investment company" under the Investment Company Act, pursuant to either Section 3(c)(3) or Section 3(c)(11). Disclosure requirements for funds such as LDBF are governed by Regulation 9 of the Office of the Comptroller of the Currency ("OCC"). *See* 12 C.F.R. § 9.18. Regulation 9 imposes only two disclosure requirements on banks that maintain these funds. First, Regulation 9 requires banks to make available upon request a written plan that describes the bank's investment powers and policies with respect to the fund, and other matters set forth in the regulation. *See* 12 C.F.R. § 9.18(b)(1). Notably, the OCC does not require banks to send a copy of the written plan to each of its clients. *Id.* Rather, the written plan must only be made available for inspection at the bank by anyone who requests it. Second, Regulation 9 requires that a bank make available upon request an audited annual financial report that includes, among other things, a list of the fund's investments, income and disbursements, and fees charged by the bank to the fund. 12 C.F.R. § 9.18(b)(6)(ii)(iv). SSgA made annual audited financial statements available for LDBF. *See, e.g.*, Hopkins Ex. 23.

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		market returns.'" Sirri Report at ¶ 24 (citing Limited Duration Bond Fund Quarterly Fact Sheets, June 30, 2002). "The Fund explained the trade-off explicitly in its fact sheets: 'The tradeoff is [that] 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.'" *Id.* (citing Limited Duration Bond Fund Quarterly Fact Sheets for 2002Q2, 2002Q4, all quarters during 2004-2006, 2007Q1, and 2007Q3). The Fact Sheets also disclosed the list of assets it would invest in, which included "securities that [go…] beyond typical money markets including…collateralized mortgage obligations, adjustable rate mortgages, fixed rate mortgages,…asset backed securities, futures, options, and swaps." *Id.* Further, "[m]oney market mutual funds are subject to strict limits regarding the quality and diversification of their portfolios." *Id.* at ¶ 26. "Mutual funds registered with the SEC and offering shares to the public must file semi-annual reports with the SEC that disclose their portfolio holdings in detail and give a break-down of the portfolio by asset class." *Id.* at ¶ 31. They must also file quarterly reports, which disclose portfolio holdings, but do not provide a breakdown by asset class." *Id.*
52	"Pickett understood that the LDBF fund declarations allowed LDBF to invest in any type of fixed income securities, including derivatives, as long as the securities were rated investment grade and, with regard to LDBF CTF, were not private placements. (Tr. 1567:13-1568:20 (Pickett).) The LDBF fund declarations required an average option adjusted duration of no more than one year, and Pickett explained that the fund held mortgage bonds with short durations because "the securities that we purchased were in a form that were called floating rate notes. So every – predominantly every month, in the middle of the month, the interest rate would change to reflect the new level of interest rates, whether interest rates were higher or lower." (Tr. 1569:12-1570:18 (Pickett).) Besides the restrictions of the LDBF fund declarations, the SSgA Investment Committee could also	• *See* Response to ¶ 48, *supra*. • Mr. Flannery did not play a role in the investment decisions for LDBF, including the decision to concentrate LDBF in housing-related asset backed securities and Mr. Pickett, who did have that role, did not regularly interact with Mr. Flannery. Flannery Tr. at 1157:23-1159:1; Pickett Tr. at 1728:15-17, 1566:12-16, 1594:14-22, 1730:8-16. • Mr. Flannery never executed a trade. Flannery Tr. at 1152:10-13. • Mr. Flannery was responsible for approximately three hundred strategies and nearly $2 trillion in assets under management. Flannery Tr. at 1142:5-11, 1156:8-

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	instruct the portfolio managers of LDBF to buy or sell securities, but the only time it ever did that was in the context of a direction "to reposition the fund in August of '07." (Tr. 1572:24-1573:15 (Pickett).)"	11.
55	"In a July 19, 2007 presentation by Flannery and others at SSgA to the State Street Corporation Board of Directors entitled "SSgA-Business Evolution and Foundations for Future Growth," Flannery presented one of the PowerPoint slides to the board that listed LDBF as one of SSgA's four "Enhanced" strategies. (Div. Ex. 116, at SS 627277, Tr. 807:9-13 (Flannery).) The presentation also described the "G-8," which were the eight strategic business goals of SSgA in 2006 and 2007. (Tr. 805:25-806:3 (Flannery).) Two of the G-8 goals were "Broadening Active Management" and "Leveraging Fixed Income." (Div. Ex. 16 at SS 6272169.) "Broadening Active Management" and "Leveraging Fixed Income" were two areas where SSgA was focusing its strategic investment and building greater capabilities to promote to clients. (Tr. 806:8-14 (Flannery).) These two goals causes State Street to focus on active fixed income. (Tr. 806:18-25 (Flannery).) ***SSgA earned higher fees on its actively managed funds than it did on its passively managed funds.*** (Tr. 1440:18-22 (Flannery).)"	• The Division misstates the record evidence it cites for the highlighted proposition. When he was asked "And active fixed income earned SSgA higher fees than its passive management – the passive assets it managed; isn't that right?" Mr. Flannery testified "It – well, higher – perhaps higher fees but ***much lower margins.***" Flannery Tr. at 1440:18-22 (emphasis added). Thus, while they charged clients more for actively managed funds, it cost more to actively manage those funds such that the net profitability was lower. • LDBF constituted less than 1% of the funds for which Mr. Flannery was ultimately responsible in his capacity as CIO. Flannery Tr. at 1142:5-11, 1145:4-1146:4. LDBF was also one of approximately three hundred investment strategies overseen by Mr. Flannery. *Id.* at 1155:5-11; Lowe Tr. at 2021:13-16. Regardless of what fees were earned by SSgA, neither Mr. Flannery's salary nor his bonus were connected to the performance of *any* fund, whether actively or passively managed. Flannery Tr. at 1163:5-10. • The term "Enhanced" strategy was only used here to describe the excess return targeted by the strategies across all of SSgA; it does not mean that the sales team marketed LDBF has an enhanced strategy.
60	"In 2006 and 2007, SSgA was promoting its expertise in portable alpha to clients and prospective clients. (Tr. 821:23-822:2 (Flannery).) Flannery was aware that a number of other State Street funds, including funds outside of the active fixed income group at SSgA, were investing in LDBF. (Tr. 825:18-21 (Flannery).)"	• In response to a question: "Did you understand that during 2006 and 2007, SSgA was promoting ***sort of*** its expertise in this – with this portable alpha to clients and prospective clients?" Mr. Flannery responded "I ***think*** in ***some*** cases, yes." Flannery Tr. at 821:23-822:2 (emphases added). • Regardless of the extent to which *SSgA* was "promoting its expertise in portable alpha to clients and prospective clients," Mr. Flannery himself was not responsible for client or prospective client communications. *See* Flannery Tr. at

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		1150:4-23, 1210:3-11; *see also* Div. Ex. 90 at SSgA-SEC 000060359. SSgA's sales team, and not Mr. Flannery, determined what products or expertise was promoted to clients. Flannery Tr. at 821:2-21. There is no evidence that Mr. Flannery ever marketed LDBF to anyone at all.
61	"Various State Street fixed income funds invested directly in LDBF as a source of portable alpha. (Div. Ex. 145 at SS 9446381; Div. Ex. 185 at SS 9157120.) As of June 30, 2007, these funds included: Absolute Return Mortgage Fund, Bond Market, Bond Market CTF, Credit Bond CTF, Credit Fund, Global Fixed Income Opportunities Securities Lending ("SL") Fund, Government Bond CTF, Government Credit Bond Fund, Government Fund, Intermediate Bond CTF, Intermediate Bond SL, Mortgage Backed Securities CTF, Mortgage Fund, Short Term Bond CTF, and Short Term Bond SL. (Id.) In addition, the Bond Market Non-Lending Series Fund – Class A, Core Bond SL CTF, Government Credit Bond Fund Series A, Government Credit Bond Fund Series C, Intermediate Bond SL Series Fund – Class A, and US Dollar Libor Plus CTF were other State Street active bond funds that invested indirectly in LDBF as of June 30, 2007 through investments in at least one other State Street active bond fund that invested directly in LDBF. (Id.) ***Ten of the funds that were either directly or indirectly invested in LDBF as of June 30, 2007 were forced to close by September 30, 2007.*** (Div. Ex. 185 at SS 9157120.) In the summer of 2007, as a result of subprime RMBS exposure, LDBF and State Street's other active fixed income funds experienced significant underperformance, including underperformance relative to their benchmarks: [Chart] (Div. Ex. 185 at SS 9157113.) During the same period, most of the funds invested in LDBF redeemed, as demonstrated by the red line in this chart: [Chart] (Div. Ex. 245 II.B.)	• Division Exhibit 185 says that "Ten funds closed as of 9/30/207." Div. Ex. 185 at SS 9157120. There is no evidence the closure of those funds was related to LDBF's underperformance and, if it was related, to what extent. • Prior to 2007, LDBF consistently outperformed its benchmarks. Flannery Ex. 257 at SS 003897474. After a period of underperformance in February-March 2007, LDBF recovered and experienced some of the best months in its history in April and May 2007. Hopkins Ex. 56; Flannery Tr. at 1232:7-8. In light of this history, and in light of the positive views on the fundamentals of the housing market held by both government officials (Flannery Ex. 25 at 4, Flannery Ex. 260) and members of SSgA's fixed income team (Wands Tr. at 2857:9-17; Flannery Ex. 42), Mr. Flannery and the Fixed Income team believed in good faith in the fundamentals of the underlying strategy. *See* Flannery Post-Hearing Mem. at 96.

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62	"LDBF was flat to LIBOR in 2005 and took on greater leverage in 2006 and 2007 to get its performance back on track."	• The Division does not provide any citation to the record for the proposition that LDBF took on greater leverage in 2006 and 2007 "to get its performance back on track." • Until 2007, securities backed by residential mortgages, including what later became known as subprime mortgages, performed very well. Sirri Report at ¶ 40; Flannery Ex. 137. Furthermore, between its inception in 2002 until January 2007, LDBF consistently outperformed its benchmark, regardless of the direction of interest rates. Flannery Tr. at 1206:23-1208:15; Flannery Exs. 257 and 243.
63	"Pickett testified: "From when I took over, 2005, [LDBF] was flat to LIBOR; 2006, I think it was up 75 basis points on LIBOR." (Tr. 1731:11-12 (Pickett).) Pickett also testified that in February 2007 LDBF experienced a brief period of underperformance and "retraced a little bit" in the months that followed. (Tr. 1731:16-23 (Pickett).) The risk budget for LDBF also increased in 2007 after the fund experienced underperformance in February 2007. (*See infra* ¶ 85.)	• By early 2007, following a period of historic strength in the housing market, housing prices began to decline and mortgage delinquencies began to rise markedly. Sirri Report at ¶¶ 52-54; Wands Tr. at 2852:18-2853:7. Hedge funds that were pessimistic about the housing market began taking large short positions against BBB ABX Index swaps, a derivative tied to the housing market. Flannery Tr. at 1225:23-1226:9; Wands Tr. at 2853:8-10. The large short positions caused a sharp drop in the price of the BBB ABX Index swaps in February 2007, which in turn affected LDBF's performance because the strategy had BBB ABX Index exposure. However, LDBF's higher rated securities were largely unaffected. Flannery Tr. at 1226:24-1227:10. While SSgA reduced LDBF's BBB ABX Index exposure in February 2007 (*see* Flannery Ex. 137), the Fixed Income team believed that the decline was temporary and the result of technical factors and that the housing-related ABS sector remained fundamentally strong and would substantially recover. Wands Tr. at 2853:16-22, 2856:6-12. The Fixed Income team was correct, stability returned to the mortgage markets in April and May 2007. Sirri Report at ¶ 56; Wands Tr. at 2857:9-17 (the BBB ABX rallied in April and May, and Mr. Wands and other members of the Fixed Income team believed in the fundamentals of subprime securities). In fact, LDBF more than "retraced a little bit" as Mr. Pickett testified, April and May 2007 were among the best months in LDBF's history. Hopkins Ex. 56; Flannery Tr. at 1232:7-8.
70	"SSgA described the ABX index and LDBF's ABX investment	• LDBF was comprised of only investment grade securities and was highly

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	in its "internal use only" frequently asked question: "The ABX represents a swap whose returns are derived from underlying credit default swaps of the 20 representative subprime mortgage securitizations issued in the United States over a 6 month timeframe. These swaps are based on the underlying deal tranches segregated by credit quality. At various points in time we have owned the AAA, AA as well as BBB segments of the index. The specific index in which we are positioned is the Series 06-2 (the returns derived from 20 deals of the first half of 2006)." (Div. Ex. 145 at SS 009446382 (answer to question "What is ABX, and which one did/do we own?") Any investment in ABX, ***regardless of rating,*** represents a basket of credit default swaps on lower quality investment rated mortgages and home equity loans. (Div. Ex. 45 at SS 7006816; Tr. 218:1-9 (Hopkins).)"	concentrated in AAA- and AA-rated securities; over 88% of the subprime ABS held by LDBF from 2004-Q2 2007 were rated AAA or AA. Sirri Report at ¶ 40, 48; Flannery Ex. 137. In fact, LDBF's average credit quality during the entire period relevant to this case was between AA and AA+. Flannery Exs. 137 and 257; Carlson Tr. at 2700:18-25, 2702:11-17, 2724:18-25; Hopkins Tr. at 438:20-22. As Mr. Sirri explained at length even if the loans underlying the tranches securities held by LDBF were subprime loans, "that would not imply that the securities themselves were risky." Sirri Report at ¶ 43. To the contrary: ***securities backed by subprime loans can and do receive AAA rating, and this was true of a substantial amount of the securities in which LDBF invested.*** *Id.* at ¶¶ 40-48; Pickett Tr. at 1597:6-1598:8. ***Notwithstanding the type of security, in each instance, the AAA rating represents a judgment by the ratings agencies that the securities are the least likely to default, regardless of the assets underlying the securities.*** Flannery Tr. at 1182:13-16; Sirri Report at ¶¶ 43, 48.
81	"State Street's internal documents quantified the increase in LDBF's leverage in 2006 and 2007. On October 18, 2007, Flannery and others at SSgA gave a presentation to the State Street Corporation Board of Directors entitled: "Active US Fixed Income – Review of Sub-Prime Market Impact." (Div. Ex. 185.) One of the presentation's slides "LDBF and Notional Leverage" stated: "For LDBF, leverage entailed entering into Total Rate of Return (TRR) swaps." (Id. At SS 9157104.) The slide included a chart called "Notional Leverage by Market Value – LDBF, which reflected that LDBF's notional leverage by market value was less than 100 percent of the fund until early 2006. (Id.) However, the slide showed that LDBF's notional leverage by market value rose rapidly in 2007 and was almost 300 percent of the fund in June and July 2007: [chart]."	• This Proposed Finding of Fact is irrelevant as to Mr. Flannery. The Division has repeatedly represented to the Court that this is not a case about whether LDBF was a good investment strategy. *E.g.*, Div. Pre-Hearing Br. at 39-40 ("The wisdom of investing in subprime in 2007 is not an issue for this tribunal to decide."); Flannery Tr. at 839:5-840:13, 1180:4-10, 1484:1-1488:9. • When investors began asking about the extent to which LDBF was leveraged in the Summer of 2007, Mr. Flannery and the Fixed Income team promptly provided information to the Relationship Management team for the purposes of providing investors with the requested information. As he explained in his testimony, there are a number of ways to represent leverage. Flannery Tr. at 1081:10-1082:11. Each method for representing leverage has its failings in that the methods can either overstate or understate the amount of risk. *Id.* One challenge that the Fixed Income team faced was that some consultants wanted to see leverage information in a manner that the Fixed Income team thought was confusing (*i.e.* gross notional leverage). *Id.* Rather than choosing one method over another, the Fixed Income team calculated leverage in LDBF using three methods and provided this

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		information to Relationship Management. Flannery Tr. at 1081:10-1085:21. This leverage information, and an explanation of the three methods they used to calculate leverage, was promptly added to the FAQs by August 6. Flannery Ex. 167 at SS 004344159 (FAQ # 35). • While irrelevant as to Mr. Flannery, the Division fails to explain in this Proposed Finding of Fact why leverage increased in LDBF. The notional leverage in the portfolio increased because the numerator (the notional value) remained constant and the denominator (market value of LDBF) dropped. This does not mean that more leverage was added to the Fund, or that LDBF took on additional risk. Instead, it just means that LDBF's existing leverage, and correspondingly the amount of risk, increased ***as a result of market events***. In fact, there were no purchases of total return swaps or ABX Index swaps after June 1, except in combination with short sales. *See generally* Div. Exs. 217 and 218. For example, in 2007 the Fixed Income team invested in Eurodollar futures that increased leverage in the fund. Despite the fact that it increased leverage, it reduced risk. Hopkins Tr. at 498:19-499:7. • When the market conditions deteriorated in summer of 2007, the Fixed Income team took steps that were intended to, and did, *reduce* the amount of leverage in the fund. Kramer Test. Stip. at 13:2-17, 16:24-17:13, 27:15-24; Zask Direct Test. at A.46-49, Exs. 5-7; Pickett Tr. at 1743:17-1745:5; *see also* Flannery Post-Hearing Mem. at 76-77.
82	"Similarly, on September 14, 2007, Lindner sent Flannery an email entitled "Risk through time." (Div. Ex. 181.) The email attached data, including a chart showing LDBF ERISA's (CMY1) leverage figures. Lindner is very certain he drafted the chart and the related comments discussing the increase in leverage: (Id.; Tr. 1896:4-12 (Lindner).) The figures in this chart represent "what the value of the assets was on a notional basis over the capital in the fund." (Tr. 1893:11-13 (Lindner).) The 3.5 figure means that if the fund had a market value of $1 billion, then the total notional value was $3.5 billion. (Tr.	• *See* Response to ¶ 81, *supra*. • Mr. Lindner's testimony reflects that he "played a role" in drafting the chart and text, not that he drafted it himself. Lindner Tr. at 1896:4-12.

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	1897:1901898:14 (Lindner).)"	
83	"Lindner testified that the increase in LDBF ERISA's leverage from 1.04 on November 30, 2006 to 3.50 on June 29, 2007, as reflected in the data attached to the September 14th email, was consistent with his recollection of an increase in LDBF's leverage through mid-2007. (Tr. 1893:20-1894:10 (Lindner).) Lindner wrote that "Leverage increased in the later part of 2005 because the increased use of Home Equity (HE) Total Return Swaps (TRS)." Lindner said that, in his view, these swaps were "somewhat risky." (Tr. 1909:3-23 (Lindner).) The swap position would be profitable for LDBF if the underlying home equity position performed well but would lose money for LDBF if the underlying home equity position did not perform well. (Tr. 1912:15-1913:3 (Lindner).) Further, as to his reference: "In the middle of 2007, leverage increased mainly due to increased use of HE TRS after the losses incurred on the BBB ABX positions in February," Lindner explained that LDBF had a long position on ABX in 2007, which meant that to make money on the trade, the subprime home equity market would have to perform well so the underlying bonds and credit default swaps would perform profitably. (Tr. 1916:18-1921:3 (Lindner).) In the second quarter of 2007, there was a decision "to increase positions in the total return swaps and retake them in ABX again…" (Tr. 1921:4-20 (Lindner).)"	• There was a reduction of BBB ABX Index swaps in late February, then the position was increased again in May/June 2007. After that, in July-August, the Fixed Income Team did not add to the BBB ABX position at all. Starting July 11, LDBF was offsetting its BBB ABX Index swaps, and as of July 31 allowed total return swaps to expire. There was no increase in these positions. There was only an increase in the notional value in relation to market value because market value decreased, not because notional value increased. Div. Exs. 217, 218 (transaction data showing purchases and sales of securities in CMY1 and CMZ5, respectively), 230 (Navigator reports showing notional and market value of securities held by CMY1 and CMZ5 on July 2 and August 31, 2007). • The Division has repeatedly represented to the Court that this is not a case about whether LDBF was a good investment strategy. *E.g.*, Div. Pre-Hearing Br. at 39-40 ("The wisdom of investing in subprime in 2007 is not an issue for this tribunal to decide"); Flannery Tr. at 839:5-840:13, 1180:4-10, 1484:1-1488:9. • Mr. Lindner said he never gave Mr. Flannery any advice about the risks in the portfolio that Mr. Flannery ignored. Lindner Tr. at 1973:2-18.
88	"Armstrong claimed that Flannery valued the risk group "very highly as an independent source of analyzing the portfolios." (Tr. 2201:6-2202:2 (Armstrong).) However, Armstrong admitted that in 2006 and 2007, the risk group was not empowered to buy or sell securities, and could not cut a position even if it felt, from a risk perspective, that the position should be cut. (Tr. 2230:17-2231:1 (Armstrong).) In his 2007 self evaluation, Armstrong stated: "The Investment Risk Management team assumed the modeling of the risk in the ABX trade from the bond team in February 2007. We notified the Investment team of the greatly heightened risk in the trade, and the adverse risk/return relationship, yet the Investment team chose to continue with the trade. It was our position to reduce sub-prime exposure prior to and throughout the market crisis." (Div. Ex. 260 at SSgA-SEC	• The Division's Proposed Finding of Fact that Risk Management was not empowered to buy or sell securities is irrelevant. The Division has represented to the Court on more than one occasion that this is not a case about whether LDBF was a good investment strategy. *E.g.*, Div. Pre-Hearing Br. at 39-40 ("The wisdom of investing in subprime in 2007 is not an issue for this tribunal to decide."); Flannery Tr. at 839:5-840:13, 1180:4-10, 1484:1-1488:9. In any event, buying or selling securities was not Risk Management's role; it was the role of the Fixed Income team's Portfolio Managers. *See* Flannery Post-Hearing Mem. at 13-14. The Risk Management team was responsible for identifying, measuring, and, where necessary, escalating issues concerning risk and exposures in SSgA's portfolios. Armstrong Tr. at 2196:8-11. The Division has presented no evidence

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	386773.) At the time of the events described in Armstrong's self evaluation, Armstrong was reporting directly to Flannery. (Tr. 2239:3-19 (Armstrong).)"	that any other investment manager "empowers" its risk group to trade securities, nor has it provided any explanation as to why people without any known trading expertise should be empowered to make trades in a portfolio. • The Risk Management team (one of the nine groups that reported to Mr. Flannery) originally did not exist as a group distinct from the Fixed Income team. Flannery Tr. at 1148:14-21. As CIO, Mr. Flannery separated the Risk Management team from the Fixed Income team, so that Risk Managers no longer reported to Portfolio Managers. Flannery Tr. at 1148:21-25. He did this so that the Risk Management team would be independent, and could provide their "unalloyed view" on funds and trades run by the Portfolio Managers. *Id.* at 1149:1-4. Mr. Flannery viewed Risk Management as a critical component of the organization, and he therefore increased the size of the Risk Management team and its resources while at SSgA. Armstrong Tr. at 2201:23-2202:7 (testifying regarding Mr. Flannery's increase of size and resources of Risk Management team; ". . . [Mr. Flannery] valued [the risk group] very highly as an independent source of analyzing the portfolios."). Mr. Flannery frequently sought out the perspective of the Risk Management team regarding issues facing funds managed by SSgA, and he consulted with the team on an almost daily basis during the summer of 2007. *Id.* at 2202:8-2203:9.
89	"Furthermore, Flannery was involved in February 2007 or March 2007 in decisions concerning the risk modeling of the ABX trade held by LDBF. (Tr. 2240:18-2241:7 (Armstrong).) From April 17, 2007 to June 13, 2007, LDBF CTF bought a notional position of $28,200,000 in ABX BBB. (Div. Ex. 225 at p.1, lines 55064.) ***In a recorded telephone call with Michael Wands on July 23, 2007, in discussing the fact that State Street's funds owned more ABX on July 23 than they did in February, Armstrong described that fact as "suicide." (July 23, 2007 Telephone Call Tr. at 13:9.)*** Akin to his comments that the risk group lacked independence regarding the ABX trade, Armstrong sent an email to himself on July 30, 2007 stating: "The PMs viewed Risk Management more as a set of	• *See* Response to ¶ 88, *supra*. • The telephone call referenced in this Proposed Finding of Fact is not in evidence. • The evidence actually shows that LDBF did not own more ABX on July 23 than in February. LDBF started offsetting these positions on July 11, and most were completely offset before the Investment Committee met on July 25. Div. Exs. 217, 218, 230. • Mr. Armstrong testified that the email he sent to himself expressing frustration was written in the heat of the moment and was not directed at Mr. Flannery.

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	Pinkertons, detectives rather than open partners. This made information difficult to access, i.e., when they were putting on trades. In the words of pg we should not have to tell you when we are putting on a trade, you should have the analytics to figure it out. Too much undiversified risk, issue raised repeatedly. Decisions made to go through stops – worse decisions made to add to the trade... You show them where the risks are and they need more babysitting. Could not stop it even if we wanted to. Risk management needs to be involved even more." (Div. Ex. 261 at p.2.) Armstrong explained that "too much undiversified risk" referred to "investments in the home equity sector." (Tr. 2243:21-2244:1 (Armstrong).) "Pg" referred to Paul Greff, the head of fixed income who also reported directly to Flannery. (Tr. 2244:13-2245:3 (Armstrong).)"	Armstrong Tr. at 2260:25-2261:15. The email was directed at Mr. Greff and Mr. Pickett. *Id.*; *see also id.* at 2239:3-2244:19.
90	"During the period in 2006 through 2007 where LDBF was concentrating more in subprime investments and using more leverage, Flannery was closely tracking what was happening in LDBF."	• The Division does not provide any citation to the record for this proposition. The term "closely tracking" is misleading. *See* Response to ¶ 91, *infra*. • LDBF was only one of three hundred SSgA investment funds that Mr. Flannery was responsible for overseeing. Flannery Tr. at 782:15-783:2, 1142:9-11, 1145:6-19, 1205:16-20; Div. Ex. 90 at SSgA-SEC000060359. Mr. Flannery remained responsible for overseeing approximately 460 people in nine separate groups while he was helping SSgA address the unprecedented market events of the summer of 2007. *Id.* at 1152:24-1153:3, 1144:14-1149:16; Div. Ex. 90 at SSgA-SEC000060359.
91	"In the spring of 2006, Flannery became concerned about SSgA's funds' exposure to the subprime market because "there were some developments in the mortgage market, in particular subprime mortgages that made me want to get a better understanding of what was going – what was going on there." (Tr. 827:5-11 (Flannery).) On May 30, 2006, Flannery emailed Armstrong, Greff, Michael O'Hara, head of active fixed income, and others with the subject line "Mortgage Risk" and stated: "Given the recent significant increase in mortgage foreclosures and general weakening in real estate, I am concerned with our exposure to risk in that market. I would like you all to review	• Although he "knew that there was [subprime] exposure," Mr. Flannery did not "recall having an idea [of] the *extent* of the exposure." Flannery Tr. at 831:4-14 (emphasis added). As CIO, the subprime sector was one of many sectors on which Mr. Flannery was keeping "tabs." *Id.* at 834:7-22. As with all of the groups that reported to him, Mr. Flannery wanted to understand what their views were and how they went about formulating those views. *Id.* Mr. Flannery did not solicit their views to change the course charted by those who reported to him. *Id.* Rather, he did it to understand their view and ensure that they had a well-reasoned view of the particular market. *Id.* Mr. Flannery deferred to these subject matter

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	this issue and revert to me with analysis on the issue. Can you please confer and get back to me by June 15th in writing? Please advise as to who is taking the lead on this." (Div. Ex. 16.) O'Hara replied to Flannery on the same day and stated: "Of course. Given the core group's typical attachment points within the subprime securitization markets (approximately 5% of funds generically allocated to BBB risk), and the concentration within these markets through LDBF (largely higher up in quality) I would volunteer that Frank and I take a crack at this. Coincidentally, Frank's team has been preparing a 'state of the subprime mortgage market' presentation for the group at this moment... If it makes sense to open this to a broader audience, we can certainly do that as well. Might I propose that this completed presentation serve as the written response which you are requesting?" (Id. (emphasis added).) Flannery was not surprised by O'Hara's reference to LDBF's subprime concentration. (Tr. 831:1-14 (Flannery).) At the time, Flannery also knew that Frank Gianatasio's group was doing a lot of work in the subprime securitization area. (Tr. 831:19-22 (Flannery).) In June 2006, the investment team responded to Flannery's request with a presentation called "U.S. Housing and RMBS Market Update." (Div. Ex. 18.) When Flannery received this presentation he was keeping tabs on the subprime market sector. (Tr. 834:2-6 (Flannery).)"	experts on investment matters because they were highly skilled individuals that had far greater subject matter expertise than he did on sectors and whether, for example, investing in subprime was a good investment. *Id.* The Exhibit cited by the Division (Div. Ex. 15), makes it clear that Mr. Flannery was challenging the experts to justify their views and actions. • The Division has repeatedly represented to the Court that this is not a case about whether LDBF was a good investment strategy. *E.g.*, Div. Pre-Hearing Br. at 39-40 ("The wisdom of investing in subprime in 2007 is not an issue for this tribunal to decide".); Flannery Tr. at 839:5-840:13, 1180:4-10, 1484:1-1488:9. • The Division provided an incorrect cite to the record. The *id.* cite after the second large quote should be Div. Ex. 15, not Div. Ex. 16. • Prior to August 2007, it was reasonable to believe that the credit and liquidity risks involved in LDBF's exposure to AAA and AA rated subprime was moderate. Sirri Report at ¶ 40.
92	"In February 2007, Flannery focused on LDBF when the fund experienced a period of underperformance because "we had a scare there in February when – when I think it was the triple B ABX widened dramatically in a way that hadn't been experienced before. So yeah, I remember I convened a big meeting to talk about, you know, what was going on in the market and were we still in the right place." (Tr. 826:19-24 (Flannery).) At the end of February 2007, Flannery was aware of the price drop and spread widening in the lower rated tranches of the ABX index, and he was also aware at that time that SSgA's active fixed income funds had exposure to that segment of the ABX index. (Tr. 844:10-17 (Flannery).) At this time, Flannery was following the problems in the subprime market closely enough to revise his subordinates' commentary about the	• The Division has repeatedly represented to the Court that this is not a case about whether LDBF was a good investment strategy. *E.g.*, Div. Pre-Hearing Br. at 39-40 ("The wisdom of investing in subprime in 2007 is not an issue for this tribunal to decide."); Flannery Tr. at 839:5-840:13, 1180:4-10, 1484:1-1488:9. • When the BBB ABX began to decline in value, Mr. Flannery convened a meeting to make sure that the Fixed Income team was looking at the issues in the market from all angles. Flannery Tr. at 1227:11-1228:11. While Paul Greff was the Head of the Fixed Income team globally, Mr. Flannery wanted to ensure that Mr. Greff's team was carefully analyzing the market events. *Id.* Flannery convened a meeting with the Fixed Income team and others, during which he challenged the team and sought opposing viewpoints regarding what was occurring. *Id.* at

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	subprime market situation. On February 28, 2007, Flannery emailed Gerard Kelly and Alistair Lowe with his comments on how to "address the US residential mortgage issue in a different way" as part of SSgA's comments on recent market movements that was drafted by Lowe. (Div. Ex. 47 at SS 5770447.)"	1227:22-1228:11; *see also id.* at 826:19-24. He invited Mitchell Shames, SSgA's General Counsel, and Shawn Johnson, Chair of the Investment Committee, to attend the meeting. *Id.* at 1227:22-1228:1. Mr. Flannery invited Mr. Johnson to ensure that the Investment Committee was aware of the issues. Flannery Tr. at 1228:20-1229:3. SSgA's Chief Economist, Chris Probyn, was also present. *Id.* at 1229:24-1230:1. At the meeting, Mr. Flannery learned that while the Fixed Income team was becoming more conservative with respect to selecting securities, they still believed very strongly in housing-related securities. *Id.* at 1230:10-1231:5; *see also* Lowe Tr. at 1999:17-19 (in a different meeting during this timeframe, Mr. Lowe of Global Asset Allocation ("GAA") understood that the Fixed Income team was "very convinced that [the January and February underperformance] was a liquidity event, and subsequently they proved to be right"), 2025:7-25, 2042:10-2043:4. The Fixed Income team's view of the market was consistent with the view held by prominent government officials at the time. *See* Flannery Post-Hearing Mem. at 21. • Mr. Flannery revised the draft commentary to reflect that there had been volatility in equity funds and currency markets around the world, and to reflect the view of the people within the Fixed Income team that specialized in researching and investing in that market. Flannery Tr. at 842:8-843:24. While Mr. Flannery believed Mr. Lowe had a brilliant investment mind, Mr. Flannery revised the commentary to reflect the view held by the Fixed Income team's specialists in the subprime market. *Id.* at 841:2-18.
93	"On April 10, 2007, Flannery emailed Ed Resch, the CFO of State Street Corporation, with data on the funds' subprime exposure. He provided Resch with general characteristics of the kinds of subprime investment SSgA had made. (Flannery Ex. 17; Tr. 845:22-846:2; 847:16-20 (Flannery).)"	• In addition to e-mailing this information to Mr. Resch, Mr. Flannery provided this information to Marc Brown (the Chief Marketing Officer, Relationship Management reported to Mr. Brown) in April. Flannery Ex. 17. On July 16, 2007, Mr. Flannery provided updated information on their funds' subprime exposure to Mr. Resch, Mr. Brown, Mr. Shames (SSgA's General Counsel was a member of the Executive Management Group), Adele Kohler (the author of the August 2 letter), and every other member of the Executive Management Group.

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		Flannery Ex. 58.
94	"In early May 2007, Flannery decided to record a piece on the subprime mortgage market for SSgA's public website for SSgA's investors. (Tr. 855:3-7 (Flannery).) His video was called "Subprime Woes Test Courage of Credit Convictions," and its text is contained in Flannery Exhibit 19. At the time he recorded the video, Flannery knew LDBF was heavily concentrated in subprime securities, but he did not know how heavily concentrated. (Tr. 857:9-15 (Flannery).)"	• The Division has repeatedly represented to the Court that this is not a case about whether LDBF was a good investment strategy. *E.g.*, Div. Pre-Hearing Br. at 39-40 ("The wisdom of investing in subprime in 2007 is not an issue for this tribunal to decide."); Flannery Tr. at 839:5-840:13, 1180:4-10, 1484:1-1488:9. • In the video, Mr. Flannery described the events that resulted in LDBF's underperformance in February 2007. Flannery Ex. 19. He also explained that, though it had very limited exposure to lower credit quality securities in the first place, the Fixed Income team used the opportunity to increase the quality in the portfolio. Flannery Tr. at 1245:18-1246:19. As was his practice, prior to making the video available to the public, he shared it with an investment person with deeper expertise in the market (Mr. Greff) and legal (Jodi Luster) for their approvals. Flannery Ex. 19.
95	"Also sometime during the spring of 2007, Alistair Lowe, the head of SSgA's Global Asset Allocation (GAA) group (a group that reported to Flannery) told Flannery that he had concerns about underwriting standards for subprime bonds. (Tr. 2000:16-2002:19 (Lowe).) Flannery answered that "subordination is designed to protect you." (Id.) The concept of subordination in the structure of subprime investments is set forth in Exhibit 7 to Professor Sirri's report, which is attached hereto as Exhibit B."	• The Division has repeatedly represented to the Court that this is not a case about whether LDBF was a good investment strategy. *E.g.*, Div. Pre-Hearing Br. at 39-40 ("The wisdom of investing in subprime in 2007 is not an issue for this tribunal to decide."); Flannery Tr. at 839:5-840:13, 1180:4-10, 1484:1-1488:9. • Mr. Lowe testified that he understood that Mr. Flannery and the Fixed Income team were "very convinced that [the January and February underperformance] was a liquidity event. And subsequently they proved to be right." Lowe Tr. at 1999:17-19. In addition to testifying that subordination was intended to protect investments in the higher-rated tranches, Mr. Flannery told Mr. Lowe that the Fixed Income team did not believe there was going to be a national housing decline. *Id.* at 2001:3-19. Mr. Lowe also testified that the Fixed Income team did their own due diligence on the bonds they invested in and that they had developed highly detailed surveillance databases that allowed them to drill down to the zip code level and examine the loans in the portfolio. *Id.* at 1999:9-20; *see also* Flannery Tr. at 1184:19-1185:11; Flannery Ex. 48 (describing SSgA's proprietary

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		security surveillance technology); Flannery Ex. 58 at SS 003865282, ¶¶ 2-3. • The Fixed Income team's view of the fundamentals was consistent with the view held by prominent government officials. Flannery Post-Hearing Mem. at 21-22. • In April and May 2007, stability returned to the mortgage markets and they were among the best months in LDBF's history. Sirri Report at ¶ 56; Wands Tr. at 2857:9-17; Flannery Tr. at 1232:7-8; Hopkins Ex. 56.
96	"By June 2007, Flannery was following the renewed problems in the subprime market. On June 21, 2007, Flannery emailed Frank Gianatasio with the subject ABX and stated: "How bad is the damage in that and elsewhere in the market?" (Flannery Ex. 31.) Flannery wanted to know whether problems in ABX were affecting a broader group of subprime investments. (Tr. 860:18-24 (Flannery).) ***By this time Flannery was monitoring daily pricing reports on ABX. (Flannery Ex. 31.)"***	• The Division has repeatedly represented to the Court that this is not a case about whether LDBF was a good investment strategy. *E.g.*, Div. Pre-Hearing Br. at 39-40 ("The wisdom of investing in subprime in 2007 is not an issue for this tribunal to decide."); Flannery Tr. at 839:5-840:13, 1180:4-10, 1484:1-1488:9. • The highlighted portion is not reflected anywhere in the exhibit noted and there is no evidence Mr. Flannery was monitoring daily pricing reports other than on the one occasion reflected in Flannery Exhibit 31. Flannery Exhibit 31 shows that Mr. Flannery relied on members of the Fixed Income team with deep subject matter expertise, such as Frank Gianatasio, to update him on market developments. The Exhibit also reflects that, as of June 21, the Fixed Income team continued to believe in the fundamentals of the strategy. Flannery Ex. 31 ("In terms of ABX, ***the fundamentals haven't changed and we remain comfortable with performance***.") (emphasis added).
98	"The size and sophistication of the investors in LDBF varied. (Tr. 3006:13-19 (Peavy).)"	• Mr. Peavy testified that, while the size and sophistication level of investors in LDBF varied, "They were all institutional investors, so there was that consistency as opposed to more unsophisticated-type investors." Peavy Tr. at 3006:13-19. • The clients invested in LDBF were sophisticated institutional investors. Carlson Tr. at 2731:2-9; Peavy Direct Test. at A.40(a), A.42-A.44, A.54, A.67-A.68. While some of these institutional investors may have been small, the majority of them were large in size and investing significant amounts of money. *Id.*; *see also*

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		Carlson Tr. at 2732:1-3. In addition, approximately 70 to 80% of the sophisticated institutional investors employed consultants to assist them with investment decisions. *Id.* at 2731:10-18. The consultants employed by the sophisticated institutional investors invested in LDBF are investment experts who charge a fee for rendering investment advice to their clients. *Id.* at 2731:19-25. Investors in LDBF included large institutions with hundreds of millions of dollars of assets under management. Sirri Direct Test. at ¶ 7, ¶ 21 n.9. • The clients invested in LDBF were sophisticated institutional investors, and their consultants were also sophisticated and charged fees for their investment expertise. Flannery Tr. at 1210:12-25; Carlson Tr. at 2730:20-2731:25; Sirri Report at ¶ 21; Peavy Direct Test. at A.40(a), A.42-44, A.54, A.67-A.68.
124	"***LDBF's subprime investments were all investments in one sector, regardless of the credit rating of the subprime investment. Flannery explained that if someone bought an AAA-rated and an AA-rated bond backed by the same pool of subprime mortgages, the person had bought bonds in the same sector.*** (Tr. 1455:13-20 (Flannery).) Similarly, in his spring 2007 video on the subprime mortgage market recorded for SSgAs clients on SSgA's website, Flannery told clients that the subprime market was a small slice" of the overall mortgage market. (Tr. 857:208 (Flannery).) Lowe, the head of GAA, also observed that regardless of whether a subprime security is rated BBB or AAA, "[i]t's still the same sector regardless of what the rating agencies happen to give for letters." (Tr. 1995:15-23 (Lowe).) Pickett also considered non-agency residential mortgage backed securities to be one sector. (Tr. 1592:11-1593:22 (Pickett).)"	• Mr. Flannery testified in response to being asked "If I bought the triple A – a bond from the triple A tranche and a bond from the double A tranche of the same – very same special purpose vehicle with the same underlying mortgages, have I bought bonds in two different sectors?" that "I think you've bought bonds that ***may*** be in the same sector ***but you've bought very, very different bonds***." Flannery Tr. at 1455:13-20 (emphases added). • LDBF's average credit quality during the entire period relevant to this case was between AA and AA+. Flannery Exs. 137 and 257; Carlson Tr. at 2700:18-25, 2702:11-17, 2724:18-25; Hopkins Tr. at 438:20-22. The Respondents' expert, Mr. Sirri, testified in his direct testimony that, even if the loans underlying the tranches securities held by LDBF were subprime loans, "that would not imply that the securities themselves were risky." Sirri Report at ¶ 43. To the contrary: securities backed by subprime loans can and do receive AAA ratings, and this was true of a substantial amount of the securities in which LDBF invested. *Id.* at ¶¶ 40-48; Pickett Tr. at 1597:6-1598:8. Notwithstanding the type of security, in each instance, the AAA rating represents a judgment by the ratings agencies that the securities are the least likely to default, regardless of the assets underlying the

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		securities. Flannery Tr. at 1182:13-16; Sirri Report at ¶¶ 43, 48. • The Division has not made any claims against Mr. Flannery with respect to sector diversification.
126	"***To the extent a reference to sector diversification was intended to merely convey that LDBF invested in assets with a negative or low correlation to each other that too was incorrect by mid-2007.*** Subprime investments were correlated by July 2007. (Tr. 1456:4-17 (Flannery).) By July 2007, the market was in a liquidity crisis, there was a lot of panic in the market, and the market did not seem to care whether a subprime investment was backed by bonds in one geographic location or in another. (Tr. 1457:20-1458:5 (Flannery).)"	• The Division has repeatedly represented to the Court that this is not a case about whether LDBF was a good investment strategy. *E.g.*, Div. Pre-Hearing Br. at 39-40 ("The wisdom of investing in subprime in 2007 is not an issue for this tribunal to decide."); Flannery Tr. at 839:5-840:13, 1180:4-10, 1484:1-1488:9. • The Division has not made any claims against Mr. Flannery with respect to sector diversification. • The Division's statement is misleading. There had never been a national housing crisis and the market had not been correlated prior to July 2007; the Fixed Income team believed in good faith that there would not be a national housing crisis. Lowe Tr. at 2001:3-19. Historically, LDBF had shown a low correlation. Mr. Sirri testified that the bulk of LDBF was invested in AA and AAA rated bonds and that up until August 2007, they were not correlated. Sirri Report Ex. 10; Sirri Tr. at 2181:20-2184:3.
133	"Sirri testified that it is necessary to tell people how "ABS" or "RMBS" is defined to understand the meaning of those terms in a particular situation. (Tr. 2074:10-19 (Sirri).)"	• Mr. Sirri did not state that "it is necessary to tell people" anything about these terms. Mr. Sirri testified "So I think you have to be careful about how you use these words. The distinction that's important here when you say 'ABS' or 'RMBS' is how people understand those words if you don't explain them with other sorts of things, ***and you can't possibly get the information about it.***" Sirri Tr. at 2074:10-19 (emphasis added). • It is undisputed that this information ***was*** available to investors in LDBF. As an unregistered fund, LDBF was subject to much less extensive disclosure requirements than a registered fund such as a mutual fund. Flannery Tr. at 1211:4-11; Sirri Report at ¶ 21. Unlike a mutual fund, for example, LDBF did not

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		issue a prospectus. Sirri Report at ¶ 21. Instead, fund declarations were provided to investors, which spelled out the objectives and limitations of LDBF, including the types of securities in which the fund could invest. Flannery Tr. at 1215:5-20. Audited financial statements were available to investors, which also contained detailed information regarding the types of securities LDBF invested in, including housing-related ABS and derivatives. *Id.* at 1216:20-1218:23, 1221:1-21; Hopkins Ex. 23 (Audited Financial Statements for CTF version of LDBF as of 12/31/06). Clients received fact sheets, which contained information about LDBF's investment strategy and the types of securities it was invested in, such as "collateralized mortgage obligations, asset-backed securities, futures, options, and swaps." Sirri Report at ¶¶ 23-25 (quoting 2002 LDBF fact sheet); Flannery Tr. at 1225:12-17. Clients also received periodic reporting packages on a monthly or quarterly basis discussing fund performance. Sirri Report at ¶ 22 (citing investigative testimony); Carlson Tr. at 2667:25-2670:21. • In addition to the standard information described above, clients could also request additional information from SSgA, or their Relationship Manager could send them information if the Relationship Manager believed it would be useful. Carlson Tr. at 2728:20-2729:7, 2733:17-2735:7 (Relationship Managers considered whether information would be of interest to the particular client); Sirri Report at ¶ 22; Peavy Direct Test. at A.45. Mr. Flannery was not responsible for determining which clients received what information and in what form; that was the role of Relationship Management. *See* Flannery Post-Hearing Mem. at 14-15. • SSgA's model for communicating with clients regarding all of its strategies, including LDBF, was reasonable, appropriate and customary in the industry. Peavy Direct Test. at A.40(c), A.46; *see also id.* at A.69. SSgA's clients requested different types, frequencies and quantities of information from SSgA, and knew that if they wanted information beyond what was available, they could request it; SSgA customized information for clients accordingly. Carlson Tr. at 2734:16-2735:7, 2736:16-20 ("[A]ny institutional client would know" they could seek information from SSgA beyond that which had already been provided);

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		Peavy Direct Test. at A.47, A.55, A.70; Flannery Tr. at 1213:11-25. While the information *requested by* clients and consultants varied depending on their needs. the information *available to* clients did not; all clients had access to the same information. Peavy Tr. at 3022:14-3024:12. • Mr. Sirri went on to testify in response to whether it was important to define MBS: "Well, I think it depends on the context of how you communicate. If you go out and you tell someone you have RMBS and you don't put anything next to it, I think there's -- there is -- I have a view on what people will think you mean. If you say: I have a pool that is ABS, I have a view on what people will mean, what we'll think you mean by that. To the extent what you hold is different than that, different than it, then I think, yeah, maybe you need to say something, but if it's consistent with that, then not. Sirri Tr. at 2102:14-2103:2. Mr. Sirri ultimately opined that sophisticated investors would understand that home equity securities would be in the asset-backed securities category and that the definitions he uses to explain "ABS" are conventional definitions from parties like Miura, Moody's and others. *Id.* at 2175:25- 2176:10. • "Sophisticated investors would have known that the term 'asset-backed securities,' as used in the industry, typically included structured securities backed by first-lien subprime mortgages and home equity loans in addition to other types of debt such as automobile loans and credit card debt. Furthermore, sophisticated investors would have also known that SSgA's LDBF portfolio was likely to include ABS backed by mortgages and home equity loans based on the LDBF's targeted return of 50bp-75bp above LIBOR and the relatively lower spreads that prevailed on ABS backed by other assets such as credit card loans and automobile loans as compared to ABS backed by mortgages and home equity loans." Sirri Report at ¶ 32.
134	"Sirri defined a mortgage-backed security generally as a security created by Fannie Mae or Freddie Mac. (Tr. 2099:13-21 (Sirri).)"	• The Division misstates the record evidence it cites for this proposition. Mr. Sirri testified that "A mortgage-backed security, generally, if someone just says, 'mortgage-backed security,' an ***example*** would be a security created by Fannie

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		Mae or Freddie Mac, a pass-through security where Fannie Mae, Freddie Mac, chartered corporations pool individual mortgages, package them together in a special purpose vehicle and issue certificates against that pool." Sirri Tr. at 2099:13-21 (emphasis added).
191	"LDBF's securities were all rated investment grade, but the Division's expert Russ Wermers testified that the market considers credit ratings relative to the sector the bond is in. Q Do the – does the market always treat triple A corporate bonds and triple A asset bond – asset-backed securities the same? A No. They'd be crazy if they did. Q I have to ask this, why would they be crazy? A Everybody knows that – well, I shouldn't say that. Even individual investors realize that the risk of buying a triple A rated corporate bond can be much different from buying the triple AA tranche of the subprime bond, even if there's not a liquidity crisis, much more so if there is a liquidity crisis. The ratings don't – the ratings, the way I understand it, are relative to sectors or at least that's the way that most investors in the marketplace understand them."	• Professor Wermers is incorrect; an AAA rated corporate bond represents the same degree of credit quality as an AAA rated securitized debt issue. Sirri Tr. at 2167:8-2171:7 (quoting Hopkins Ex. 162). Professor Sirri testified that Moody's, Fitch, and Standard & Poor's state that AAA rating *do not* differentiate between corporate or structured bonds—AAA means AAA regardless of whether the underlying securities are corporate or structured bonds. *Id.*; Hopkins Ex. 162 (information from Standard & Poor's website affirming Mr. Sirri's view); *see also* Flannery Tr. at 1177:14-1183:1.
192	"Wermers' contention was also demonstrated in Hopkins' February 28, 2007 CAR Alert. (Div. Ex. 45.) The CAR Alert compared spreads on ABX BBB-rated tranche of the index, which the CAR Alert said represented "20 different secured debt deals," of RMBS to spreads on credit default swaps for corporate bonds: [insert] (Id. At SS 7006821.)	• *See* Response to ¶ 191, *supra.* Mr. Flannery fails to understand how this Exhibit demonstrates Professor Wermers' contention.
197	"On August 2, 2007, at 1:08 PM, Flannery emailed the managers in the relationship management group with the subject line "Feedback on Calls and Interactions re Bond Problems." (Div. Ex. 160.) In the email Flannery stated: "All – At this point I know we have had a number of interactions with clients and	• Mr. Flannery did not testify that the way in which SSgA described a portfolio's use of leverage to clients was confusing. Instead, he testified that there are a number of ways to represent leverage. Flannery Tr. at 1081:10-1082:11. Each method for representing leverage has its failings in that the methods could either

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	consultants. It is important to get frank and constructive feedback on what is working well and what we can do to improve things. I want to underscore that our role here is to do the best job possible. Please provide that feedback to me (and directly to individuals if appropriate) so I can help. In addition, anything you need from me (I haven't had any client calls) is on the table." (Id. At SS 000162489) Carlson responded to the email the next morning at 7:35 AM and stated: "Thanks Sean. There have been a few comments that we may be a little cavalier about the situation. A couple of RMs have mentioned that we feel that we do not necessarily need to apologize per se ... but should be saying up front that we realize that this is a serious situation, that we are disappointed in what has transpired and are doing everything we can to mitigate the damage and make sure that we rectify the situation. One consultant felt that we are a "byzantine" organization and have been slow to provide what they are looking fore. .... Ie. – holdings and exposure to the various problematic securities." (Id. At SS 000162488) Flannery responded to the email at 8:44 AM on August 3 and stated, in pertinent part: "Thanks for the feedback. I will work on these issues. It is also clear to me that we are sometimes sending confusing signals when we answer questions on exposures, since there is more than one way to present exposures in levered funds." (Id.) ***Flannery explained that what was "confusing" was the way in which a portfolio's use of leverage was being described to clients.*** (Tr. 1081:6-9 (Flannery).)"	overstate or understate the amount of risk. *Id.* Some consultants wanted to see leverage information (*i.e.* gross notional leverage) in a manner that the Fixed Income team thought was confusing. *Id.* Rather than choosing one method over another, the Fixed Income team calculated leverage in LDBF using three methods and promptly provided this information to Relationship Management to provide to clients. Flannery Tr. at 1081:10-1085:21. *Id.* This leverage information, and an explanation of the three methods used to calculate leverage, was also promptly added to the FAQs by August 6. Flannery Ex. 167 at SS 004344159 (FAQ # 35). • Division Exhibit 160 reflects that, as of August 2, Mr. Flannery had not yet participated in any client calls, further evidence of the fact that Relationship Management, and not Mr. Flannery, who was responsible for identifying what information investors wanted or needed.
276	"Flannery's knowledge about anticipated redemptions was also discussed in a contemporaneous telephone call between Wands and Armstrong where Wands described a conversation Hopkins had recently had with Flannery. On July 23, 2007, on a recorded telephone line, Mike Wands and Patrick Armstrong had the following conversation about a conversation Hopkins had with Flannery on July 20, 2007 concerning client redemptions: MR. WANDS: Right. And, you know, Hoppy caught [Mr. Flannery] Friday afternoon and told him that we are preparing, you know, FAQ's on a whole different bunch of topics and gave him the heads-up. He said, you know, "Mike and I, between the	• The Division used the testimony cited in PFOF ¶ 276 solely for the purpose of attempting to refresh Mr. Flannery's recollection and ***not*** as substantive testimony as the Division is using it here. Flannery Tr. at 943:23-944:3 ("Mr. Pearlstein: Your Honor, I take it, though, this is not being offered as substantive evidence, that, in other words, the record should be clear that this is not part of the record except to the extent he's refreshed by it. Judge Murray: That's my understanding.") It did not actually even serve to refresh Mr. Flannery's recollection. Flannery Tr. at 951:24-952:2 ("Q. And does that help you to remember the conversation between you and Mr. Hopkins that's described in the call? A. No."). Accordingly, there is no evidence in the record to support the

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	two of us, have spoken to over a dozen account at this point." And he said, "Sean, you've got to realize at this point that we're going to be losing assets. People are going to be pulling their money out." And he said it hit Sean for the first time, and his face just turned white. And I'm like at what point do you realize that that's the route we're going down here? MR. ARMSTRONG: Yeah. MR. WANDS: And we've already been told by two clients that we're being fire. MR. ARMSTRONG: Yeah. MR. WANDS: Three if you include Ali. MR. ARMSTRONG: Uh-huh. MR. WANDS: So it's not – I mean it's not a huge stretch. (Tr. 950:19-951:19 (as corrected).) The "Ali" referred to is Alistair Lowe, the head of GAA, whose clients were invested in LDBF. (Tr. 1095:14-20 (Flannery); 2043:2044:6 (Lowe).)"	Division's assertion in PFOF ¶ 276.
278	"On July 25, 2007, the SSgA Investment Committee convened to discuss the subprime market that was negatively impacting LDBF. (Division Exs. 132 (final draft of minutes) & 134 (draft of minutes).) Shawn Johnson, Chairman of the Investment Committee, did not attend this meeting and Flannery functioned as the chair. (Tr. 990:8-10 (Flannery).) Division Exhibit 134 is a draft of the minutes of the meeting with statements attributed to the various participants in the meeting, and Flannery testified that these draft minutes are a reasonably accurate reflection of what took place at the meeting. (Tr. 998:22-999:2 (Flannery).)"	• The Investment Committee did not convene for the purpose of discussing the subprime market. This was a regularly scheduled Investment Committee meeting; Mr. Flannery had added LDBF and related issues to the agenda in light of the turmoil in the market. Flannery Tr. at 1267:11-1268:13.
279	"At the beginning of the "Fixed Income Subprime" discussion, "Sean Flannery reminded the Investment Committee members and colleagues in the room of the strict confidentiality of the	• Every Investment Committee meeting is confidential. Flannery Tr. at 999:14-18. Mr. Flannery reminded members of the confidentiality requirement during this meeting because he was trying to act in the best interests of all investors invested

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	information being discussed in today's meeting." (Div. Ex. 134.)"	in LDBF. Flannery Tr. at 1275:2-1276:4. Mr. Flannery was concerned, without thinking about it, someone in the meeting may have said something outside of that would depress prices and disadvantage SSgA's investors in LDBF. *Id.* Part of what caused Mr. Flannery to remind members of their confidentiality obligations was that some of the members of the Investment Committee were equities traders who were not used to trading in fixed income markets.
280	"Regarding anticipated redemptions, including redemptions by other State Street funds invested in LDBF, the Investment Committee minutes reflect that Flannery stated: "There have been on going meetings, including one yesterday afternoon, to discuss these issues. The overriding issue is we need to provide liquidity if our clients want to leave the fund. Discussion [sic] have suggested we build 40% liquidity in the Limited Duration Bond Fund - other funds/strategies using LDBF will benefit from extra liquidity in the fund." (Div. Ex. 134 at SSgA-SEC 252909.) Flannery acknowledged that while he may not have said all this verbatim, it's generally what he said. (Tr. 999:19-1000:9 (Flannery).) Flannery admitted that the 40% figure came from "what we were hearing from our colleagues, our client-facing colleagues, about their estimates on what potential liquidations might be." (Tr. 1000:10-15 (Flannery).) Flannery also admitted that the following statement from the minutes is in essence what he said at the meeting: "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." (Div. Ex. 134 at SSgA-SEC 252912; Tr. 1001:20-1002:6 (Flannery).) According to the meeting minutes, the following statement is also attributed to Flannery: "Uncomfortable to only reacting to client demand/redemption. The IC needs to make some decision." (Div. Ex. 134 at SSgA-SEC 2529012.)"	• Mr. Flannery requested that Mark Duggan, SSgA's Deputy General Counsel and the securities disclosure expert within SSgA, attend the meeting, and met with him in advance to discuss the issues that were going to be raised at the meeting. Flannery Tr. at 1269:25-1271:22; Duggan Tr. at 80:8-15; Shames Tr. at 155:19-156:12 (testifying Mr. Duggan was an "expert" regarding compliance with securities laws). Mr. Flannery wanted Mr. Duggan to attend and participate in the meeting so that he could advise SSgA on its legal obligations in light of those business issues. Flannery Tr. at 1270:9-15, 1274:7-9. Mr. Flannery also invited a number of other key personnel who did not regularly participate in Investment Committee meetings. He invited Michael Wands, the Head of Fixed Income for the United States, to attend because he was very knowledgeable about LDBF and had been interacting with many clients and consultants. *Id.* at 1273:11-22. He invited Paul Greff, Mr. Wands' boss and the Head of Global Fixed Income, to attend because of his fixed income expertise. *Id.* at 1273:19-1274:6. He invited Bob Pickett, the LDBF portfolio manager, to attend for the same reason. *Id.* at 1273:19-1274:6. And he invited Patrick Armstrong, the Head of Risk Management, to attend because of his risk management expertise. *Id.* at 1273:19-1274:6; *see also* Flannery Ex. 92 (listing meeting attendees); Wands Tr. at 2873:17-2874:1. Consistent with his inclusion of a number of individuals with different areas of expertise at the meeting, Mr. Flannery expressly "encourag[ed] debate" regarding the issues facing LDBF among all who were present during the meeting. Pickett Tr. at 1736:12-23. • While the potential for LDBF client redemptions was discussed at the July 25 2007 Investment Committee meeting, neither Mr. Flannery nor anyone else knew

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		at that time what the actual level of redemptions from LDBF would be. Flannery Tr. at 1278:22-24, 1289:10-20; Pickett Tr. at 1738:14-1740:19. In fact, there was substantial discussion regarding the difficulty of predicting the precise magnitude of client withdrawals. Flannery Ex. 92 at SSgA-SEC 000252909 (Mr. Wands stated, "It's hard to predict if the market will to [*sic*] hold on or if there will be a large number of withdrawals by clients."). • Other key issues were discussed at the meeting as well, including reducing risk in LDBF, liquidity and pricing issues, and freezing LDBF. Flannery Post-Hearing Mem. at 27-35. • The Division highlights select aspects of the discussion at that meeting to draw misleading conclusions and suggest that a fraud scheme was hatched at the July 25 Investment Committee meeting. As set forth in greater detail in Mr. Flannery's Post-Hearing Memorandum and in his Reply Brief being filed herewith, there was no scheme to defraud here. Various options were discussed at the July 25 meeting; ultimately, the Investment Committee instructed LDBF's portfolio managers to "1) 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[; and] 3) reduce the AA exposure, a target of 5%, by the end of the week." Flannery Ex. 92 at SSgA-SEC 000252912. • Mr. Pickett testified that the Investment Committee's instructions were interrelated: Q. Now, that specific instruction, did that apply – did you have to satisfy that at the same moment in time that you sold the AAA, or was it a multi-step process? A. It was largely a two-step process. The liquidity was one thing, but thereafter – so the liquidity's been

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		raised by the end of the month, ***and then going into August,[3] as those redemptions came in, is doing our best to do this pro rata across what was largely***, I believe, AA left, but there were some AAA swaps . . . . Q. Okay. So I want to break this down so it's as clear as possible. Your first step, to fulfill the instructions, sell the AAA? A. Correct. Q. Then at that moment in time that the AAA is sold, the portfolio is repositioned; is that right? A. That's right. Q. And then the second step after repositioning is to sell pro rata going forward post repositioning; is that right? A. That's right. ***I would say pro rata as redemptions came in.*** That would cause you to do that sale. Q. But that's after the portfolio's repositioned? A. Correct. Q. And generally speaking, for the post-repositioning period, after the AAA's are sold, is it your recollection that you did that? That you generally kept the fund –

[3] Mr. Pickett testified that the redemption activity was not anticipated until August. Pickett Tr. at 1739:15-1740:3.

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		A. Generally speaking, but I can't say -- I don't have the numbers in front of me, but it was a goal of that unwind process. Pickett Tr. at 1666:15-1667:22 (emphases added). Later in his testimony, Mr. Pickett explained that the AAA bond sale accomplished three things: increased liquidity, decreased risk, and reduced leverage in the portfolio. Pickett Tr. at 1744:19-1745:5. With respect to anticipated redemptions, Mr. Pickett explained that the AAA bond sale repositioned the portfolio and that, subsequently, pro rata sales were made when redemptions requests were made in accordance with the Investment Committee's instructions. Pickett Tr. at 1749:6-1752:25. Ultimately, Mr. Pickett testified as follows: Q. Well, for clarification, did you take it that a goal of the investment committee -- of the investment committee of instructing that there be pro rata sales was so that investors who remained in the fund, let's say in mid to late August after redemptions, would have a similar portfolio as investors who were invested in LDBF prior to redemptions? A. I think ***the goal was to treat all shareholders as equal as possible.*** Q. And so besides treating them as equal as possible, it's also to have a portfolio that has the same type of risk characteristics as much as possible?

[4] This is also consistent with the discussion at the meeting, discussed *supra*. *See generally* Flannery Ex. 92.

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		A. As much as possible, correct. Q. And so that meant that you were trying through the pro rata sales to keep the spread duration the same; is that correct? A. Correct. Q. And you were trying to keep the average credit rating of the portfolio similar to the extent possible? A. To less so, because of the makeup of the bonds versus the swaps, but there was an attempt there as well. Q. But that was the goal at least? A. Yes. Q. And you think that your portfolio management team under the circumstances, I take it, performed pretty well, don't you? A. Yes. Pickett Tr. at 1751:24-1752:25 (emphasis added). Mr. Pickett's testimony corroborates the testimony of the other witnesses that participated in the July 25 Investment Committee meeting that testified at trial. *See* Flannery Tr. at 1020:22-1021:3; Wands Tr. at 2875:21-24. • Professor Wermers, the Division's expert, acknowledged that taking steps, such as the sale of the AAA bonds, to increase liquidity in advance of anticipated redemptions allows for a more orderly redemption process, and reduces the need for "fire sales" to raise cash on short notice. Wermers Tr. at 719:8-720:18. The

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		AAA sale did, in fact, raise liquidity, consistent with the first instruction from the Investment Committee meeting. Zask Direct Test. at A.50; Flannery Tr. at 1035:7-11; Div. Ex. 248. • The first instruction given by the Investment Committee was more general in nature. While Mr. Pickett interpreted the Investment Committee's instruction to mean that he needed to sell the AAA bonds (Pickett Tr. at 1665:3-1666:9), the actual instruction given by the Investment Committee was general in nature. *See* Flannery Ex. 91 at SSgA-SEC 000252901; Flannery Tr. at 1028:2-1030:4 (noting that the Investment Committee instructions were not trade specific; it was left to the discretion of the Portfolio Manager to follow the letter and spirit those instructions to the best of his ability in a challenging market); Wands Tr. at 2875:21-24 (stating he does not remember the Investment Committee giving a specific instruction to sell the AAA cash bonds). • The purpose of the first instruction was to raise liquidity and reduce risk. Pickett Tr. at 1743:17-1745:5; Flannery Tr. at 1035:7-11; Zask Direct Test. at A.44, A.46, A.50; *see* Flannery Post-Hearing Mem. at 32-35 (discussing the purpose of the first instruction at length). • <u>All</u> redemption requests were to be met *pro rata*. The plain language of the second instruction itself provides states that the Portfolio Manager should seek to sell a pro rata share of securities to meet "any" withdrawals, not just later redemption requests. The purpose of this instruction was to keep the risk profile of the fund as consistent as possible while meeting any redemption activity. Pickett Tr. at 1747:10-18. • <u>Some</u> of the cash from the AAA bond sale would be used to fund redemptions. Consistent with the instruction[4] that "any" withdrawals were to be met by selling a pro rata share, and given that a pro rata share would include AAA-rated bonds, it follows that as redemption requests were made, some of the cash from the AAA sale would be used to fund those redemptions. Although he did not know

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		how much cash was in the fund or how redemption requests were being met at any point, Mr. Flannery understood that as redemptions came in, some of the cash from the AAA sale would be used to fund investor redemptions. Flannery Tr. at 1053:23-1054:24. This is in stark contrast to the Division's characterization that the cash from the AAA bond sale was to be used to pay early redemption requests only. • The cash proceeds from the AAA cash bonds were not exhausted meeting early redemption requests. *See* Flannery Post-Hearing Reply Br. at Section II.A.1. The Division's theory is based on the erroneous conclusion that the cash proceeds from the AAA bond sale were gone by August 2 such that there was no longer any cash in LDBF. This theory is simply wrong. • The Investment Committee instructions were followed. *See* Flannery Post-Hearing Mem. at 32-35. Even according to a chart prepared by the Division's expert, Professor Wermers, a series of AA sales occurred in late July and early August: $611 million in AA bonds were sold for cash by August 14, with significant additional AA sales occurring thereafter, totaling $1.2 billion by August 24. Div. Exs. 217, 218, 245 at Ex. III(A); Pickett Tr. at 1749:15-1750:1. • The Division has repeatedly represented to the Court that this is not a case about whether LDBF was a good investment strategy. *E.g.*, Div. Pre-Hearing Br. at 39-40 ("The wisdom of investing in subprime in 2007 is not an issue for this tribunal to decide."); Flannery Tr. at 839:5-840:13, 1180:4-10, 1484:1-1488:9.
281	"The July 25 Investment Committee minutes' discussion regarding anticipated redemptions was consistent with Pickett's recollection of the meeting. Pickett recalled discussion at the Investment Committee meeting about building liquidity in LDBF to meet investor redemption demands (Tr. 1655:11-15 (Pickett).) Pickett also recalled a discussion at the meeting about client-facing personnel forecasting investor redemptions, and based on these forecasts, there was a desire to raise liquidity by	• *See* Response to ¶ 280, *supra*. Also, Mr. Pickett testified in response to a question from the Court that he did not know what the level of redemption activity was going to be, and that the Investment Committee was waiting to get a figure from Relationship Management. Pickett Tr. at 1738:14-1740:19.

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	the end of July so the redemptions could be met thereafter. (Tr. 1655:16-1656:8 (Pickett).) When Pickett was asked whether he got "a sense as to whether the investment committee knew what the level of redemptions were going to be during the course of this meeting," Pickett responded: "I think the committee was in the process of being told by the relationship managers, whether in that meeting or getting feedback." (Tr. 1739:8-13 (Pickett).) The Investment Committee meeting was "the first time [Pickett] learned that August -- in August we were going to be – we were going to be meeting redemption requests." (Tr. 1739:22-1740:2 (Pickett).)"	
282	"Flannery acknowledged that the Investment Committee, him included, voted on the instruction to the portfolio managers to sell assets in the amount of 30-40% of LDBF to build liquidity in the fund. (Tr. 1003:22-1004:2 (Flannery).) The first instruction of the Investment Committee to the portfolio management team was "to increase the liquidity in the Limited Duration Bond Fund portfolio, per consultation with the Relationship Management team, by the end of the month." (Div. Ex. 134 at SSgA-SEC 252912.) ***Flannery understood that the Investment Committee decided to raise 40 percent liquidity in the fund, because "the purpose of this whole conversation" about raising liquidity was because the Investment Committee was expecting client redemptions.*** (Tr. 10006:8-13 (Flannery).)"	• *See* Response to ¶ 280, *supra*. • Mr. Flannery went on to testify that they were going to have to raise liquidity in order to (1) fund anticipated redemptions, ***and*** (2) re-position the portfolio. Flannery Tr. at 1006:14-1007:4. Mr. Flannery specifically testified that ***one*** of the reasons they wanted to raise liquidity was to fund the unknown level of anticipated redemptions. *Id.* He later explained that raising liquidity also reduced risk and leverage in the portfolio. Flannery Tr. at 1035:7-11 (rejecting the insinuation that the AAA bond sale was done just to meet anticipated client redemptions).
283	"Flannery understood that one of the things the LDBF portfolio managers would have to do was sell assets to get money to pay clients. (Tr. 1006:14-24 (Flannery).) Flannery admitted that an instruction from the Investment Committee to the portfolio managers to sell assets was fairly unusual and he could not recall a similar instruction from the Investment Committee to portfolio managers in the past. (Tr. 1007:5-14 (Flannery).)"	• *See* Responses to ¶¶ 280, 282, *supra*.
284	***"At the July 25, 2007 meeting, the Investment Committee also discussed the facts that LDBF's AA-rated bonds were illiquid and selling only LDBF's more liquid AAA-rated bonds could change the risk profile of the fund. Flannery recalled that someone at the meeting "did raise the issue are the AA's ...***	• *See* Responses to ¶¶ 280, 282, *supra*. • Mr. Flannery testified "I think someone did raise the issue are the AA's – you know, specifically the AA's were illiquid, ***but there was liquidity events going in***

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	***specifically the AA's were illiquid...*"** (Tr. 1007:15-24 (Flannery).) Pickett stated at the meeting: "There are major liquidity concerns. The rating agencies' downgrades, such as Moody's tightening, has long only managers dealing with lower ratings than before. So a AA rated bond is now just a single A. Note that the AA component is very illiquid." (Div. Ex. 134 at SSgA-SEC 252909.) Flannery admitted that, during the Investment Committee meeting, he recalled "something about Pickett saying AA's were illiquid." (Tr. 1008:8-17 (Flannery).) Flannery also understood at the time of the Investment Committee meeting, that generally AA bonds were more illiquid than AAA bonds. (Tr. 1013:14-21 (Flannery).) Pickett also stated at the meeting: "We should raise cash through selling the AAA, but it will change risk profile." (Div. Ex. 134 at SSgA-SEC 252911.)"	***other segments of the market as well.*"** Flannery Tr. at 1007:15-24 (emphasis added). Mr. Flannery also testified that there were illiquidity issues throughout the portfolio and that illiquidity was something being covered in the press at that time. *Id.* at 1011:7-15. Mr. Flannery's memory is consistent with the expert testimony of Erik Sirri. Sirri Report at ¶¶ 51, 58-67.
285	"With regard to the statement attributed to Pickett at the meeting that "We should raise cash through selling the AAA, but it will change risk profile," Pickett recalled that LDBF generally held all AA or AAA-rated bonds at this time, so selling the AAA-rated bonds for cash would change the profile of LDBF from an even mix of AA and AAA-rated bonds to AA-rated bonds and cash. (Tr. 1656:16-1657:11 (Pickett).)"	• *See* Responses to ¶¶ 280, 282, *supra*. • The Division's citation to one quote from Mr. Pickett is out of context and misleading. *See* Response to ¶ 280, *supra*. The evidence actually shows that the AAA sale reduced risk in LDBF. "[B]oth credit and market risks were reduced as a result of the transaction, as CVaR was reduced and converting securities to cash reduced the credit risk of the fund. Also, the repayment of the repo loans associated with these securities, which totaled $1.12 billion, reduced leverage and overall risk in the portfolio." Zask Direct Test. at A. 46-49. Further, Mr. Pickett himself stated that selling the bonds for cash reduced risk in LDBF because cash is less risky than AAA-rated bonds and the sale reduced risk because the financed bonds were paid back, reducing leverage in LDBF. Pickett Tr. at 1743:17-1745:5. Paul Greff, the Head of Global Fixed Income, reported at an August 8 Investment Committee meeting, that the AAA sale raised liquidity while maintaining the fund's risk profile. Div. Ex. 248; Flannery Tr. at 1293:3-12.
286	"Pickett also testified that if the AAA-rated bonds were financed through reverse repurchases or sell buybacks, LDBF would not receive all the cash from the sale of the bonds because it would have to repay the borrower ***and might even have to repay the***	• Repayment of the repo loans associated with these securities that resulted from the sale of the AAA bonds reduced leverage and overall risk in the portfolio. Zask

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	borrower more than cash raised from the sale if the bonds decreased in value during the financing period. (Tr. 1658:16-1662:3 (Pickett).)"	Direct Test. at A.46-A.49. • While irrelevant, the Division has not offered evidence to show that the highlighted portion of PFOF ¶ 286 actually happened.
287	"According to the minutes, Flannery stated: "there are 2 points: 1) raise money selling AAA (liquid), but if liquidity is siphoned, we are struck with a lower quality portfolio [;] 2) raise liquidity by selling pro-rata share of portfolio, which leaves the remaining portfolio more like a pro-rata share." (Div. Ex. 134 at SSgA-SEC 252911.) According to the minutes, Paul Greff made a statement that "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." (Div. Ex. 134 at SSgA-SEC 252909.) Flannery then stated "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." (Div. Ex. 134 at SSgA-SEC 252910.) Flannery explained that the view he was expressing at the time was that one way to maintain the risk profile was to sell equal slices across the portfolio, but "it turns out there were other ways to [maintain the risk profile] as well." (Tr. 1023:16-1024:7 (Flannery).) Flannery also stated: "If we don't sell a slice across the portfolio then we end up with a less liquid portfolio – valued less." (Div. Ex. 134 at SSgA-SEC 252910; Tr. 1024:8-25 (Flannery).)"	• *See* Responses to ¶¶ 280 and 282, *supra*; *see also* Flannery Reply Br. at Section IV.C.1.
288	"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." (Div. Ex. 134 at SSgA-SEC 2528912.) Pickett explained the Investment Committee's directive at the July 25	• The Division's characterization of Mr. Pickett's testimony is misleading. *See* Responses to ¶¶ 280 and 282, *supra*; *see also* Flannery Reply Br. at Section IV.C.1. • Mr. Flannery acted as the Chairman of the meeting only because Shawn Johnson, the Chair, and Peter Leahy, the Vice-Chair, were unavailable. Flannery Tr. at 989:19-990:10, 1268:24-1269:17; Lowe Tr. at 2012:5-19. Chairing the meeting did not give Mr. Flannery any additional voting rights or decision-making authority. Flannery Tr. at 1269:21-24. It simply meant that he ran the meeting

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	meeting as a two-step process: 1) raise liquidity by month end by selling LDBF's AAA-rated bonds; and 2) after LDBF was repositioned following the AAA sale, and the fund held mostly AA-rated bonds, sell remaining assets proportionally to meet further demands for liquidity. (Tr. 1666:15-1667:15 (Pickett).)"	"from a protocol point of view." Lowe Tr. at 2012:23-24.
289	"Pickett recalled at the time of the meeting that LDBF's AA-rated residential RMBS were generally more illiquid than LDBF's AAA-rated RMBS, and the following statement attributed to him at the meeting made sense: "Note that the AA component is very illiquid." (Tr. 1650:20-1652:3 (Pickett).) Pickett also recalled that, at the time of the meeting, the spreads on LDBF's AA-rated RMBS bonds were growing wider than the spreads on LDBF's AAA-rated RMBS bonds. (Tr. 1652:4-10 (Pickett).) Regarding the AA and AAA-rated home equity spread data from June 28, July 26, and August 2, 2007 as shown in Flannery Exhibit 218, Pickett testified that the magnitude of the widening was consistent with his recollection. (Tr. 1653:7-1654:22 (Pickett).) This exhibit shows: [chart] (Flannery Ex. 218 at SS 4832874.)	• *See* Responses to ¶¶ 280 and 282, *supra*; *see also* Flannery Reply Br. at Section IV.C.1.
292	"Regarding the first part of the Investment Committee's instruction, "to increase the liquidity in the Limited Duration Bond Fund portfolio, per consultation with the Relationship Management team, by the end of the month," Pickett understood that he had "left the meeting with the instruction for a goal to sell one point something billion of AAA's by the end of the week." (Div. Ex. 134; Tr. 1665:3-7 (Pickett).) Pickett understood that "it was clear to [him] to go out and sell the AAA portfolio ... to raise liquidity." (Tr. 1665:21-1666:9 (Pickett).)"	• The Division's characterization of Mr. Pickett's testimony is misleading. *See* Responses to ¶¶ 280 and 282, *supra*; *see also* Flannery Reply Br. at Section IV.C.1. • While Mr. Pickett interpreted the Investment Committee's instruction to mean that he needed to sell the AAA bonds (Pickett Tr. at 1665:3-1666:9), the actual instruction given by the Investment Committee was general in nature. *See* Flannery Ex. 91 at SSgA-SEC 000252901; Flannery Tr. at 1028:2-1030:4 (noting that the Investment Committee instructions were not trade specific; it was left to the discretion of the Portfolio Manager to follow the letter and spirit those instructions to the best of his ability in a challenging market); Wands Tr. at 2875:21-24 (stating he does not remember the Investment Committee giving a specific instruction to sell the AAA cash bonds).
293	***"Flannery had a role in the sale of the AAA-rated bonds as a member of the Investment Committee because the sale of the***	• The Division's proposed finding of fact is misleading. The instruction given at the July 26 Investment Committee meeting was general in nature and did not

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	AAA-rated bonds was the specific direction of the Investment Committee. (Tr. 1676:13-1677:1 (Pickett).) Furthermore, there was no doubt whatsoever in Pickett's mind that when he participated in carrying out the AAA bond sale on July 26 he was carrying out the direction of the Investment Committee on July 25. (Tr. 1677:13-18 (Pickett).)"	instruct Mr. Pickett to go out and conduct a specific trade. Flannery Tr. at 1028:22-1029:4. Mr. Flannery was one member with one vote on the Investment Committee, which unanimously voted to instruct LDBF's portfolio managers in the manner described above. *See* Responses to ¶¶ 280, 292, *supra*. • The Division admits in PFOF ¶ 294 that Mr. Pickett worked with James Kramer, who actually executed the trade, and Andrew Tenczar, both on the trading desk, in carrying out the AAA-rated bond sale. Pickett Tr. at 1670:4-1671:1; Kramer Test. Stip. at 16:15-10. Mr. Flannery did not have any role in the sale of those bonds, other than voting in favor of the instructions given at the Investment Committee meeting.
295	"All of the AAA-rated bonds that LDBF sold on July 26 were sold to Citigroup. (Tr. 1671:23-1672:3 (Pickett).) State Street provided the list of bonds to Citigroup at 4:28 PM on July 25. (Div. Ex. 136.) Citigroup paid one price for all the AAA-rated bonds it purchased from LDBF on July 26. (Tr. 1672:16-1673:1 (Pickett).) ***Wermers explained that in a fire sale block trade, such as this, the buyer is "going to offer ..... than you anticipate,*** they will take a haircut from the quoted price or the price that you think you might get in an orderly market and in return they'll give you – they'll buy from you the entire package of securities, again, to eliminate the risk that things turn out even worse than you anticipate." (Tr. 741: 742:4 (Wermers).)"	• The Division misstates the record evidence it cites for the highlighted sentence in this proposition. The record cited does not state that the July AAA sale was a fire sale block trade. Rather, it says that a block trade *could* be a fire sale and explained instances where that could be the case. Wermers Tr. at 741:13-742:4. • In fact, Professor Wermers acknowledged that taking steps, such as the sale of the AAA bonds, to increase liquidity in advance of anticipated redemptions were prudent actions to take because it allowed for a more orderly redemption process, and reduces the need for "fire sales" to raise cash on short notice. Wermers Tr. at 719:8-720:18. Mr. Pickett corroborated that testimony. Pickett Tr. at 1747:1-8. The AAA sale did, in fact, raise liquidity, consistent with the first instruction from the Investment Committee meeting. Zask Direct Test. at A.50; Flannery Tr. at 1035:7-11; Div. Ex. 248; Flannery Ex. 180 at SSgA-SEC 000252968. • Contrary to Professor Wermers' claim, Mr. Pickett—a subject matter expert involved with the actual trade—testified that the price for which the AAA bonds were sold was a good price. Pickett Tr. at 1674:22-1675:5, 1745:6-20.
296	"With regard to the Investment Committee's second instruction to "sell a pro-rata share (across capital structures) to warrant any	• *See* Responses to ¶¶ 280 and 282, *supra*; *see also* Flannery Reply Br. at Section

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	withdrawals," Pickett explained; "It was largely a two-step process. The liquidity was one thing, but thereafter – so the liquidity's been raised by the end of the month, and then going into August, as those redemptions come in, is doing our best to do this pro rata across what was largely, I believe, AA left, but there were some AAA swaps." (Div. Ex. 134; Tr. 1666:15-1667:1 (Pickett).)"	IV.C.1.
297	"The first step in the two-step process was to sell the AAA-rated bonds. Then, as soon as the AAA-rated bonds were sold, the portfolio was repositioned. The second step in the two-step process occurred after the repositioning; the goal was to sell the assets left in the fund on a pro rata basis as redemptions came in. (Tr. 1667:2-21 (Pickett).) The pro rata instruction did not apply until after LDBF was repositioned following the AAA bond sale. (Tr. 1766:25-1767:5 (Pickett).)"	• *See* Responses to ¶¶ 280 and 282, *supra*; *see also* Flannery Reply Br. at Section IV.C.1.
299	"Pickett agreed that the change in the percentages of AA and AAA-rated bonds on July 27, 2007 as reflected in the above chart was consistent with the repositioning of LDBF as a result of the first step, and the relatively steady percentages of AA and AAA-rated bonds in LDBF after July 27 as reflected in this chart were consistent with his recollection of how he managed LDBF in late July and August 2007. (Tr. 1667:22-1670:3 (Pickett).) Lindner also recalled that there was a repositioning of LDBF after the AAA bond sale on July 26 whereby the percentage of AA-rated bonds in LDBF went up significantly and the percentage of AAA-rated bonds in LDBF went down significantly. (Tr. 1969:16-1970:8 (Lindner).)"	• The Division's Proposed Finding of Fact is misleading to the extent it is in furtherance of its argument that there was no cash in LDBF as of August 2. As is described at length in Mr. Flannery's Reply Brief being filed herewith, there were hundreds of millions of dollars in cash in LDBF past August 2. Flannery Reply Br. at Section II.A.1.
300	"As illustrated in Division Exhibit 245, III.B., the risk of LDBF was reduced at the moment in time that cash went into the fund from the AAA bond sale on July 29. (Tr. 1764:11-25 (Pickett).) ***However, as redemptions occurred and the market value of the fund decreased as a result of redemptions, the risk of LDBF would go back up if the cash from the AAA bond sale was used to meet the redemptions.*** (Tr. 1765:22-2766:10 (Pickett).)	• The Division misstates the record evidence it cites for this proposition. Pickett was asked a hypothetical question about "fund[s], such as LDBF" and not about the LDBF, specifically. Pickett Tr. 1765:22-1766:10. As the objecting attorney for Mr. Flannery noted at the time, the Division's questions assumed facts not in evidence. *Id.* The evidence actually shows that SSgA met all redemptions while maintaining the risk profile (Div. Ex. 248; Flannery Ex. 180 at SSgA-SEC 000252968), and that there were hundreds of millions of dollars in cash in LDBF after August 2. *See* Flannery Reply Br. at Section II.A.1.

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301	"On August 7, 2007, Lindner emailed Greff, Wands and Hopkins summarizing LDBF's investments as of June 29, 2007 and July 31, 2007. (Div. Ex. 167.) ***From a market value perspective the AA and AAA-rated bonds in both LDBF compound funds changed dramatically following the July 26, 2007 AAA bond sale.*** LDBF CTF went from 53.59% (or $771,428,718) AAA-rated home equity bonds on June 29 to 0.60% (or $6,717,472) on July 31, and from 59% (or $858,655,064) AA-rated home equity bonds on June 29 to 65.95% (or $737,801,243) on July 31 (Id.) LDBF ERISA went from 70.63% (or $948,191,672.38) AAA-rated home equity bonds on June 29 to 4.61% (or $48,606,311) on July 31, and from 63.14% (or $847,730,224.12) AA-rated home equity bonds on June 29 to 68.03% (or $716,751,106) on July 31. (Id.) (According to Div. Ex. 167, both versions of LDBF also held home equity bonds rated A and BAA, but these bonds were less than 10% of the market value of the funds.) A demonstrative created at the hearing from the data is below: [post-it note]."	• The demonstrative used by the Division in PFOF ¶ 301 ignores the fact that the AAA bond sale reduced risk and leverage in the portfolio after the loans used to purchase the bonds were paid, that some of the remaining cash proceeds (after the loans had been paid) remained in LDBF, and that LDBF continued to have hundreds of millions of dollars in cash after August 2. *See* Responses to ¶¶ 280, 300, *supra*; *see also* Flannery Reply Br. at Section II.A.1.
302	"Flannery was aware of LDBFs July 26 AAA bond sale by the end of the day on July 26. He had "heard that there had been a big sale of AAA bonds," but didn't recall "exactly when [he] heard it. (Tr. 1031:5-9 (Flannery).)"	• In the testimony preceding the line cited by the Division in its Proposed Findings of Fact, Mr. Flannery testified in response to the question: Q You learned the next day [7/26/07], is it fair to say, that these instructions from the committee to raise liquidity in the fund and to sell a pro rata share across capital structures, did you learn that those instructions had been carried out?" A "I don't know that I did." Flannery Tr. at 1030:5-10. Mr. Flannery does not know when he learned that the AAA sale had taken place (*id.*; *see also* Flannery Tr. at 1031:5-9), but indicated that "[he]'d have to say that it was [the last week of July]" when he learned of the sale. *Id.* at 1031:10-14. Mr. Flannery believes he knew by August 2 that the Fixed Income team had sold

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		$1.6 billion in AAA. *Id.* at 1035:5-6.
304	"Although Pickett could not recall a discussion with Flannery on July 26, there was no doubt in Pickett's mind that Flannery was aware by the end of the day on July 26, 2007 that the AAA-bond sale to Citigroup was complete. (Tr. 1680:4-19 (Pickett).)"	• Mr. Pickett testified that he did ***not*** know whether Mr. Flannery was aware on July 26, 2007 that the asset sale had taken place. Q Is there any doubt in your mind that by the end of the day on July 26, 2007, the AAA asset sale is done at that point in time -- is there any doubt in your mind that by the end of the day on that day, Mr. Flannery was aware that there had been a very large sale of AAA bonds for LDBF? MR. FIRESTONE: Objection, your Honor. JUDGE MURRAY: I will overrule the objection. ***Do you know whether Mr. Flannery knew that day?*** THE WITNESS: ***No.*** I only know specifically that he was in the investment committee meeting that handed down this conclusion. I couldn't tell you that I talked to him or called him up and said that. ***I can only speculate*** that it's a pretty big event, pretty big sale, and the investment committee would more than likely know by the end of that day after we did it. Pickett Tr. at 1680:4-19 (emphases added).
306	"Kramer executed the LDBF AAA bond sale on July 26. (Kramer Test. Stip. Tr. 16:15-10.) By the afternoon of July 25, Flannery was among those at State Street who were aware that State Street was trying to get Citigroup to buy LDBF's AAA	• Mr. Kramer states that he does not know what Mr. Flannery knew and that he only "assumed" Mr. Flannery knew about the AAA trade. Kramer Test. Stip. at

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	bonds. (Kramer Test. Stip. Tr. 17:14-18:3.) Also, on July 26 before the trade was executed, Flannery was aware that State Street had offered a large block of bonds to Citigroup. Kramer recalled: "I spoke to [Flannery] at some point in the afternoon on the 26th. I would assume. I don't actually know if he knew the exact size or what was involved in the trade. But I did explain to him, I did mention to him on the 26th that we had not executed the trade. Now I'm not sure if he knew what we were executing. He asked me about the trade and I said we haven't executed it yet…[Flannery asked] Where do we stand and I said we were not executed." (Kramer Test. Stip. Tr. 25:5-13.) Prior to the trade being executed, Kramer assumed Flannery knew the size of the trade but did not know if Flannery knew it was all AAA bonds. (Kramer Test. Stip. Tr. 24:17-25:25.)"	24:7-25:25.
307	"When the sale was complete, Kramer recalled that he "specifically [told] Mr. O'Hara, [Sean] Flannery and Bob Pickett specifically that this was done." (Kramer Test. Stip. Tr. 21:2-10.) Regarding Mr. Flannery, Kramer recalled: "[W]hen the securities, when the trade was executed and I looked and I said we are done. And they asked me the price and I gave them the price of 94. I don't believe [Flannery] was present at that point. He did come down. I do recall him standing right next to my desk asking me was the trade completed. Or I actually by the time he showed up at my desk, I said we are done with the trade… It was after the trade was executed. I do recall [Flannery] coming beside my desk where there is a wall and an isle to the window. And I said we are done and we are out of the trade we sold it to Citigroup… I'm not sure how much information he had on the trade. You know he did know. He knew there was a large block at Citigroup. And that's as much information I know that he would have known."	• Mr. Kramer states that he is "not sure how much information [Mr. Flannery] had on the trade." Kramer Test. Stip. at 24:11-12.
309	"There is also strong circumstantial evidence that Flannery was aware of LDBF's AAA bond sale by at least July 27. Martha Donovan, a client service representative for SSgA's Office of Fiduciary Advisor ("OFA"), ***informed Flannery on July 27, 2007 at 5 or 6 PM*** of OFA's decision to recommend redemption of LDBF. (Tr. 1800:4-1801:15 (Donovan).) Flannery told her that OFA would not have to wait ***until some of LDBF's swaps***	• The evidence the Division cites to in this Proposed Finding of Fact does not reflect that Mr. Flannery knew the details of the AAA trade by July 27. The "swaps" referred to by Ms. Donovan were total return swaps that the Fixed Income team allowed to roll off LDBF at month end; it is not a reference to the AAA bond sale as they were separate transactions. *E.g.*, Flannery Tr. at 1053:23-1054:10; *see* Flannery Ex. 144 at SS-SEC 000120104 (the "Actions Taken"

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	rolled off at the end of July because "I remember him saying there was – there way liquidity, 'You can get out whenever you need to get out.' And to me that mean 'We can accommodate your sale whenever you need to make your sale.'" (Tr. 1800:5-1801:25 (Donovan).) Similarly, on July 27, 2007, Marc Brown, to whom the client service groups reported, emailed Hunt a "Brief update" that stated, in pertinent part: "Sean F. indicated that they sold another piece – good for liquidity, but it is locking in losses in the portfolios." (Div. Ex. 143.)"	paragraph explains that these were separate transactions). • With respect to Mr. Flannery's conversation with Ms. Donovan, Mr. Flannery testified that he never knew how much cash was in LDBF. Flannery Tr. at 1007:1. There are no documents or evidence reflecting that Mr. Flannery knew how much cash was in LDBF. Rather, Mr. Flannery told Ms. Donovan that LDBF was a daily liquidity fund (investors could redeem daily), and that if OFA felt as though it was in the best interests of its clients to have them redeem prior to August 1, than they should do that and not wait until August 1. Flannery Tr. at 877:6-882:18; *see* Response to ¶ 424, *infra*. Mr. Flannery was reminding Ms. Donovan that LDBF was a daily liquidity fund and that she did not need to accommodate the preferences of Messrs. Greff and Wands, who had told or suggested to her that OFA could redeem on August 1.
311	"State Street sent letters to investors on July 26, August 2, and August 14, 2007. (Stip.¶ 13.) The Division charged Hopkins in connection with the July 26 letter but not the August 2 or August 14 letters. (Stip. ¶ 14.) In contrast, the OIP's allegations at paragraph 37 through 41 describe Flannery's responsibility for misrepresentations in the August 2 and August 14 letter, although paragraphs 42 and 44 of the OIP reflect that, with respect to the August 14 letter, Flannery is only being charged under Section 17(a)(2) and Section 17(a)(3) of the Securities Act. Finally, although Flannery was not charged with a misrepresentation claim concerning the July 26 letter, the July 26 letter is part of the OIP's claim against Flannery that he engaged in transactions, practices, or courses of business that operated or would operate as a fraud or deceit upon the purchasers of securities. (OIP at ¶¶ 25-36, 42.) As Peavy acknowledged, the July-August letters were part of the total mix of information provided to investors about their investments. (Tr. 3072:7-17 (Peavy).)"	• Mr. Flannery disputes that the July 26 letter is part of the Division's so-called course of conduct claim. *See* Flannery Post-Hearing Reply Br. at Section IV.A. • The Division's statement regarding Mr. Peavy is misleading. Mr. Peavy testified that clients' information needs varied, and Relationship Managers were responsible for ensuring that a particular client received the information that client wanted; different investors sought different types of information. Peavy Direct Test. at A.49; Carlson Tr. at 2734:9-2735:7. He also testified that there were a number of sources of information available on a regular basis to LDBF clients. *See* Peavy Direct Test. at A.45. In addition to the standard information, clients could also request additional information from SSgA, or their Relationship Manager could send them information if the Relationship Manager believed it would be useful. Peavy Direct Test. at A.45; *see also* Carlson Tr. at 2728:20-2729:7, 2733:17-2735:7 (Relationship Managers considered whether information would be of interest to the particular client); Sirri Report at ¶ 22. Mr. Peavy opined that SSgA's model for communicating with clients regarding all of its strategies, including LDBF, was reasonable, appropriate and customary in the

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		industry. Peavy Direct Test. at A.40(c), A.46; *see also id.* at A.69. • SSgA's clients requested different types, frequencies and quantities of information from SSgA, and knew that if they wanted information beyond what was available, they could request it; SSgA customized information for clients accordingly. Carlson Tr. at 2734:16-2735:7, 2736:16-20 ("[A]ny institutional client would know" they could seek information from SSgA beyond that which had already been provided); Peavy Direct Test. at A.47, A.55, A.70; Flannery Tr. at 1213:11-25. While the information *requested by* clients and consultants varied depending on their needs, Mr. Peavy testified that the information *available to* clients did not; all clients had access to the same information. Cross Examination Testimony of Peavy Tr. at 3022:14-3024:12. All of the information the Division claims was omitted from the letters had already been disclosed to investors prior to the letters (and some of it was also highly publicized). *See generally* Flannery Post-Hearing Mem.; Flannery Post-Hearing Reply Br. • Mr. Peavy explained that typical investors in a fund such as LDBF would not rely on a single letter in deciding whether to remain invested in the fund. Peavy Direct Test. at A.65, A.73. Instead, these investors and their consultants would consider the totality of information provided by, among other sources, the fund's marketing materials, discussions with fund managers, responses to questions and requests for information, and other publicly available information in deciding whether to remain invested. *Id.* at A.40(e), A.66.
312	"Pickett had no role whatsoever in drafting letters State Street sent to investors in LDBF about the subprime situation in 2006 and 2007. (Tr. 1550:6-17 (Pickett).) Neither Flannery nor anyone else at State Street ever asked him to have a role in drafting the letters. (Tr. 1550:18-20 (Pickett).)"	• The Division has conceded that SSgA dedicated tremendous time and resources to the client letters at issue; that the letter-drafting process was inclusive and key members of Relationship Management, Legal, and the Fixed Income team provided input; and that multiple meetings were held to discuss and refine each of the letters. Div. Post-Hearing Br. at 56. For example, the July 26 letter was reviewed and edited by Frank Gianatasio, the Head of the Structured Products Group (and part of the LDBF portfolio management team), Michael Wands (Head of North American Fixed Income), Paul Greff (Global Head of Fixed

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		Income), and Michael O'Hara (Head of U.S. Active Fixed Income Portfolio Management Team; former Portfolio Manager for LDBF). Hopkins Exs. 77, 78, 84, 85, 88, 89, 93, 96. Mr. Flannery considered Mr. Gianatasio to be an expert on the housing-related asset-backed securities market and deeply knowledgeable of LDBF and the underlying facts described in the draft letter. *E.g.*, Flannery Tr. at 1249:7-19; *see also* Flannery Ex. 4 (prepared by Mr. Gianatasio). Messrs. Wands, Greff, and O'Hara also had a more "granular" knowledge of LDBF and the underlying facts than Mr. Flannery. Flannery Tr. at 943:13-944:24. Mr. Gianatasio and Mr. Wands also both reviewed and commented on the draft letter. Hopkins Exs. 72, 74, 77. Messrs. Wands, Greff, and O'Hara received subsequent iterations of the draft letter. Hopkins Exs. 77, 78, 84, 85, 88, 89, 93, 96. The evidence also reflects that Mr. Wands reviewed and commented on the August 2 letter after Mr. Flannery made his "suggested edits" to an early draft. Flannery Ex. 126. In addition to Mr. Wands, a number of other people that were either closer to LDBF, and aware of the underlying business issues reviewed the letter. *See, e.g.*, Div. Ex. 155; Carlson Tr. at 2752:23-25 (testifying that Mr. Wands was closer to LDBF than Mr. Flannery), 2710:18-2711:16 (stating he was aware of anticipated and actual redemption activity); Donovan Tr. at 1799:7-14 (testifying she left a message for Staci Reardon telling her OFA was recommending redemption to its clients); Lowe Tr. at 2042:5-7 (discussing Flannery Ex. 129 and indicating that he notified Staci Reardon of GAA's recommendation to clients they redeem); Flannery Tr. at 1315:1-15. The August 14 letter was similarly reviewed by key people with knowledge of the relevant facts and issues. *E.g.*, Flannery Post-Hearing Mem. at 60-68. • Even if Mr. Pickett did not participate directly in drafting the letters, he provided information on the portfolio and its activities that were reflected in all the letters. For example, he calculated the credit quality of the portfolio.
314	"Flannery understood that the role of client service in reviewing or commenting on the three letters was to know what clients needed to know and whether there were gaps in the	• The Relationship Management (aka Client Service) team, and not Mr. Flannery, knew what information was being provided to clients and consultants and what questions were being asked. Carlson Tr. at 2724:4-7; Flannery Tr. at 903:14-

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	communication. (Tr. 903:14-904:3 (Flannery).) In connection with the review of the July 26 letter, Carlson, the co-head of SSgA's relationship management group in 2007, explained that "the client-facing people were not there to judge what was in the letter itself from a substance point of view but from a form [perspective] so that when it went to clients, hopefully it made sense to them." (Tr. 2664:7-14, 2680:25-2681:7 (Carlson).) With regard to the August 2 letter, the client-facing personnel were responsible for getting the letter to the client and Carlson did not recall having any role in the content of the letter. (Tr. 2685:15-19, 2686:9-11 (Carlson).) Carlson reviewed edits to the letters for form and not substance. (Div. Ex. 155; Tr. 2687:10-2688:13 (Carlson).) Carlson did no fact checking on the investment information contained in the letters because he would not know if the facts were correct or not. (Tr. 2688:14-23 (Carlson).) Generally, investment people would be responsible for the content of the letter. (Tr. 2690:10-14 (Carlson).)"	904:3 (Relationship Management and Consultant Relations were "in the best position to know what the client needs to know" and "and the "most likely to be aware of what the gaps are in the communication."), 1214:1-8 ("That was their job, to understand the needs and preferences of the clients and to try to accommodate those."). Clients' information needs varied, and Relationship Managers were responsible for ensuring that a particular client received the information that client wanted; different investors sought different types of information. Peavy Direct Test. at A.49; Carlson Tr. at 2734:9-2735:7. For example, Relationship Management—and not the Fixed Income team—was tracking anticipated and actual redemption activity. *See* Flannery Ex. 92 at SSgA-SEC 000252909; *see also* Flannery Tr. at 1000:10-1001:19, 1279:9-1280:22. Relationship Management was also meeting regularly with members of the Fixed Income team to discuss the markets and LDBF during this period. Wands Tr. at 2882:14-19.
315	"Flannery understood that the legal group's role in reviewing the letter was to offer legal advice on the letters, including legal opinions as to whether a particular statement should or should not be in the letter. (Tr. 904:4-23 (Flannery).) Furthermore, with at least some of the letters, Flannery reviewed edits made by the legal team, and checked to see that legal's changes were not in conflict with what he understood the facts and the dynamics of the market situation to be. (Tr. 909:22-910:7; 919:25-920:16 (Flannery).) Flannery also agreed that, when he or other members of the investment team reviewed legal's edits, they would make sure that they felt that the edits did not somehow change the letter in a way that would make it less accurate. (Tr. 925:3-21 (Flannery).)"	• Mr. Flannery also testified that "when someone in legal provided comments on the letter, [his] role was to check to see that legal's changes were not in conflict with what [he] understood and the dynamics of the market situation to be" with the caveat that "some of their edits may have to do with … legal opinion about how to couch certain things … so I don't know that it would necessarily be clear in every case." Flannery Tr. at 909:22-910:7, 919:25-920:16. Mr. Flannery also had tremendous confidence in SSgA's legal team. *See* Flannery Post-Hearing Mem. at 86-88. • Not only did Legal "have a role in every letter," (Carlson Tr. at 2749:25-2750:1), but the Legal Department had final approval power over all of the letters sent to clients during the summer of 2007. *See, e.g.*, Flannery Ex. 127 (Mr. Shames advised Mr. Carlson that he needed to see any changes to the August 2 letter); Flannery Exs. 207, 219 (demonstrating Legal had to and did approve sending August 14 letter). As Mr. Shames stated, "I assembled …a team which I would

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		have been confident in, would have reviewed the letter in a way that they thought was necessary in order for the legal group to sign-off on the letter." Shames Tr. at 89:21-90:2. Legal's review, editing, and approval of the client-letters, and knowledge of the relevant facts, is discussed at length in Mr. Flannery's Post-Hearing Memorandum at 43-45 and Post-Hearing Reply Brief at Section II.D.3.b.
317	"Shames reviewed both the July 26 and August 2 letters. When he reviewed each of these letters, Shames did not do any independent checking of the facts stated in the letters. (Shames Test. Stip. at Tr. 81:1-6.) He "reviewed the letter for clarity," was "involved in the collection and coordination of comments," and "assembled the team" to review each letter. (Id.) Shames did not himself do any follow-up inquiry as to the accuracy and completeness of the letters. (Id. At Tr. 79:24-80:17.) Shames did not do any fact-checking about facts expressed in those letters because the letters "were communications prepared by our most senior level investment people and [he] relied upon the fact that there was nothing to lead [him] to believe that the facts weren't anything other than as they were set [] forth." (Id. At Tr. 81:15-82:4.) When Shames looked at those two letters, nothing jumped out at him as requiring fact-checking, so he did not do any. (Id. At Tr. 82:5-14.)"	• The evidence reflects that Mr. Flannery requested that the lawyers vet the letters before they went out. Flannery Exs. 52 and 54. Mr. Flannery had confidence in the lawyer's ability to do their job. *See* Flannery Post-Hearing Mem. at 86-88. • The Division misstates the record evidence it cites for the highlighted proposition. Mr. Shames did not do any independent fact checking because he did not view that to be his role in reviewing the letters as General Counsel. Shames Test. Stip. at 80:4-13, 89:21-90:2. Instead, he viewed his role as "assembling the right team with the right expertise to handle matters" and that he "had the confidence that my team of counsel was doing what they deemed necessary to review the communication." Shames Test. Stip. at 79:24-80:17. • Mr. Shames brought "in lawyers who specifically had investment and securities experience. [A] team which [he] would have been confident in, would have reviewed the letter in a way that they thought was necessary in order for the legal group to sign-off on the letter. Shames Test. Stip. at 89:21-90:2. Further, Mr. Shames explained that his "understanding was that this was an accomplished and well-experienced team of legal advisers, and that they would raise the issues and make changes, so that the letters were consistent with whatever rules and regulations [SSgA was subject to]." *Id.* at 156:1-5. • Notwithstanding his view of his role as General Counsel, the evidence reflects that Mr. Shames and Legal had the relevant factual information and were in a

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		position to effectively advise SSgA on the relevant issues to this case. *See* Flannery Post-Hearing Mem. at 43-45; Flannery Post-Hearing Reply Br. at Section II.D.3.b.
321	"By June of 2007, people were asking questions regarding ABX because of communications drafted by Hopkins. (Tr. 276:18-21 (Hopkins).) Also by June of 2007 there were news reports regarding subprime, specifically the problems that Bear Stearns had with its hedge funds. (Tr. 276:22-277:3 (Hopkins).)""	• There is no evidence Mr. Flannery was aware of these alleged questions.
324	"The July 2, 2007 CAR alert did not disclose the extent of exposure that LDBF had to subprime. (Tr. 284:18-22 (Hopkins).)"	• Although this Proposed Finding of Fact does not pertain to Mr. Flannery, it is irrelevant in any event. It was public knowledge by July 26 that LDBF was invested mostly in subprime and used leverage. Flannery Ex. 108 at SS 003837015 (July 25 MML article stating LDBF was invested "mostly in subprime" and used leverage). Moreover, Mr. Flannery ***knew*** that information was public knowledge by July 26. *Id.*; Flannery Tr. at 1306:21-1308:15. Mr. Flannery was also aware of the many other disclosures made to investors of LDBF's subprime exposure, including the February 28 CAR alert that discussed LDBF's investment in subprime at length, which had been sent to the Relationship Management team, and that investors had access to extensive information concerning the composition of the portfolio including, but not limited to, audited financial statements. Flannery Tr. at 1216:20-1217:1; *see also* Flannery Exs. 17 (Mr. Flannery detailing subprime and leverage exposure to, among others, Marc Brown, the Head of Relationship Management) and 58 (same; Mr. Brown was a member of the EMG, which was included on the e-mail). Mr. Flannery also knew that the Relationship Management team was being provided with the FAQs to use with investors and consultants. Flannery Tr. at 1309:9-1310:10. The FAQs contained the allegedly omitted information. *E.g.*, Flannery Ex. 167 at SS 004344158. • The information regarding LDBF's level of subprime exposure was available at all times to any investor who asked for it (Carlson Tr. at 2728:20-2729:7; Sirri Report at ¶ 22; Peavy Direct Test. at A.45), and was provided to many investors

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		via the answer to FAQ # 1 and 46. Flannery Ex. 167 at SS 004344197, SS 004344163 (note also that the FAQs are called the "subprime FAQs"); Flannery Tr. at 1310:11-1311:1, 1363:19-1364:5; Carlson Tr. at 2744:22-2745:12; Duggan Test. Stip. at 326:11-17.
330	"Shames recalled that the letter eventually sent to clients on July 26 was drafted by "senior fixed-income professionals" and that Flannery was involved in its review and its drafting. (Shames Test. Stip. at Tr. 86:20-87:10.)"	• The documentary evidence demonstrates that Mr. Flannery did not draft the letter, and had limited involvement in the review and editing of it, having sent one set of "a couple of edits" to the letter weeks before it was finalized and sent out to clients. Div. Ex. 103; *see also* Flannery Post-Hearing Reply Br. at Section IV.C.2.b. Mr. Shames testified that his only specific memory concerning Mr. Flannery's involvement with the letter was that he wanted to ensure that Legal reviewed it. Shames Test. Stip. at 87:11-21.
331	"Flannery made his first edits to the July 26 letter on July 11 when he emailed Patricia Hudson with his track changes edits. (Div. Ex. 103.) Flannery understood that, when he made these edits, the letter would eventually go to clients. (Tr. 933:5-8 (Flannery).) After he made his July 11th edits, Flannery continued to be involved in the process of editing the letter. (Tr. 934:5-8 (Flannery.)"	• The evidence actually shows that these were the ***only*** edits that Mr. Flannery made to the letter (more than two weeks before it was sent)—saying it was his "first edits" is misleading. • As with the August 2 and August 14 letters, the July 26 letter underwent an extensive review process. *See* Hopkins Post-Hearing Br. at 25-35; Div. Post-Hearing Br. at 56 (acknowledging the extensive review process of all the letters). Though SSgA's review of the letter was extensive, Mr. Flannery's role was limited to making a "couple of edits" to the draft letter Ms. Hudson had previously circulated. Div. Ex. 103. Mr. Flannery made his edits because he wanted to make the letter more accurate, and consistent with the Fixed Income team's view of the long-term fundamentals. Flannery Tr. at 937:9-23 (testifying he revised language from "downgradings" to "actions" to make it more accurate). That is the only time Mr. Flannery edited the letter. • Mr. Flannery included Frank Gianatasio, the Head of the Structured Products Group (and part of the LDBF portfolio management team), and Mr. Wands on the e-mail he sent with his "couple of edits." *Id.*; *see also* Hopkins Tr. at 369:4-8, 471:20-22. Mr. Flannery considered Mr. Gianatasio to be an expert on the

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		housing-related asset-backed securities market, and deeply knowledgeable of LDBF and the underlying facts described in the draft letter. *E.g.*, Flannery Tr. at 1249:7-19; *see also* Flannery Ex. 4 (prepared by Mr. Gianatasio). Mr. Wands also had a more "granular" knowledge of LDBF and the underlying facts than Mr. Flannery. Flannery Tr. at 943:18-24. Mr. Gianatasio and Mr. Wands both reviewed and commented on the draft letter. Hopkins Exs. 72, 74, 77. • In addition to distributing the draft letter to the Fixed Income team to ensure its accuracy, Mr. Flannery also had the July 26 Letter vetted by Legal. Shames Test. Stip. at 87:16-21; Flannery Tr. at 1299:11-22; Flannery Exs. 52, 54; Hopkins Ex. 77. Thereafter, Mr. Flannery's involvement with the letter was limited to meeting regarding the letter on a few occasions, and forwarding a subsequent draft of the letter reflecting Legal's comments to Mr. Wands, Mr. Greff, and Michael O'Hara to ensure that the revisions that had been made by Legal were factually accurate. Div. Ex. 113; Flannery Tr. at 944:10-13. Like Mr. Wands, Messrs. Greff and O'Hara had a deeper knowledge of LDBF and the underlying facts than Mr. Flannery. Flannery Tr. at 943:13-944:13; Hopkins Exs. 71, 72, and 74. Messrs. Wands, Greff, and O'Hara received subsequent iterations of the draft letter. Hopkins Exs. 77, 78, 84, 85, 88, 89, 93, 96. Messrs. Wands and Greff specifically received a draft of the letter including the "risk reduction" language the Division has claimed is misleading, and participated in a meeting with Mr. Flannery and others to discuss that version of the draft letter. Hopkins Ex. 96.
332	"On July 12, 2007, Hudson emailed Shames, forwarding a draft of the client letter and stating that "Sean confirmed to me this afternoon that he wanted this to be vetted by legal ..." (Div. Ex. 106.) Flannery did not ask Hudson to provide legal with any factual material to assist in legal's review of the letter (Tr. 939:14-16 (Flannery).) Shames saw a draft of the client letter for the first time when he received a copy of it from Hudson on July 12. Before or after receiving the draft, no one provided Shames with facts about the subprime situation to be used in his, or	• The Division misstates the record evidence it cites for this proposition. Mr. Shames testified as follows: Q Prior to receiving this draft letter on July 12, had anyone provided you with facts about the subprime situation that they felt like or at least articulated to you you should have in your review?

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	legal's, review of the letter. (Shames Test. Stip. at Tr. 203:24-204:3.) Shames became aware that LDBF had subprime exposure in July 2007, but he was not aware of any details concerning LDBF's subprime investments. (Id. At Tr. 65:20-66:1, 68:10-69:2.) Shames did not recall being aware, in 2007, of the overall amount of subprime exposure held in SSgA's active fixed income funds, or knowing anything about the credit quality of any of those subprime holdings. (Id. At Tr. 72:7-73:6.) Shames did not become aware that LDBF or the funds invested in LDBF used leverage until September 2007. (Id. At Tr. 73:7-74:1.)"	A No. Mr. Shames did not testify that he was not provided with factual information after he reviewed this draft letter (a letter that he reviewed multiple times). *See* Flannery Post-Hearing Reply Br. at Section IV.C.2.c. The evidence reflects that Mr. Shames and the other lawyers that reviewed the letter having received all of the factual information they needed to be in a position to effectively advise SSgA, and for Mr. Flannery to believe in good faith that they were in a position to effectively advise SSgA. Mr. Flannery made a complete disclosure to the counsel involved in the review of the July 26 letter (Mr. Shames, Mr. Duggan, and Mr. Douglass): • Mr. Duggan participated in the July 25 Investment Committee and July 26 Impaired Asset Valuation Committee meetings. The discussion of subprime, illiquidity, and pricing issues at that those meetings was extensive. Flannery Exs. 92, 102. Mr. Duggan briefed Mr. Shames on the July 25 Investment Committee meeting promptly after it ended. Duggan Test. Stip. at 210:5-20. • Mr. Duggan was briefed by Mr. Flannery on the issues facing LDBF on at least two occasions prior to July 26, including one meeting with Paul Greff. Flannery Tr. at 80:8-21; Duggan Test. Stip. at 105:15-106:7. • Mr. Shames and Mr. Flannery regularly discussed the market situation. Flannery Tr. at 942:5-14 (testifying he and Mr. Shames did "have a lot of discussions about what was going in the market and the direction the market had taken" around that time). • Mr. Flannery provided Mr. Shames and others with periodic reports on the amount of subprime exposure in the fund—including a report reflecting SSgA's subprime exposures as of July 10, 2007—and "a breakdown of the allocation of CDOs/SubPrime exposure" held by the various funds, including LDBF. Hopkins Ex. 171 (Mr. Shames was a member of the EMG group); Shames Test.

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		Stip. at 213. • Mr. Shames brought "in lawyers who specifically had investment and securities experience. [A] team which [he] would have been confident in, would have reviewed the letter in a way that they thought was necessary in order for the legal group to sign-off on the letter." Shames Test. Stip. at 89:21-90:2. Further, Mr. Shames explained that his "understanding was that this was an accomplished and well-experienced team of legal advisers, and that they would raise the issues and make changes, so that the letters were consistent with whatever rules and regulations [SSgA was subject to]." *Id.* at 156:1-5.
333	"When reviewing the July 13, 2007 draft, Shames "saw that this investment commentary had been reviewed by many senior people, and so with respect to the facts, the legal group was relying upon the facts that were given to us, and we had no reason to question the facts." (Shames Test. Stip. at Tr. 221:8-15.) Among the senior people on whom Shames was relying was Flannery, the most senior member of the investment team responsible for these funds. (Id. At Tr. 221:24-222:21.) Shames understood that the draft letter had already been reviewed on the business side before he saw it for the first time, so he assumed that the facts contained in the letter were correct. (Id. At Tr. 223:5-17; 230:2-4; 231:16-20 ("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.").)"	• The facts in the letter were correct. That said, the Division's characterization of Mr. Shames testimony is misleading. Mr. Shames testified as follows: Q. . . . So is what you're saying that you had an understanding that several individuals had already looked at the letter before it ever went to you? Is that what you're basing this on? A. Yes, and specifically these were senior people who would both know what the portfolio consisted of as well as – you asked me to focus on this language, as you know. ***The client service people would be aware of the various communications that had gone on.*** Q. For example, Sean Flannery is the chief investment officer at that point in time? A. Well, it's – Sean, yes, ***but Frank Gianatasio, Mike Wands—I don't know who was actually managing the portfolios,*** but those were very senior people in the fixed income area. Staci Reardon, Larry Carlson, Maureen

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		Fitzgerald, they were all very senior people on the client service marketing and those client facing responsibilities." Shames Test. Stip. at 221:24-222:16 (emphasis added). The evidence reflects that, like Mr. Flannery, Mr. Shames was relying on (a) the people that were aware of the communications that had gone on (i.e., Relationship Management), and (b) were ***actually*** managing the portfolio. Even when the Division tried to steer Mr. Shames toward Mr. Flannery with its questioning, he was quick to note that he was primarily referring to the people closer to the portfolio—*i.e.*, Messrs. Gianatasio and Wands. • Mr. Flannery was not a member of the Fixed Income Investment Team. *See* Flannery Post-Hearing Mem. at 6.
334	"On July 17, 2007, Shames emailed Flannery with the subject line "Subprime – Client Letter," and stated: "Sean – just a quick follow-up. I'm still 'processing' some of our discussion earlier, as it relates to the proposed letter. I want to catch up with Mark Duggan and run some things by him. We'll be able to get back to you by mid-afternoon. There may be some additional comments. I know that I said earlier that I was 'all set', I just need to confirm a couple of things." (Hopkins Ex. 80.) Flannery could not recall what he and Shames discussed. (Tr. 940:6-10 (Flannery).) Shames emailed Flannery again on July 17 with the same subject line and attached a draft letter showing track changes. (Hopkins Ex. 81.) In his email to Flannery, Shames stated: "Sean – Let's talk before this gets sent out. Note, in the Performance #'s, do we want to include an index such as Lehman Agg?" (Hopkins. Ex. 81.) Flannery could not recall if he and Shames discussed the edits, but Flannery thought it was likely they did discuss at least one of the edits because: "We did have a lot of discussions about what was going on in the market and the direction the market had taken." (Tr. 942:5-14 (Flannery).) Flannery looked at Shames' edits to ensure that Shames had gotten the facts right from a market perspective.	• The Division mischaracterizes the record evidence it cites for the highlighted proposition. Mr. Shames testified as follows: Q Who had primary responsibility for the final content of this communication, who, whether it be one person or several, who would those people be? A ***I don't know.*** Let me clarify that. It is my memory that this commentary was, if you will, sort of a joint responsibility between the investment team as well as the client service team, but as to ***who, specifically, had the authorization, I'm unclear.*** Shames Test. Stip. at 98:8-15. To the extent the Division seeks to claim that the investment team and Relationship Management were the only groups that had to approve the letters, it is misleading. Elsewhere in his testimony, Mr. Shames testified that legal had to approve the letters. *E.g.*, Shames Test. Stip. at 80:4-13;

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	(Hopkins Ex. 81; Tr. 942:20-24 (Flannery).) The edits to the July 26 letter contained in Hopkins Exhibit 81 were comments from the legal group, although the lawyers may have been discussing the letter with business people at the time. Shames Test. Stip. at Tr. 219:7-23.) The investment team and the client service team were jointly responsible for the final content of the July 26 letter. (Id. at Tr. 98:8-15.) Shames could not recall whether the legal group offered any advice on facts expressed in the July 26 letter. (Id. at Tr. 95:21-25.)	89:21-90:2; *see also* Div. Ex. 124 (referencing the letter Mr. Shames had previously approved). The Division has conceded that SSgA dedicated tremendous time and resources to the client letters at issue; that the letter-drafting process was inclusive and key members of Relationship Management, Legal, and the Fixed Income team provided input; and that multiple meetings were held to discuss and refine each of the letters. Div. Post-Hearing Br. at 56; *see* Response to ¶ 315, *supra*.
344	"Shames' email also suggests that he was seeking approval for the letter from his peers, Flannery and Brown. (Div. Ex. 124.)" "Flannery testified that Shames was trying to meet with Flannery and Brown, but he does not recall if they met. (Tr. 157:16-25 (Flannery).) Flannery understood that someone in legal and Brown, as the head of client service, would have to sign off on the letter before it could go out to clients. (Tr. 958:3-10 (Flannery).) Flannery testified that Brown was at the same level as Flannery. (Tr. 971:16-19 (Flannery).)"	• Division Exhibit 124 is not a final version of the letter, which went through multiple subsequent revisions and was not sent out to clients until two days later. • The reason Mr. Shames was meeting with Mr. Flannery and Mr. Brown is unclear from the document and the Division failed to adduce any evidence explaining what Mr. Shames meant in his e-mail. • Mr. Flannery did not receive a final copy of the letter sent to clients. Flannery Ex. 111.
352	"Hopkins does not recall any communications with Shames other than the two July 24, 2007 emails. (Tr. 307:16-25 (Hopkins).) Hopkins also does not recall any communications with Mark Duggan regarding the July 26th letter. (Tr. 308:1-3 (Hopkins).) Hopkins does not recall having a conversation with any other lawyer regarding the July 26th letter (Tr. 308:9-13 (Hopkins).) Hopkins has no reason to believe that Shames knew that LDBF was invested 95% in subprime and/or that the spreads on the higher tranches of the subprime mortgages were widening. (Tr. 308:14-24 (Hopkins).)"	• *See* Response to ¶ 324, *supra*.
354	"At 7:38 PM on July 24, Staci Reardon (co-head of relationship management), emailed Shames, Brown and Flannery with the subject line "Subprime letter." (Div. Ex. 126.) Reardon's email attached a draft of the July 26 letter and stated, in pertinent part: "It is our understanding that you do not want us to send with the letter the SSgA Fixed Income June 2007 commentary section (page two of the attached document)." (Id. At SS-SEC 103743)	• The Division's statement with respect to Mr. Duggan is misleading. The Division has conceded that the Investment Committee instructions were followed and the evidence reflects that they were followed. Div. Post-Hearing Br. at 25-28; Flannery Post-Hearing Mem. at 32-36; Flannery Ex. 180 (Paul Greff reports to Investment Committee that instructions were followed; Duggan is at the

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	Reardon also stated in her email: "Mitch, Attached is the letter with the changes discussed. After the meeting with Sean Flannery, Mark Duggan, Paul Greff, Mike Wands and Nick Mavro the only additional change we made was to add a sentence to the last paragraph … After the Investment Committee meets we should reconvene to agree on the action plan going forward for client communication. We continue to work on the FAQ but I still feel that we will need something like the SSgA Fixed Income June 2007 commentary to send to clients." (Id.) The last sentence of the draft letter attached to Reardon's email stated: "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. At SS-SEC 103743A) Although Flannery had no recollection of a meeting with Reardon, Duggan, Greff, Wands and Mavro on July 24, he had no reason to think he was not present at the meeting. (Tr. 972:23-973:15 (Flannery).) Flannery also had no recollection of discussing the addition of the last sentence of the letter, but the concept conveyed in the sentence (i.e., State Street had reduced LDBF's exposure to risk) was familiar to him. (Tr. 974:15-20 (Flannery).) ***When Duggan reviewed the July 26 letter, Duggan did not know whether SSgA was complying with the investment committee's directives about how to raise liquidity in LDBF.*** (Exhibit A to Joint Stipulation Regarding Testimony of Mark J. Duggan filed on March 15, 2011 ("Duggan Test. Stip.") at Tr. 232:10-16.)"	meeting). Moreover, Mr. Shames expected that Mr. Duggan would have put himself in a position to effectively advise SSgA concerning the letter. *See* Response to ¶ 315, *supra*. If Mr. Duggan had questions about that portion of the letter, for example, he could have asked, and Mr. Shames expected that Mr. Duggan would ask questions if he needed to do so. *Id.* In any event, it is unclear from Mr. Duggan's testimony whether he was saying he did not know at the time he testified whether he knew if they were following the instructions or that he never knew. Duggan Test. Stip. at 232:10-16.
355	"Shames did not recall being part of any discussion about whether the July 26 letter should be changed based on what happened at the Investment Committee meeting held on July 25. (Shames Test. Stip. at Tr. 144:13-19; 243:11-15.) He did not recall having a discussion with Reardon and Duggan about the client letter after the July 25 Investment Committee meeting. (Id. At Tr. 150:7-10 (in reference to Reardon's comment in Div. Ex. 126), 243:5-10.) Shames also did not recall whether he made edits to the letter after the July 25 Investment Committee meeting. (Id. At Tr. 243:16-23.) Shames also had no recollection of knowing anything about any of the directives issues by the	• Mr. Duggan briefed Mr. Shames on the July 25 Investment Committee meeting promptly after it ended. Duggan Test. Stip. at 210:5-20. Mr. Duggan's testimony is corroborated by other evidence in the record. Hopkins Ex. 134 (reflecting that Mr. Duggan stopped by Mr. Shames' office right after conclusion of July 25 Investment Committee meeting); *see also* Lowe Tr. at 2014:15-19 (testifying that Investment Committee meeting was at 8:30 a.m.).

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	Investment Committee at its July 25 meeting. (Id. At Tr. 174:12-175:10.) Shames did not recall ever learning about the issues discussed at that meeting or about any actions that were going to be taken as a result of that meeting. (Id. At Tr. 244:24-245:6.)"	
357	"The letter was sent to clients on the afternoon of July 26, 2007. (Hopkins Ex. 98.) The final version of the July 26 letter stated that "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. At SS 10687577.) The changes from the July 25th draft were minor word-smithing edits. (Compare Id. And Div. Ex. 137 at SS-SEC 120177 (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. Shames was not aware of any of the facts contained in that sentence independently of his review of the letter. (Shames Test. Stip. at Tr. 97:5-17.) Further, with respect to the facts in that sentence, Shames relied upon the letter's accuracy because he was not aware of any facts that would indicate the facts were wrong. (Id. At 158:10-159:2.) Shames also though other reviewers of the letter would check any facts they felt it was necessary to confirm and make their own decisions about what facts could be accepted without checking. (Id. At Tr. 158:23-160:2.) Ultimately, all of the lawyers who reviewed the July 26 letter were relying on the business people for the accuracy of the factual information contained in the letter. (Id. At Tr. 161:7-11.)"	• The letter was accurate. *See* Flannery Post-Hearing Reply Br. at Section IV.C.2; *see also* Response to ¶ 334, *supra*.
358	"The July 26 letter was misleading because it emphasized risk reduction based on the reduction of the BBB ABX investment when, at the time Hopkins suggested that edit, LDBF's greatest risks were coming from its exposure to higher rated AA and AAA subprime bonds and total return swaps. By July 19, 2007, Hopkins knew that the spreads on the AAA and AA tranches of subprime ABS were experiencing a "huge widening." (Div. Ex.	• The letter was accurate and not misleading. *See* Flannery Post-Hearing Reply Br. at Section IV.C.2.

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	120 at SS-SEC 132904; Tr. 292:1-293:11 (Hopkins).)"	
359	"Flannery knew that after about July 20, 2007, AA-rated subprime bonds were trading cheaper than junk bonds. (Tr. 1472:6-11 (Flannery).) Flannery also knew that in late July, the market was valuing subprime securities less than securities of other types with comparable credit ratings. (Tr. 1473:16-20 (Flannery).)"	• The letter was accurate and not misleading. *See* Flannery Post-Hearing Reply Br. at Section IV.C.2. • Mr. Flannery testified that the letter was consistent with the Fixed Income team and his view that technical (*i.e.*, liquidity) issues were causing volatility in the market at that point, and the pricing issues were not reflective of a fundamental change in the market. Flannery Tr. at 1471:18-1473:20. This view is reflected in the July 26 letter sent to investors. Div. Ex. 111 at SS 010687577 (". . . . technical forces can often drive the market to extreme valuations").
360	"Pickett's absolute return analytics can be used to attribute the July 2007 losses in the LDBF CTF to the various asset classes held by that fund. (Div. Ex. 347; Tr. 1697:20-22 (Pickett).) The document shows that the fund lost 8.159% of its value in July 2007, including a 4.152% loss from AAA-rated subprime bonds and a 3.878% loss from AA-rated subprime bonds. (Div. Ex. 247; Tr. 16908:8-1700:1 (Pickett).)"	• The letter was accurate and not misleading. *See* Flannery Post-Hearing Reply Br. at Section IV.C.2.
361	"The July 26 letter was also misleading because it said nothing about LDBF's overall subprime exposure, including the fact that the fund was concentrated in subprime bonds and leveraged through other subprime investments. (Div. Ex. 184.) Drafts that Hopkins reviewed of the July 26, 2007 letter similarly failed to disclose the overall exposure of subprime in LDBF even though that exposure was causing the underperformance in the fund by July 2007 (Div. Ex. 124; Div. Ex. 125.).""	• It was public knowledge by July 26 that LDBF was invested mostly in subprime and used leverage. Flannery Ex. 108 at SS 003837015 (July 25 MML article stating LDBF was invested "mostly in subprime" and used leverage). Moreover, Mr. Flannery ***knew*** that information was public knowledge by July 26. *Id.*; Flannery Tr. at 1306:21-1308:15. Mr. Flannery was also aware of the many other disclosures made to investors of LDBF's subprime exposure, including the February 28 CAR alert that discussed LDBF's investment in subprime at length, which had been sent to the Relationship Management team, and that investors had access to extensive information concerning the composition of the portfolio including, but not limited to, audited financial statements. Flannery Tr. at 1216:20-1217:1; *see also* Flannery Exs. 17 (Mr. Flannery detailing subprime and leverage exposure to, among others, Marc Brown, the Head of Relationship Management) and 58 (same; Mr. Brown was a member of the EMG, which was included on the e-mail). In addition, Mr. Flannery also knew that the Relationship Management team was being provided with the FAQs to use with

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		investors and consultants. Flannery Tr. at 1309:9-1310:10. The FAQs contained the allegedly omitted information. Flannery Ex. 167 at SS 004344158.
362	"Flannery thought, in the summer of 2007, that investors needed to know that they were holding subprime investments in order to make an intelligent decision about whether they wanted to be invested in subprime. (Tr. 1458:6-12 (Flannery).) Also by mid to late July 2007, Flannery thought investors in LDBF would want to know the fund was concentrated in subprime. (Tr. 1470:18-1471:1 (Flannery).) Flannery did not keep track of whether relationship managers were pushing out information to clients about what was going on in the subprime market and he did not talk to relationship managers about whether they were telling clients about what was going on in the subprime market. (Tr. 1462:11-23 (Flannery).) Flannery also did not know if clients actually got audited financial statements for LDBF, including the December 31, 2006 LDBF CTF audited financial statements. (Hopkins Ex. 23; Tr. 1463:13-16 (Flannery).)"	• *See* Response to ¶ 361, *supra*. • *See* Flannery Post-Hearing Mem. at 14-15. • The Division's Proposed Finding of Fact ignores Mr. Flannery's role and responsibilities within SSgA. Mr. Flannery was the Chief Investment Officer, responsible for overseeing strategy for all of SSgA's funds. *See* Flannery Post-Hearing Mem. at 6-7. He was not, as the Division's statement assumes, responsible for SSgA's compliance, legal, or client and consultant communications functions. *See id.* Mr. Flannery did not "keep track of whether relationship managers were pushing out information to clients about what was going on in the subprime market and did not talk to relationship managers about whether they were telling clients about what was going on in the subprime market" because it was not his responsibility to do so. *See id.* While Mr. Flannery was aware that there was a substantial amount of information available to investors and consultants in the FAQs and elsewhere, there was an entire structure in place—Relationship Management—that was expressly responsible for communicating with investors and consultants. Relationship Management personnel, and not Mr. Flannery, were responsible for tracking whether Relationship Managers and consultant relations personnel were using the information provided to them.[5]
363	"The July 26 letter was also misleading because it said nothing about the fact that other State Street funds invested directly or indirectly in LDBF had begun the process of redeeming from LDBF. Wands' notes of a meeting with the client service group on July 23 concerning LDBF state that "Any decision to reduce	• The Division's Proposed Finding of Fact is misleading. Mr. Wands testified that he did not know what he was referring to in Division Exhibit 122 when he wrote "Any decision to reduce exposure has to be communicated broadly (to all clients)." Wands Tr. at 2900:5-21. It is unclear from the Exhibit what Mr.

[5] The evidence establishes that Relationship Managers were providing this information to investors and their consultants. *See* Flannery Ex. 270.

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	exposure has to be communicated broadly (to all clients)." (Div. Ex. 122 at SSP 43883.) Wands recalled discussions in late July concerning other SSgA funds invested in LDBF redeeming from LDBF and those conversations "were going on at or around the time we were preparing communications, from my recollection, to go out, and there was some discussion as to what detail we had to be in those communications about what other investments managers were doing." (Tr. 2901:12-2902:10 (Wands).) Despite these discussions, and despite the fact that both Hopkins and Flannery were aware LDBF would be experiencing significant redemptions, the July 26 letter says nothing about the fact that other State Street funds had begun the process of redeeming from LDBF."	Wands was referring to, but there is nothing to suggest that it was a reference to the so-called Related Funds redeeming from LDBF. When SSgA did reduce exposure (*i.e.*, risk), ***it disclosed that it had done so in the August 2 letter****—i.e.*, the Actions Taken paragraph. • The Exhibit cited by the Division is evidence that SSgA was attempting to act in the best interests of all clients. The document (1) reflects that the "to do" list "need[ed] to be guided by our <u>fiduciary</u> responsibility;" (2) any liquidation has to be done <u>pro rata</u> w/in the fund and across strategies; and (3) any decision to reduce exposure <u>has to be communicated broadly</u> (to all clients)." *Id.* (emphasis in original). The foregoing is consistent with a course of conduct intended to treat all client equally, and some of Mr. Wands' handwritten notes are consistent with discussions that subsequently took place at the July 25 Investment Committee meeting. A large portion of the handwritten notes are redacted for attorney-client privilege, which suggests that an attorney was present for the meeting and provided legal advice. *Id.* at SSP 000043884. • There is no evidence that Mr. Flannery knew any of the information reflected in those notes—it was not taken in connection with a meeting that he participated in; Mr. Wands said he believed he got the information in his notes during a meeting with the Relationship Management team. Wands Tr. at 2894:20-2895:7. • There is no evidence that Mr. Flannery knew that significant amounts of "other State Street funds" had begun redeeming by the time the letter went to clients. *See* Flannery Reply Br. at Section IV.C.1.
366	"Flannery changed the tense of the sentence concerning total return swaps and added "some" before total return swaps because the swaps had just rolled off at the end of the month of July and he wanted to clarify that only a portion of the funds' total return swaps had rolled off. (Div. Ex. 155 at SS-SEC 119621; Tr. 1052:10-1053:2 (Flannery).) When Flannery edited the letter to reflect that "some" AAA swaps had already rolled	• The Division offers no support for its statement that "less than half" of the total return swaps held by LDBF had rolled off, and there is no evidence that Mr. Flannery knew the volume of swaps rolling off when he edited the August 2 letter. Moreover, it is irrelevant whether the number of swaps rolling off was less or more than half; as Ezra Zask explained, the rolling off of swaps reduces risk, such that whether or not the fund continued to hold swaps, it was still less risky

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	off, "some" was less than half, meaning that, when Flannery made his edits on August 1, it was not only the case that the only assets LDBF could sell to meet further redemptions (i.e., AA-rated subprime bonds) were illiquid but also LDBF and State Street's other active bond funds were still highly levered through exposure to total return swaps that would not roll off until September."	when some rolled off. Zask Direct Test. at A.55-A.58. • It is false that the only assets remaining in LDBF to meet further redemptions were AA bonds, and the Division provides no support for this proposition. The fund continued to hold AAA bonds on August 1 when Mr. Flannery made his suggested edits; as demonstrated by the fact that more AAA bonds were sold on August 3. *See* Division Exs. 217 and 218 (CMY1 and CMZ5 transaction data showing sales).
367	"Flannery's edits made it clear that he knew that LDBF had sold virtually all of its AAA-rated subprime bonds."	• The Division does not provide any citation to the record for this proposition. • There is no evidence whatsoever that Mr. Flannery knew LDBF had sold "virtually all" of its AAA-rated bonds. The draft letter sent to Mr. Flannery said only that the Fixed Income team had sold a "large amount" of LDBF's AAA bonds. Div. Ex. 155 at SS-SEC 000119621. • Mr. Flannery's involvement in connection with the August 2 letter was limited to a few "suggested edits" to this paragraph, and only five words from these edits were included in the final version of the letter. *See* Flannery Post-Hearing Mem. at 53-54. Mr. Flannery did not write, request, sign, or distribute this letter. Flannery Tr. at 1316:18-23; Carlson Tr. at 2729:8-2730:4.
368	"When he edited Kohler's draft, Flannery did not change the sentence concerning risk reduction because he believed that risk had been reduced when leverage was reduced as a result of some AAA swaps rolling off and the reduction of reverse repurchase financing on LDBF's AAA-rated bonds. (Tr. 1049:19-1052:3 (Flannery).) Flannery did not remember if he was basing the risk reduction understanding off of a CVaR analysis because he did not remember if he had a CVaR analysis. (Tr. 1050:9-16 (Flannery).) However, Flannery connected the concepts of CVaR and leverage: "And the way that – that we thought about leverage internally was this concept called CVaR. And so we	• Mr. Flannery agrees with the Division's statement that he believed risk had been reduced. As the evidence shows, his belief was accurate, as each of the transactions referenced in the August 2 letter reduced risk. *See, e.g.*, Zask Direct Test. at A.61, A.38, A.39-A.43, A.46-A.49, A.55-A.58, A.62; Armstrong Tr. at 2206:9-2207:19; Flannery Tr. at 1050:17-1051:3, 1296:5-17. • Mr. Flannery was not a member of the Risk Management team, did not calculate CVaR for LDBF, and there is no evidence that the CVaR of LDBF had been reported to him when he made his suggested edits to the letter. However, Mr.

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	could produce CVaR, but the problem is it's a very advanced concept, and it wasn't something that some of these consultants or clients were – were familiar with." (Tr. 1083:9-14 (Flannery).)"	Flannery believed that risk had been reduced in LDBF has a result of the transactions, as the Division concedes, in part because reducing leverage and reducing LDBF's subprime exposure reduced risk. Flannery Tr. at 1020:22-1021:3. Moreover, whether or not the overall CVaR of LDBF rose during the relevant time period is irrelevant, as each of the transactions referenced in the August 2 letter reduced risk; without them, the overall CVaR would have been higher.
371	"When Flannery made his edits in Division Exhibit 155 he knew LDBF had sold a lot of AAA bonds. (Tr. 1053:3-6 (Flannery).) Flannery "expected that some of the cash portfolio, some of the cash in the portfolio, whether existing or recently raised through that [AAA bond sale], would be used to fund some redemptions." (Tr. 1054:11-19 (Flannery).) Flannery also admitted that the instruction of the Investment Committee was to raise 40 percent liquidity in LDBF to meet expected client redemptions. (Tr. 1054:20-25 (Flannery).)"	• While Mr. Flannery knew that the instructions given at the Investment Committee meeting were in part due to the need to raise liquidity to meet anticipated client redemptions, so did everyone else who was present at that meeting. *See, e.g.*, Flannery Ex. 92 at SSgA-SEC 000252909 (Mr. Pickett reported that there were "major liquidity concerns;" Mr. Wands stated, "[w]e need to have liquidity should the clients decide to withdraw;" Mr. Flannery noted the need to raise liquidity); *id.* at SSgA-SEC 000252912 (Everybody at the meeting agreed that there was a need to raise 30-40% liquidity in the fund by month end, based on Relationship Management's estimates of possible liquidity needs of between 25 and 50%; Mr. Duggan asked, "[d]o we sell a small portion of the AA in the next 5 days to increase liquidity because we feel there will be illiquidity issues in the future?"). Nobody knew what the amount of anticipated redemptions would be, and the instruction to raise liquidity was based on mere estimates provided by Relationship Management. Flannery Ex. 92 at SSgA-SEC 000252909 (Mr. Wands stated, "It's hard to predict if the market will to [*sic*] hold on or if there will be a large number of withdrawals by clients."); Flannery Tr. at 1278:22-24, 1289:10-20; Pickett Tr. at 1738:14-1739:1 (testifying that he did not know the amount of redemptions that were going to occur). Indeed, Relationship Management, through its discussions with clients, had provided a rough estimate of the amount of withdrawals that might be made from the fund, suggesting that between 25% and 50% liquidity would be needed to fund potential redemptions. Flannery Tr. at 1279:9-1280:22; Flannery Ex. 92 at SSgA-SEC000252910. • The evidence demonstrates that not all of the cash generated by the AAA bond

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		sale had been depleted to fund redemptions by August 2; in fact, LDBF had approximately $200,000,000 in cash on that date. *See* Div. Ex. 230 ($176 million in cash equivalent securities); Flannery Ex. 288 ($21 million in bank accounts).
372	"Flannery edited the final sentence of the Action Taken paragraph in Division Exhibit 155 to make a present statement about actions that had been taken to reduce risk instead of a future statement about actions that would be taken to reduce risk. (Tr. 1055:12-17 (Flannery).)"	• Mr. Flannery's suggested edits to the letter were intended to – and in fact did – make the paragraph more accurate. Mr. Flannery suggested adding language to the "Actions Taken" paragraph stating that recent events "indicate some deterioration in longer-term fundamentals" because he believed that what was happening was not a mere technical issue in the market, and that some fundamental weakening was occurring. Flannery Tr. at 1321:15-1322:14; Div. Ex. 155 (Mr. Flannery's suggested edits). "[A]t this point we had to acknowledge that we, in fact, had seen some signs of fundamental deterioration. I didn't want to be misleading . . . I wanted it to be accurate." Flannery Tr. at 1322:15-25 (emphasis added); *see also id.* at 1319:22-1320:9 (substituting "delinquencies" for "defaults" because there were situations where people had become delinquent on their mortgages prior to defaulting, and thus the word "delinquencies" was more accurate), 1320:10-21 (deleting description of the ABX Index as an "exchange-traded vehicle" because it was not an exchange traded vehicle and instead was traded over-the-counter), 1321:3-11 (asking that Ms. Kohler check some numbers that she had included, because Mr. Flannery "wanted to make sure that what we sent out to clients was accurate"). The change referenced by the Division in its PFOF was made because the referenced transactions had already occurred; accordingly, Mr. Flannery merely corrected the tense to make the paragraph more accurate. Flannery Tr. at 1324:4-12.
373	"On August 3, 2007 at 7:19 AM, Larry Carlson emailed Jodi Luster, who was a State Street attorney, Nicholas Mavro, and Vincent Thornton regarding the last sentence of the August 2 letter's "Action Taken" section concerning risk reduction in LDBF and funds invested in LDBF. (Div. Ex. 163.) Carlson stated in the email that the sentence was left the way it was after he showed the letter to "Sean, Mitch et al having deleted" part of the sentence from an earlier draft. (Id. At SS-SEC 132926.)	• Nobody, including Mr. Carlson, recalled the meeting the Division suggests occurred, or what was discussed. Flannery Tr. at 1064:10-13; Carlson Tr. at 2756:25-2757:2; 2701:16-2702:22; Shames Test. Stip. ¶ 4; Div. PFOF ¶ 376. Moreover, whether or not a meeting occurred does not prove, contrary to the Division's contentions, that Mr. Flannery added the "average credit quality" language to the letter — the evidence shows that it is more likely that language came from other sources. *See* Response to ¶ 375, *infra*; Flannery Post-Hearing

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	"Sean" was a reference to Flannery and "Mitch" was a reference to Shames. (Tr. 2696:25-2697:5 (Carlson).) Earlier within the email string in Division Exhibit 163, Carlson emailed Luster, Mavro and Thornton at 12:57 PM on August 2, 2007 and stated: "Per our my voice mail ... changes noted below ... going up to see Marc now. Thanks for your help." (Div. Ex. 163 at SS-SEC 132927.) The "Marc" in his email was his supervisor Marc Brown who sat on the same senior management floor as Flannery and Shames. (Tr. 2694:3-4, 2695:12-14 (Carlson).) The last sentence of the Actions Taken paragraph in this email at 12:57 PM stated: "The actions we have taken in the Limited Duration Bond Strategy will simultaneously seek to reduce risk in other SSgA active fixed income and active derivative-based strategies. (we deleted the last part which looks like it was left over)." (Div. Ex. 163 at SS-SEC 132928.) Flannery had "no idea" whether he met with Carlson and Shames and anybody else on August 2 after 12:57 PM about the letter. (Tr. 1064:10-13 (Flannery).)"	Reply Br. at Section II.C. • Only five words added by Mr. Flannery in his "suggested edits" to the "Actions Taken" paragraph were included in the letter sent to clients. *Compare* Div. Ex. 155 *with* Flannery Ex. 144 (emphasis added). After providing his initial suggestions, Mr. Flannery was never asked to review the letter again, but the letter was reviewed by Ms. Reardon, Ms. Kohler, Mr. Carlson, Mr. Mavro, Mr. Hopkins, Mr. Thornton, Ms. Shea, and Ms. Nelson as well as outside counsel Ms. Fries and Ms. Luster and in house counsel Mr. Cullinane and Mr. Shames. *See* Flannery Exs. 122, 127, 129, 130, 132, 140, 141, 142, 144; Div. Exs. 156, 158. Legal had final approval authority over the letter (Carlson Tr. at 2753:22-2754:3; Flannery Ex. 127) and was "pretty particular about what [] could/couldn't [be] change[d]." Carlson Tr. at 2759:1-16; Flannery Ex. 149.
375	"Between 12:57 pm and 3:16 pm on August 2, a new sentence was added to the "Actions Taken section of the August 2 letter. (Div. Ex. 159 at SS-SEC 116944-045, Div. Ex. 163 at SS-SEC 132928.) That sentence states: "Throughout this period, the Strategy has maintained and continues to be AA in average credit quality according to SSgA's internal portfolio analytics." (Div. Ex. 159 at SS-SEC 116944-45.) Flannery did not know where the sentence came from. (Tr. 1073:7-1074:5 (Flannery).) ***Between 12:57 pm and 3:16 pm that afternoon, Carlson met with, or showed the draft letter to Flannery, Shames, and Brown, whose offices were adjacent.*** (Div. Ex. 163 at SS-SEC 132926-27; Tr. 1300:18-20 (Flannery).)"	• The Division has conceded both that the credit quality language was true, and that Mr. Flannery believed it was true. *See* Div. Post-Hearing Br. at 431; Div. Pre-Hearing Br. at 18. • Mr. Flannery agrees he does not know where the credit quality language came from, and the Division has failed to prove that it came from Mr. Flannery. As discussed above, nobody recalls the meeting that the Division contends occurred, what was discussed, or the source of the credit quality language. Flannery Tr. at 1064:10-13; Carlson Tr. at 2756:25-2757:2; 2701:16-2702:22; Shames Test. Stip. ¶ 4; Div. PFOF ¶ 376. Mr. Flannery did not calculate average credit quality or know how it was calculated by SSgA. Flannery Tr. at 1076:2-18, 1338:16-1339:3. Not a single witness testified that Mr. Flannery added the language, and not a single exhibit shows that he did. There are numerous other sources from which the credit quality language could have come. The August 1 FAQs contained the very same credit quality language as that which appeared in the August 2 letter. Div. Ex. 153 (FAQ # 8). Mr. Carlson testified that beginning in late July, he began meeting daily with the LDBF investment team, who possessed

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		more granular knowledge of LDBF than Mr. Flannery. Carlson Tr. 2725:1-8. SSgA internal documents involving a variety of individuals also contained the average credit quality language. *See, e.g.*, Flannery Ex. 137 at SSP 003875765 (August 2, 2007 e-mail from Michael O'Hara to Mr. Flannery, Matthew Steinaway, James Hopkins, Patrick Armstrong, Michael Wands and Paul Greff attaching a memo stating LDBF's average credit quality has always been AA to AA+). • The Division misstates the record evidence it cites for the highlighted proposition. Division Exhibit 163 shows that Carlson e-mailed a draft to Luster, Mavro, Cullinane, and Thornton at 12:57 and Luster emailed back to all four of them at 1:43 that day, and states that Carlson had "shown the letter to Sean, Mitch, **et al**" (emphasis added), meaning that Mr. Carlson could have shown the letter to any number of people. Furthermore, Division Exhibit 163 does not discuss the addition of the average credit quality language.
376	"Shames handwritten notes (Division Ex. 242) reflect the drafting of the fifth sentence of the "Actions Taken" paragraph of the letter, which, in its final form, states: "Throughout this period, the Strategy has maintained and continues to be AA in average credit quality according to SSgA's internal portfolio analytics." (Div. Ex. 242; Shames Test. Stip. ¶ 4; Div. Ex. 159 at SS-SEC 000116944.) The handwritten notes state: [insert] (Div. Ex. 242.) Shames does not recall the source of the language shown in this exhibit. (Shames Test. Stip. ¶ 4.)"	• There is no evidence that the undated handwritten notes (Div. Ex. 242) were made in connection with the August 2 letter, as the credit quality language appeared in a variety of other sources at the time, including the FAQs. *See* Response to ¶ 375, *supra*. • There is no evidence that Mr. Flannery was the source of this language, which could have come from any number of sources. *See* Responses to ¶¶ 373, 375, *supra*.
377	***"Shames, Flannery, Carlson and Brown reviewed the letter during the two-hour window that the fifth sentence of the "Actions Taken" paragraph was added. (Div. Ex. 163.)*** Carlson does not recall showing the letter to, or discussing the letter with, anyone else during that time period. (Tr. 2697:22-24 (Carlson).) "Of these people, only Flannery had the knowledge necessary to draft this sentence. (See infra ¶¶ 378-382.)"	• The document used to support the bolded/italicized statement (Div. Ex. 163) does not say that any of the individuals referenced saw the letter during the window of time suggested by the Division. The exhibit states that Carlson had "shown the letter to Sean, Mitch, **et al**" (emphasis added), meaning that Mr. Carlson could have shown the letter to any number of people. Div. Ex. 163. Furthermore, Division Exhibit 163 does not discuss the addition of the average credit quality

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		language. *Id.*; *see also* Response to ¶ 375, *supra*. • There is no evidence that Flannery reviewed the letter during the two-hour window during which the Division claims the fifth sentence of the "Actions Taken" paragraph was added; nobody recalls the meeting that the Division contends occurred, what was discussed, or the source of the credit quality language. Flannery Tr. at 1064:10-13; Carlson Tr. at 2756:25-2757:2; 2701:16-2702:22; Shames Test. Stip. ¶ 4; Div. PFOF ¶ 376. • Mr. Flannery did not calculate average credit quality or know how it was calculated by SSgA. Flannery Tr. at 1076:2-18, 1338:16-1339:3.
378	"Carlson did not understand the difference between "internal portfolio analytics" and "internal risk analyses." (Tr. 2708:12-20 (Carlson).) Carlson also did not have the investment knowledge to know whether the transactions described in the August 2 letter reduced risk in LDBF. (Tr. 2711:17-2712:12 (Carlson).)"	• Whether or not Mr. Carlson had investment knowledge is irrelevant. It is undisputed that both the average credit quality language and the statements about risk reduction were in the August 1 FAQs, which were being used by he and members of his team to respond to client questions. Div. Ex. 153 (FAQs # 8, 32). Mr. Carlson also testified that beginning in late July, he began meeting daily with the LDBF investment team, who possessed more granular knowledge of LDBF than Mr. Flannery. Carlson Tr. at 2725:1-8.
379	"Flannery admitted that the sentence on portfolio analytics added to the letter on the afternoon of August 2 related to an investment fact. (Tr. 1075:22-1076:1 (Flannery).) ***Flannery also acknowledged that it was his sense at the time that the average credit quality of LDBF was AA, and he knew both that there were internal portfolio analytics and that SSgA did an internal risk analysis relating to LDBF.*** (Tr. 1076:2-18 (Flannery).)"	• As the Division concedes, Mr. Flannery believed that the average credit quality of LDBF was at least AA, information that was available in other sources at the time of the August 2 letter, including the FAQs. Mr. Flannery did not calculate the average credit quality of LDBF. Flannery Tr. at 1076:2-18 (testifying that he was not familiar with the ways that the portfolio's average credit quality was measured); 1338:16-1339:3 (same).
380	"There is no evidence that Flannery consulted with the risk group in editing or drafting any of the statements in the "Actions Taken" section of the August 2 letter. Patrick Armstrong, the head of global risk management at the time of the letter, could not recall having any role whatsoever in drafting, reviewing or approving the "Actions Taken" section of the letter. (Tr.	• As an initial matter, the Division has conceded that Mr. Flannery believed the transactions described in the "Actions Taken" paragraph reduced risk. *See* Response to ¶ 368, *supra*. Accordingly, whether or not Mr. Flannery consulted with the Risk group in connection with his "suggested edits" is irrelevant.

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	2247:22-2248:9 (Armstrong).) Furthermore, Armstrong had previously expressed his opinion that he would prefer to sell a fund's most illiquid assets first in the event of market illiquidity, which is exactly the opposite of what State Street did with regard to LDBF's bonds in late July 2007. In a September 2006 email from Wands to Armstrong, Armstrong dealt with the following hypothetical question from an investor: "If an event occurred and the spreads on the AAA and AA swaps blew out twice as far as the AA spread did in 1998, could you still hold the positions or would you be forced to sell?" (Div. Ex. 262 at SS 9168396-97.) In Armstrong's response to Wands' email, Armstrong stated: "Hello Mike, I would tell him that we recognize the inherent liquidity of positions within the portfolio, and rank them accordingly. In a 20 standard deviation even t, we would realize the need to liquidate our least liquid securities first, so as to preserve maximum liquidity should the liquidity situation deteriorate further." (Div. Ex. 262 at SS 9168396.) Armstrong's reference to a "20 standard deviation event" was referring to a period of extremely high volatility. (Tr. 2251:17-21 (Armstrong).) On December 31, 1998, AAA spreads widened to 56 and AA spreads widened to 110, which were an all time high for spreads prior to August 2, 2007 when AAA spreads were 80 and AA spreads 508, indicating a much higher level of illiquidity than the event described in the investor's example in Div. 262. (Flannery Ex. 218 at SS 4832874.) Further more, Armstrong described that the subprime market in late July 2007 as "something on this order of a 20 standard deviation event." (Tr. 2252:19-25 (Armstrong).)"	• With respect to the statements regarding Mr. Armstrong, Mr. Armstrong was present at the July 25, 2007 Investment Committee meeting where the Investment Committee voted on the measures that would be taken to raise liquidity in LDBF. Flannery Tr. at 1273:19-1274:6; *see also* Flannery Ex. 92 (listing meeting attendees). Regardless of how the Division interprets e-mail correspondence from September 2006, approximately ten months before the Investment Committee meeting, Mr. Armstrong was involved in the decision-making process at the meeting, which did not include an instruction that AAA bonds be sold. *See, e.g.*, Flannery Ex. 92. The instructions were to: "1) 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[; and] 3) reduce the AA exposure, a target of 5%, by the end of the week." Flannery Ex. 92 at SSgA-SEC 000252912. Whatever actions Mr. Armstrong may have advocated taking almost a year before the relevant time period, the Division has repeatedly represented that this is not a case about SSgA's investment decisions. *E.g.*, Div. Pre-Hearing Br. at 39-40; Trial Tr. at 839:5-840:13, 1180:4-10, 1484:1-1488:0. • Mr. Armstrong agreed that the "Actions Taken" as described in the August 2 letter reduced risk. Armstrong Tr. at 2206:9-17, 2207:5-19. • With respect to the statement regarding Mr. Flannery's role in "editing or drafting" the statements in the "Actions Taken" paragraph, the evidence shows that he made minimal, suggested edits to this paragraph, each of which made it more accurate, not less. Div. Exs. 154, 155; *see also* Response to ¶ 372, *supra*. He did not draft the paragraph, which was already in the draft letter when it was attached to an e-mail on which Mr. Flannery was copied, and in response to which Mr. Flannery made his suggested edits. Div. Exs. 151, 154, 155. Aside from making "suggested edits" to the letter on August 1, Mr. Flannery did not have any further role in connection with the Actions Taken paragraph, and he understood that a number of capable people would also be reviewing, editing and

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		disseminating the letter. Flannery Tr. at 1318:3-1319:2.
381	"As with the July 26 letter, Shames "once again rel[ied] entirely on the business people for the factual information in the letter. (Shames Test. Stip. At Tr. 249:20-250:3.) Shames' process for reviewing the August 2 letter was similar to that for reviewing the July 26 letter, but different lawyers were involved. (Id. at Tr. 100:13-101:2.) Because Duggan was out of the office, Shames included attorneys Jodi Luster and Charles Cullinane in the review process. (Id. Art Tr. 101:18-20; 102:6-8; 247:8-12.) Shames was less involved in the August 2 letter than he had been in the July 26 letter. (Id. At Tr. 102:20-103:2; 247:4-7, 21-24.) Shames did not recall whether the legal group offered advice concerning any of the facts described in the August 2 letter. ((d. at Tr. 103:17-21.) Shames did not recall the formal practice concerning sign-off on letters like the August 2 letter but assumed that, because "there's a lot of investment information within this letter," "someone from the investment team would be signing off" on it. (Id. At Tr. 106:24-107:20.)"	• Mr. Shames and Legal were provided with the relevant facts by the business people to review the letter and advise SSgA as to its legal obligations. First, he was present at the July 30 Executive Management Group ("EMG") meeting where the severity of the issues facing LDBF, illiquidity concerns, anticipated redemptions and the possibility of freezing the fund were discussed. Flannery Tr. at 1314:2-131515. Mr. Shames' Deputy General Counsel, Mark Duggan, attended the July 25 Investment Committee meeting, where similar issues were discussed, and he reported what had been discussed at that meeting to Mr. Shames. *See* Flannery Post-Hearing Mem. at 27-32. Moreover, Mr. Shames' Legal Department was responsible for reviewing and approving the FAQs, which contained extensive information on LDBF's performance as a result of subprime, and included the fact that GAA had recommended redemption to its clients. *See* Flannery Ex. 133 at SSgA-SEC 004379050 (FAQ # 31). Moreover, the Legal Department reviewed and approved LDBF II, which was announced to clients in an August 6 letter, sent just two business days after the August 2 letter. Flannery Ex. 161. The premise of LDBF II was illiquidity and protection of clients from the redemption decisions of other clients, as the letter announcing the alternative fund made clear. Flannery Tr. at 1293:19-1295:25, 1358:19-1359:11. While LDBF II was formally approved on August 3, it had been subject to a legal and other approval process that began several days earlier. *See* Flannery Tr. at 1356:18-1357:9; Carlson Tr. at 2761:8-17. • Mr. Shames testified, "I had established a framework and a process for the review of materials similar to this client communications, market commentary, so this letter, this August 2nd letter, followed that process. So members of the legal team were involved as well as Liz Fries. My memory is that Jodi Luster and Charles Cullinane had a larger role in this letter than they did in the July letter." Shames Test. Stip. at 100:13-101:2. The evidence shows that a number of attorneys, both internal and external, were directly involved in reviewing the letter including outside counsel Ms. Fries and Ms. Luster and in house counsel

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		Mr. Cullinane and Mr. Shames. *See* Flannery Exs. 127, 129, 130, 132, 136, 140, 141, 142, 144; Div. Exs. 156, 158. Legal had final approval authority over the letter (Carlson Tr. at 2753:22-2754:3; Flannery Ex. 127) and was "pretty particular about what [] could/couldn't [be] change[d]." Carlson Tr. at 2759:1-16; Flannery Ex. 149. • The evidence also shows that Mr. Shames brought "in lawyers who specifically had investment and securities experience. [A] team which [he] would have been confident in, would have reviewed the letter in a way that they thought was necessary in order for the legal group to sign-off on the letter. Shames Test Stip. at 89:21-90:2. Further, Mr. Shames explained that his "understanding was that this was an accomplished and well-experienced team of legal advisers, and that they would raise the issues and make changes, so that the letters were consistent with whatever rules and regulations [SSgA was] subject to]." *Id.* at 156:1-5.
382	***"With respect to the facts stated in the "Actions Taken" paragraph, Shames did not recall being aware of any of those facts independently of being presented with a draft of the letter. (Id. At Tr. 104:1-105:6.)*** Shames did not know whether, as of August 2, 2007, any of the actions taken by SSgA relating to LDBF had reduced risk in other SSgA funds. (Id. At Tr. 105:13-19.) Shames relied purely on the business people for the accuracy of the Actions Taken paragraph's statement regarding assets being sold. (Id. At Tr. 250:4-15.) ***Shames did not believe that anyone from the legal team was involved in reviewing which assets were being sold by LDBF in July and August 2007. (Id. At Tr. 108:3-109:8.)"***	• Mr. Shames and other members of the Legal Department were aware of the relevant issues. By August 1, the FAQs set forth described the AAA sale had occurred and swaps rolling off at the end of July as measures SSgA had taken to reduce risk, the fact that the fund's average credit quality was AA, the fact that GAA had recommended redemption, and the fact that liquidity was a concern. Div. Ex. 153 (FAQs # 32, 8, 31, and 13). Mr. Duggan had reported to Mr. Shames what had happened at the Investment Committee meeting, as discussed above. Mr. Shames was present at the July 30 Executive Management Group ("EMG") meeting where the severity of the issues facing LDBF, illiquidity concerns, anticipated redemptions and the possibility of freezing the fund were discussed. Flannery Tr. at 1314:2-131515; *see* Responses to ¶¶ 371, 381, *supra*. • Furthermore, the Division misstates the record evidence it cites for the highlighted propositions. Mr. Shames testified that he did not recall ***whether or not*** he was aware of these facts independently of looking at the letter. With regard to the last highlighted sentence in the Division's Proposed Finding of Fact, Mr. Shames testified "You know, again, I had assembled the team, and ***I wasn't***

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		aware of who they were talking to, what they were analyzing, so I don't know. I have confidence that they did what they needed to do to sign-off on this. Shames Test. Stip. at 108:3-109:8. (emphasis added).
383	"The August 2 letter was materially misleading because it omitted the fact that LDBF had higher liquidity risk because the cash generated by the sale of LDBF's AAA-rated bond had already been used to meet investor redemptions."	• The cash generated as a result of the AAA sale was not depleted to meet redemptions by August 2. The evidence shows that there was nearly $200 million in LDBF as of August 2nd. According to Division Exhibit 230, the Navigator Reports from August 2nd that were relied upon by the Division's expert Professor Wermers, there was $175 million of cash equivalents in the LDBF. In addition, there was another $20 million of cash in the Daily Trial Balance Reports. Flannery Ex. 288; *see also* Flannery Post-Hearing Reply Br. at Section II.A.1. The unrebutted testimony of the Respondents' expert, Ezra Zask, reflects that the AAA bond sale reduced risk in the portfolio because it (a) reduced LDBF's exposure to subprime, (b) reduced leverage, and (c) increased the amount of cash in LDBF; the evidence further reflects that SSgA was able to maintain the average credit quality of the portfolio while meeting client redemptions. *See* Flannery Post-Hearing Mem. at 75-79.
384	"Wermers' charts (Div. Ex. 245) III.A (showing daily net sales of bonds by rating category) and III.B (showing portfolio percentage allocation to bonds by rating category) demonstrate the repositioning of the fund after the July 26 AAA bond sale. Wermers III.B also demonstrates the drawing down of cash raised from the sale. Wermers II.B demonstrates that, by August 2, cash redeemed from LDBF was going predominantly to State Street's internal advisory group clients and the other State Street funds that were invested in LDBF. As that chart demonstrates, investors advised by GAA and OFA (the red "ADV" line) largely redeemed from LDBF on July 27 and August 2: [chart]. 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. In addition to $5,836,901 in dividend reinvestments in the Fund on September 28, 2007, "independent investors" also made	• *See* Flannery Post-Hearing Reply Br. at Section II.A.1.

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	purchases of LDBF after 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. (Div. Exs. 229 at p.60- and 231 at p. 27 and p. 32)."	
386	"LDBF ***received*** $431,932,795 from the sale of its AAA-rated bonds. (Supra at ¶ 291.) This cash was depleted by August 2. From July 27, which was the day after the AAA-rated bond sale, to August 2, there were $486,353,751 in total cash redemptions from LDBF. (Div. Ex. 229 at pp. 58-59; Div. Ex. 231, pp. 26-27.) There were no in-kind redemptions from LDBF ERISA until August 3 (Div. Ex. 229), and there were no in-kind redemption from LDBF CTF until August 10 (Div. Ex. 231)."	• The amount of proceeds is incorrect, and it was not depleted by August 2. Div. Ex. 230; *see* Flannery Reply Br. at Section II.A.1. • LDBF did not sell $1,592,148,795 of AAA bonds. Div. Post-Hearing Br. at 25. Respondents' expert, Mr. Zask, used the bid list of the AAA bonds sent to Citigroup to match up the actual bonds in the SSgA transaction data to determine the correct amounts. *See* Flannery Ex. 299 at Zask Ex. 5. Similarly, the Division's statement that the AAA bonds were subject to $1,160,216,000 of repo loans is also incorrect. Div. Post-Hearing Br. at 25. Because its proceeds and repo amounts are both incorrect, the Division's calculation of net proceeds of $431,932,795 is also incorrect. *Id.* • The correct amounts for the AAA sale can be found at Exhibit 5 of Mr. Zask's report, which shows that on July 26, 2007, LDBF sold $1,631,892,115 of AAA bonds for $1,542,333,580 of which $1,118,802,100 was used to pay repo loans, resulting in net cash proceeds of $423,531,480.
388	"Wermers described why AAA subprime bonds were more liquid than AA bonds in the July to August time period. He explained that AA ABS are "riskier" "[b]ecause a double A is set up to protect a triple A from things like default risk or excessive prepayment of mortgages. The triple A is the most protected class in the structure." (Tr. 745:1-8 (Wermers); Hopkins Ex. 161, Ex. 7.) Even AAA subprime bonds could default if enough of the underlying subprime mortgages defaulted. (Tr. 745:9-13 (Wermers).) Relying on a chart of Floating Rate Home Equity Loan Spread from December 26, 1997 through August 2, 2007, Wermers also testified that, during the July to August 2007 time period, AA-rated subprime	• Mr. Wermers did not provide any basis for his testimony, and it is unclear how he reached this conclusion. Mr. Wermers also was not offered by the Division as a witness for this purpose, nor is it clear that he has expertise as to this issue. *See* Div. Witness List, filed with the Court on January 31, 2011, at 5. *See generally* Wermers' Direct Testimony. Mr. Sirri, who does have expertise on this issue and was offered for the purpose of discussing the credit quality of the portfolio, by the Respondents, describes the basis for his conclusions as to what happened leading up to and during July and August 2007 at some length. *See generally* Sirri Report.

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	bonds became more illiquid as measured by their spreads relative to LIBOR because there was a flight to quality. (Flannery Ex. 218 at SS 4832874; Tr. 745:14-748:6 (Wermers).)"	
389	"Flannery testified that if he had been an investor in LDBF at the end of July 2007, he would have been interested in knowing that the AA-rate bonds held by LDBF were illiquid. (Tr. 1011:16-21 (Flannery).)"	• Mr. Flannery also testified that there were liquidity issues throughout the portfolio and that the illiquidity in the market "was all over the press." Flannery Tr. at 1011:7-15. The August 2 letter, in fact, explains that AA and AAA-rated bonds in the portfolio experienced negative performance in July as the "spread widening" moved up the credit structure into higher-rated bonds. Div. Ex. 159 at SS-SEC 000116943 (also referencing pressure on asset values). The corresponding FAQs that were released around the time of the letter provided further information on the spread-widening that had occurred in the AA and AAA tranches. Flannery Ex. 133 at SS004379050. • Furthermore, the AA bonds were not entirely illiquid. AA bonds were sold for cash after August 1, when Mr. Flannery made his suggested edits. *See* Div. Exs. 217 and 218 (CMY1 and CMZ5 transaction data showing sales).
390	"On August 3, 2007, James Dupont, a client service representative, asked Carlson and Mavro whether he could add a sentence to the August 2 letter stating that: "It should also be noted that our Asset Allocation Team has made the decision to reallocate exposure from the active fixed income funds to our passive fixed income funds for all discretionary accounts." (Flannery Ex. 149 at SS 3707128.) ***Mavro responded and instructed Dupont to leave the sentence out of the letter, although Mavro added that "[c]ertainly when you speak to the client on the phone you can mention that." (Id. At SS 3707126.)*** Carlson agreed that the email messages indicated at least one client relationship manager thought that clients would want to know about the GAA redemptions. (Tr. 2782:24-2783:8 (Carlson).)"	• Mr. Mavro's e-mail states: "For the time being please leave that sentence out of any communication. ***Legal was pretty particular about what we could/couldn't change***. Certainly when you speak with the client on the phone you can mention that." Flannery Ex. 149 (emphasis added). It was Legal who was controlling whether information could be added to the letter. • Moreover, the information about GAA's recommendation was already included in the FAQs, which Legal had approved. Div. Ex. 153; Flannery Tr. at 1361:17-1362:2 ("The process was expressly set up such that every question had to be approved and vetted by the Legal Department . . . ."); Carlson Tr. at 2743:2-11 (Legal had to approve FAQs before they could be used with clients); Shames Test. Stip. at 169:1-3.
391	"LDBF's CVaR actually increased from June 1 to August 2, 2007. A presentation that Flannery and others made on October	• The August 2 letter does not claim that the overall CVaR of the LDBF portfolio

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	18, 2007 to the State Street Corporation Board of Directors demonstrated that the CVaR of LDBF increased from around 100 on June 1, 2007 to around 400 on August 1, 2007: [chart] (Division Ex. 185 at SS 9157104) Pickett testified that this chart was consistent with his recollection that the CVaR of LDBF increased in the summer of 2007 because "[w]ith the pricing of the securities, the CVaR went up, went upward... The CVaR of the underlying assets went up, as well as the CVAR's for the portfolio as a whole." (Tr. 1701:13-1702:14 (Pickett).)"	was decreasing during this time period. Rather, the point made in the August 2 letter, and verified by Respondents' expert Mr. Zask, is that the three transactions reduced risk, that is, each of them resulted in lower risk in the portfolio than there would have been in the absence of the transactions. *See* Flannery Post-Hearing Mem. at 75-78. The increased CVaR in the portfolio was a function of the dramatically high and growing levels of volatility in the market. Lindner Tr. at 1960:14-1961:18; Pickett Tr. at 1754:6-11; Flannery Tr. at 1491:1-16. That the overall CVaR of the LDBF portfolio increased, despite the risk-reducing impact of these three transactions, does not change the fact that the transactions were intended to reduce risk, had that effect, and ***risk would have been higher had they not occurred***. Pickett Tr. at 1701:18-1702:15, 1745:14-24; Lindner Tr. at 1963:19-1964:20; Flannery Tr. at 1491:1-16; *see* Response to ¶ 399, *infra*.
392	"Regarding an increase in LDBF's leverage in July 2007, Wands testified that the CVaR of LDBF would have been higher after July 1, 2007 if total return swaps were rolled over as opposed to rolled off. (Tr. 2934:25-2935:12 (Wands).) Total return swap positions were in fact rolled over on July 1. (Div. Ex. 253 (reflects LDBF's total return swap positions on June 30 as compared July 18).) Specifically, this data reflects that *on both June 30 and July 18*, the two LDBF funds held $2,833,615,000 in AAA-rated total return swaps and $192,770,000 in AA-rated total return swaps. (Division Ex. 253 at p.4, column I, rows 191-192 and 199-200 and p.9, column I, rows 187-188 and 195-196.)"	• The Division's Proposed Finding of Fact is confusing and irrelevant, though it does support the proposition that allowing total return swaps to roll off at the end of the month would reduce the amount of leverage in the portfolio. The evidence reflects that the transaction being referenced in the August 2 letter is the total return swaps that rolled off ***at the end of July 2007***. Zask Direct Test. at A.53, Ex. 8. • Because total return swaps are a form of leverage, the expiration of the swaps at the end of July 2007 was a "natural deleveraging" event for LDBF. Flannery Tr. at 1292:15-1293:2; Div. Ex. 248 at SSP000105535; Hopkins Tr. at 141:1-7; Wands Tr. at 2897:3-11. Moreover, as Mr. Zask explained, "[r]olling off LDBF's TRS lowered the fund's overall risk. The TRS exposed the fund to the risks of the subprime mortgage market. As a result of the TRS' expiration, the TRS notional exposure to the subprime mortgage market was eliminated and market risk decreased." Zask Direct Test. at A.55; *see also id.* at A.56, A.58, Exs. 8-9; Pickett Tr. at 1753:12-21. The fund's credit risk also decreased. Zask Direct Test. at A.57; *see also* Wands Tr. at 2897:3-11 (explaining that swaps rolling off reduce leverage and exposure to the asset class).

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		• The Division has repeatedly represented to the Court that this is not a case about whether LDBF was a good investment strategy. *E.g.*, Div. Pre-Hearing Br. at 39-40 ("The wisdom of investing in subprime in 2007 is not an issue for this tribunal to decide"); Flannery Tr. at 839:5-840:13, 1180:4-10, 1484:1-1488:9. That the Fixed Income team made the decision to allow the swaps to roll over at the end of June is irrelevant as it pertains to the claims against Mr. Flannery in this case.
395	"For the CVaR data in the portfolio analytics, Pickett testified that "there were time series calculated by the risk department that calculated the mean return, the worse case, the VaR, the CVaR, and we would use those." (Tr. 1589:13-20. (Pickett).) Given the example of an AAA-rated residential mortgage backed security held by LDBF, Pickett did not determine the CVaR figure, and "relied on [the] risk group to run it at the different quality levels... [T]he risk group performed their calculations and housed them somewhere in a database. (Tr. 1590:3-20 (Pickett).) The specific CVaR figures for AA and AAA-rated bonds in the portfolio analytics (Div. Exs. 251, 252, and 253), came from the risk group and were provided by someone on the risk team who figured out what the numbers should be. (Tr. 1713:8-1714:11 (Pickett).) Because the CVaR figures might not be updated in the spreadsheet more than once a month, Pickett did not know whether the CVaR figures for AA and AAA-rated bonds as of July 30, 2007 in Division Exhibit 252 were accurate CVAR figures as of that date. (Tr. 1714:12-1715:11 (Pickett).)"	• Mr. Pickett testified that either he or the risk group ran the CVaR figures. Pickett Tr. at 1713:8-1714:11 ("I mean I've run it as well. I know it, and I've helped them with the data."). • The Division also misstates the record evidence cite for the last sentence in the Proposed Finding of Fact. Mr. Pickett testified that the CVaR figures were updated "throughout the month" in normal periods and starting in February 2007 they were run "daily" and that he may have put the CVaR figures being run by Risk Management into his portfolio analytics spreadsheet daily. Pickett Tr. at 1714:12-1715:11. Thus, the CVaR figures were run more frequently (*i.e.*, daily) starting in February 2007. That Mr. Pickett could not "prove" that the data in the July 30 spreadsheet (Div. Ex. 252) was updated on July 30 is not surprising given that this was a spreadsheet that he used for his own internal purposes nearly four years ago. • Assuming the data was updated monthly as the Division contends, it is unclear how this relates at all to Mr. Flannery or Mr. Zask's conclusions that the transactions referenced in the August 2 letter reduced risk. As to Mr. Flannery, there is no evidence to suggest that he was aware of how frequently the CVaR information was being updated. As to Mr. Zask, his unrebutted testimony demonstrated that each of the three transactions – the AAA bond sale, the offset of the BBB ABX Index swaps, and allowing the total return swaps to roll off – reduced risk in the LDBF portfolio as measured by several different metrics. First, each of these transactions reduced exposure to subprime, which had become an increasingly risky investment in the Summer of 2007. Second, each

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		of the transactions reduced market risk as measured by CVaR. Third, these transactions decreased credit and liquidity risk. • With respect to CVaR and whether the figures were updated more than once a month, Mr. Zask expressly rejected the argument being advanced by the Division in its Proposed Finding of Fact: Q You didn't look to do anything to determine whether the CVaR figure in this spreadsheet for AA bonds was [stale or not updated], did you? . . . . JUDGE MURRAY: No. I think that's contrary to the witness's testimony. Staleness is not an element in this. I don't mean to--- A No. That's exactly right. Stale, again, the critical input here [in a CVaR calculation] is the expected shortfall, and the expected shortfall is based on five years' worth of data. So that the fact that LDBF markets were volatile for one day, hypothetically, the effect on expected shortfall is trivial; it would be hardly even measurable. So don't see – and this is done as of July 30th. So it's current – it's a current snapshot at that time. So I think – I don't think staleness is a factor in this analysis. Zask Tr. at 2317:5-2318:2. Ultimately, though, Mr. Zask made clear: I never argued – my argument the risk was reduced is not based on this [internal portfolio analytics chart]. My

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		argument – ***I very extensively talked about why I think the risk was reduced [in my Direct testimony]; it had to do with liquidity, credit risk consideration, leveraging, exposure to the subprime marketplace.*** I mean the main reason I think risk was reduced is laid out pretty clearly in the [August 2 letter]. Which was – lays out very clearly that the subprime market is deteriorating and the portfolio – and the way to deal with it is to reduce exposure to the subprime mortgage market. CVaR, the CVaR is just a statistical model. That's all it is. ***My conclusion – my conclusion that risk was reduced is not based on this calculation or the model or anything like that.*** Zask Tr. at 2328:3-17 (emphases added); *see also* Response to ¶ 399, *infra.*
397	"When asked whether the CVaR figures for LDBF's bonds were being updated on daily basis during the volatile July 2007 period, Lindner explained: "[W]e only did it – we did it for the ABX and the TRS positions for the – for the bond positions, the internal systems used the internal data which – that were in the database or if we used Point system output that was based on the Lehman risk model based on monthly frequencies." (Tr. 1950:17-25 (Lindner).) Lindner explained that the risk group only updated increases in AA and AAA-rated bond spreads with monthly information even though, as Armstrong explained, "the recommended way of capturing" new information in the context of home equity bonds in 2007 was to update CVaR figures with more current data "[a]s instruments become more volatile or the market becomes more volatile." (Tr. 1951:6-17 ("there was no daily update on the underlying data to compute CVaRs at that point for the bonds") (Lindner); Tr. 2225:17-2226:4	• *See* Response to ¶ 395, *supra.*

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	(Armstrong).)"	
398	"***The higher liquidity risk of owning only AA-rated RMBS bonds after the July 26 AAA sale is also evidenced by the cost of forced liquidations when State Street was forced to sell the AA-rated bonds throughout August 2007 in order to meet additional redemption requests.*** The October 18, 2007 presentation by Flannery and others to the State Street Corporation Board of Directors contained a slide called "Cost of Liquidation: How Much Did Forced Liquidation Cost LDBF." (Division Ex. 185 at SS 9157106.) The slide indicated that the most significant losses in LDBF were caused by the sale of illiquid AA bonds in August 2007, whereas the sale of LDBF's AAA bonds in July 2007 only had a 3% impact on LDBF: [chart] (Id.) Pickett interacted with a team that analyzed the cost of forced liquidations in LDBF in the summer of 2007. (Tr. 1703:7-1704:4 (Pickett).) The percentage of loss on the AA-rated bonds shown in this chart was consistent with Pickett's recollection and made sense to him. (Tr. 1705:2-20 (Pickett).)"	• There is no testimony explaining how the chart relied on by the Division (Div. Ex. 185 at SS 009157106) was prepared or what it means. Mr. Flannery testified that the chart was "controversial" at the time it was prepared because "this would have been extremely difficult to produce, and I guess that's why [the chart says] 'approximate fund impact.'" Flannery Tr. at 1120:24-1121:7. Neither Mr. Flannery nor any witness knew the methodology used to calculate the estimates appearing on that chart. *Id.* at 1122:13-1122:19. Mr. Pickett could only speculate as to what was reflected in the chart, he did not know how it was prepared, either. Pickett Tr. at 1702:13-1705:20. Ultimately, it is unclear what the chart really means in terms of the effect the change in market conditions, or forced liquidations, had on LDBF.
399	"After the August 2 letter was sent to investors, Lindner undertook a project for Flannery to determine how the risk of LDBF had changed from July 25 to July 31. (Flannery Ex. 160.) On August 5, 2007, Armstrong emailed Linder (sic) wondering "whether the riskiness of the portfolios had gone down," and Armstrong told Linder (sic) "that Mr. Flannery wanted" an analysis of the change in portfolio risk over the period. (Flannery Ex. 160; Tr. 1939:16-1942:9 (Lindner).) Lindner responded to Armstrong that "for the remaining AA- and AAA-rated cash bonds, I suggest using the ESF that we apply to the AA- and AAA-RMBS index, respectively." (Flannery Ex. 160 at SS 003117631 5.) "ESF" is equivalent to CVaR, and Lindner's analysis for Flannery was to calculate changes in portfolio CVaR. (Tr. 1943:6-24 (Lindner).) ***As part of Lindner's CVaR analysis he was asked to include the CVaR of any cash equivalent raised from the AAA bond sale during this period, and no one told him to assume the cash would leave the fund in a few days.*** (Tr. 1944:12-1945:6 (Lindner).)"	• The Division assumes facts not in evidence in the highlighted proposition. As set forth above and as discussed in Mr. Flannery's Reply Brief, all of the cash from the AAA had not left the fund by August 2; there was hundreds of millions of dollars in LDBF to meet client redemptions and maintain the risk profile of LDBF. Flannery Post-Hearing Reply Br. at Section II.A.1; *see also* Flannery Ex. 180 at SSgA-SEC 000252967-68 (Mr. Greff reporting to the Investment Committee on August 8 that SSgA had met client redemptions while maintaining the risk profile in LDBF). • Mr. Lindner testified that he does not know when cash left LDBF. Lindner Tr. at 1958:3-14. Division Exhibit 167, however, bolsters Mr. Flannery's conclusion that there was ample cash in the fund as of July 31, contrary to the Division's claim. Specifically, ***that Exhibit reflects that there was over $275 million in cash in CMZ5, which represented 24.6% of the total assets in LDBF; and over $51 million in cash in CMY1, which represented over 39% of the total assets in CMY1 as of July 31.*** Div. Ex. 167 at SS 000463146, SS 000463148. Thus, the day before Mr. Flannery made his suggested edits to the August 2 letter there was

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		more than $325 million in cash in LDBF. To the extent this project was ever delivered to Mr. Flannery, it would have demonstrated to him that there was ample cash in the fund which, in fact, was the case. • Mr. Lindner corroborated the testimony of Respondents' expert Mr. Zask, testifying that the transactions referenced in the August 2 letter reduced risk in LDBF. Lindner Tr. at 1963:10-1964:20. • Mr. Lindner testified that CVaR is a function of volatility itself, and that it was "easily possible" that even if transactions were executed that reduced leverage or other risks, CVaR may nonetheless increase because of market events. Lindner Tr. at 1960:10- 1961:9. Mr. Lindner specifically testified that developments in the subprime market in late July and early August may have been a factor in causing CVaR to increase. *Id.* at 1961:11-18. • Professor Wermers' chart (III.A) demonstrates that additional securities (AA and A) were sold throughout July and August in order to increase liquidity. Pickett Tr. at 1749:15-1750:17; Wermers Tr. at 710:11-22; Lindner Tr. at 1958:15-1959:9. The cash generated by these sales, as well as the cash from the AAA bond sale, was reduced *pro rata* to pay redemptions in proportion to the overall market value of the fund. Pickett Tr. at 1750:18-22.
400	"Lindner also emailed Armstrong on August 5 and stated: "We sold all AAA-bonds, so risk reduction was not proportional to notional reduction. To my knowledge, no TRS were sold. With clients leaving the fund, risk may not have been reduced much." (Flannery Ex. 158 at SS 003176447.) Lindner thought that this email was part of the same project to analyze LDBF's risk that he was engaged in for Flannery. (Tr. 1945:14-23 (Lindner).) Lindner also testified that, during this time period, LDBF's AA-rated subprime bonds had lower liquidity and, assuming CVaR was reflecting increases in spreads, had an increasingly higher CVaR figure than LDBF's AAA-rated bonds. (Tr. 1947:9-25 (Lindner).)"	• *See* Responses to ¶¶ 391, 392, 395, and 399, *supra*.

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401	"Regarding his August 5, 2007 email (Flannery Exhibit 158), Lindner also testified: Q All right. Going back to your e-mail that you have in 158, you conclude with "With clients leaving the fund, risk may not have been reduced much." What are you referring to? A Yeah, the fact that we had these sales of the triple A bonds which probably, you know, they may have resulted in a significant increase of cash, but then over – we probably had clients leaving funds every single day. So the cash had to be paid out to those clients. So you might have a risk reduction on July 31 and August 1, but with every succeeding day, if you didn't sell more positions and/or swaps rolled off and so on, you could be back – your risk would be increasing with the outflows. Q It depends what's happening to the cash, right, whether it's sitting there or going out to clients? A That is correct… Q You have a recollection that there was a large triple A bond sale on July 26 or thereabouts – A Yes, I do. Q – within the LDBF portfolio? Q Okay. If all of the cash from that triple A sale went out to meet redemptions, based on what's left in the fund after that, what happens to CVaR based on your recollection of what's left in the fund? A It would increase. (Tr. 1953:20-1955:24 (Lindner).)"	• *See* Responses to ¶¶ 391, 392, 395, and 399, *supra*. Professor Wermers' chart (III A) demonstrates that additional securities were in fact sold in a pro rata manner in accordance with the Investment Committee instructions as redemption requests came in.

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403	***"Second, the CVaR of LDBF increased after the AAA bond sale because investors' redemptions from LDBF after the AAA sale were satisfied with the disproportionate share of cash from the AAA sale as opposed to cash raised from the AA bonds that remained in the fund.*** Division Exhibit 245, III.B. reflects that the increase in "cash equivalent" investments in LDBF from the July 26 sale was extinguished by August 2 during a period where the percentage of AA bonds held by LDBF continued to increase. Division Exhibit 245, III.A. and III.B. demonstrate that there was not a significant sale of LDBF's A bonds until after August 2 when there was virtually no other asset left in the fund to sell to meet redemptions."	• *See* Responses to ¶¶ 391, 392, 395, and 399, *supra*. • The Division's PFOF is misleading and not supported by the evidentiary record. The cash from the AAA sale was not "extinguished" by August 2. *See* Flannery Reply Br. at Section II.A.1. Further, the Investment Committee instructions were never intended to be satisfied in one day; it was understood that in a difficult market the transactions would be executed over time. *See* Flannery Tr. at 1030:11-1031:4. As Mr. Pickett testified, though, the goal of the Investment Committee instructions was to act in the best interests of all clients. Pickett Tr. at 1751:24-1752:25.
404	***"Finally, the CVaR of LDBF increased after the AAA sale because LDBF's remaining assets were more volatile than the mix of assets held by LDBF before the sale.*** According to LDBF's July 18, 2007 portfolio analytics, the CVaR of LDBF's AA-rated ABX position was updated from 31 to 210 after 91% of this investment was sold between July 13 and July 16. (Division Ex. 253 at p.9, column M, rows 207-208 (reflecting 31 as the CVaR figure for AA ABX on June 30, 2007) and p.4, column M, rows 207-208 (reflecting the change in AA ABX CVaR to 210 on July 18).) In contrast to the CVaR of LDBF's AA-rated bonds remained at 31 over the same period (Division Ex. 252 at p.6, column M, rows 403-404) because the CVaR of LDBF's bonds was only updated once per month. (Tr. 1950:11-1951:17 (Lindner).) ***If the CVaR of LDBF's AA-rated bonds was updated to match the increase in the CVaR of LDBF's AA ABX position, the CVaR of LDBF on July 30, 2007 would actually have been much higher***. Attached hereto as Exhibit C is a demonstrative showing that LDBF ERISA would have had a CVaR of 222.5 instead of 112.6 LDBF CTF would have had a CVaR of 182.7 instead of 85.6."	• *See* Responses to ¶¶ 391, 392, 395, and 399, *supra*. • The Division does not explain why it is appropriate to take the CVaR of one security (AA-rated bonds) and match it to the increase in CVaR of another securitiy (AA ABX position). While it is true that if you change the inputs in the CVaR spreadsheet you will get different outputs, the Division has offered no explanation as to why it matters or is appropriate to do here. Even if one were to assume it were appropriate, it does not undermine the unrebutted expert testimony of Mr. Zask, which is that the transactions reduced risk by a number of different metrics and that the CVaR would have been higher had the risk-reducing transactions not occurred.
405	"In sum, there are several reasons why there was an exponential increase in the risk of LDBF as measured by CVaR during the period between the July 26 AAA sale and August 2. These	• *See* Responses to ¶¶ 391, 392, 395, and 399, 404; *supra*. Again, the Division ignores the unrebutted testimony of Mr. Zask that the transactions referenced in

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	reasons include: 1) cash raised from the AAA bond sale had been used to meet redemptions; 2) the CVaR figures for AA bonds, which were virtually the only asset held by LDBF after the July 26 AAA sale, were much higher than the CVaR figures for AAA bonds; and 3) the CVaR figures for the assets left in LDBF after the July 26 AAA sale and the subsequent redemptions in late July and early August (i.e., AA bonds and total return swaps on AA and AAA bonds) caused substantial risk to investors remaining in LDBF after August 2. It was thus false to state in the August 2 letter that the actions State Street had taken up to August 2 had actually reduced the risk to investors who continued to hold LDBF shares. Even State Street's client service personnel recognized this. Carlson testified that he thought the August 2 letter was trying to give clients some comfort that State Street was doing what it could to reduce risk, but if the cash generated from the AAA bond sales described in the August 2 letter had already left the fund, then a client might have a false sense of comfort. (Tr. 2787:18-2788:9 (Carlson).)"	the August 2 letter reduced risk.
408	"Flannery's initial email in Division 160 was an offer to client-facing personnel to help out with communications with clients. (Tr. 1078:17-24 (Flannery).) Given the seriousness of the problems with LDBF and the related funds, Flannery thought clients should hear from the CIO on these issues. (Tr. 1079:10-15 (Flannery).) Flannery recalled conversations with Carlson, Reardon or other client relationship people about "the fact that clients weren't feeling – or there were a number of indications that clients weren't feeling like they were getting the information that they needed, they sort of felt that we were being a little distant from the situation, and, you know, they were of course unhappy with that." (Tr. 1079:24-1080:11 (Flannery).) Flannery's reference in his response to Carlson to "confusing signals" referred to the way in which a portfolio's use of leverage was being described to clients. (Tr. 1081:6-9 (Flannery).) When he learned that clients thought SSgA was being cavalier and they wanted to know that SSgA was serious about the situation, Flannery decided that "perhaps I should just stand up and write a letter." (Tr. 1087:1-15 (Flannery).)"	• *See* Response to ¶ 368, *supra* (regarding leverage and explaining leverage). • Mr. Flannery volunteered to send what became the August 14 letter to clients. Flannery Tr. at 1370:1-5, 1377:25-1378:3. He volunteered to write it because "I wanted our clients to know that I was taking responsibility for what happened and trying to explain it to them and that we took it seriously. We understood how disappointed they were likely to be." *Id.* at 1377:25-1378:3. Mr. Flannery explained that the magnitude of the situation was like nothing SSgA had ever seen and "instead of everyone sort of scurrying around and, you know, answering in bits and pieces, I felt like somebody needed to stand up and raise their hand and say: It's me. I stops with me. And so I just felt very strongly about that." *Id.* at 1378:25-1380:5. Mr. Flannery volunteered despite the fact that his boss, CEO Bill Hunt, initially told Mr. Flannery he did not think it was a good idea. *Id.* at 1370:6-1371:5. Mr. Hunt ultimately agreed it was a good idea for Mr. Flannery to send the letter. *Id.* Mr. Flannery discussed his idea for the letter with Mr. Shames, who provided guidance on what Mr. Flannery could and could not say in

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		the letter, including that he could not apologize for the situation, that he should avoid forward-looking references, and that he should not give advice. *Id.* at 1371:6-1372:3. Mr. Carlson also told Mr. Flannery that he thought writing the letter was a good idea. Carlson Tr. at 2764:6-10:2766:5-8.
409	"Flannery believed that Division Exhibit 165 is the first draft of the August 14 letter. (TR. 1087:19-22 (Flannery).) When he wrote this draft, Flannery was trying to respond to the client concerns Carlson had identified in Division Exhibit 160, and, when he drafted the letter, he was aware that clients were perhaps confused about how leverage affected the exposures of LDBF. (Tr. 1087:23-1088:6 (Flannery).) Flannery also admitted that the draft letter did not say anything at all about the total subprime exposure in LDBF. (Tr. 1089:17-1090:4 (Flannery).) In his hearing testimony, Flannery explained that the letter did not describe LDBF's total subprime exposure because the intent of the letter was to take responsibility for horrible performance. (Tr. 1091:1-11 (Flannery).) ***However, in his March 5, 2009 investigative testimony when asked why the letter did not say anything about total subprime exposure in LDBF or any funds invested in LDBF, Flannery testified: "We were describing the market background there. I don't think typically in an illiquid market it's a good idea to – first of all, I don't know if I thought about that issue, but if, as I reflect on it now, 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." (Tr. 1092:14-1093:1.)"***	• *See* Response to ¶ 368, *supra* (regarding leverage and explaining leverage). The evidence reflects that the FAQs were updated to make detailed leverage information available to clients prior to August 14. • Mr. Flannery's investigative testimony was offered for the purposes of impeachment and is not part of the evidentiary record in this case. Flannery Tr. at 1092:14-1093:12. Further, the Division mischaracterizes his investigative testimony. Mr. Flannery specifically testified that he did not recall thinking about whether it was good to telegraph a position to the market when he drafted the August 14 letter, he was only stating that was his observation in 2009 during his investigative testimony. Flannery Investigative Testimony at 620:4-25. Notwithstanding Mr. Flannery's observation in 2009, the August 14 letter did telegraph LDBF's position in the market. Div. Ex. 176 at SS-SEC 000087632 (discussing "downside of forced selling in this chaotic and illiquid market"). The letter also discloses redemption activity, and that liquidity was a source of concern: "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***." *Id.* at SS-SEC000087633 (emphasis added). The foregoing sentence from the August 14 letter "telegraphs" to the market that (a) investors had and may continue to redeem their investments from LDBF; and (b) LDBF was being negatively impacted by the pervasive illiquidity issues in the market. • In response to the impeachment question at trial, Mr. Flannery agreed that the Division had accurately quoted his investigative testimony but stated that his investigative testimony was not a complete answer to the question he had been asked during his investigative testimony. Flannery Tr. at 1092:14-1093:3 ("Yes,

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		but that's not a complete answer."). *See* Responses to ¶¶ 383, 395, *supra* (regarding exposure to subprime). That LDBF was invested primarily in subprime was public information, and Mr. Flannery was aware that Relationship Management had been provided with significant information concerning the extent of subprime exposure so that they would share it with investors as they determine appropriate given that investors needs. *See* Responses to ¶¶ 383, 395, *supra*.
411	"Flannery testified that he sent his first draft to Duggan for his review, but Flannery could not recall providing Duggan with any additional facts to assist in his review. (Div. Ex. 165; Tr. 1096:10-1097:6 (Flannery).) Flannery also did not recall ever discussing decisions made by GAA or OFA with Duggan. (Tr. 1509:3-5 (Flannery).) Nor did Flannery recall having a conversation with Duggan in the context of editing the August 14 letter about State Street's funds that had been invested in LDBF redeeming from LDBF. (Tr. 1509:19-23 (Flannery).)"	• Mr. Flannery testified: "I don't know what factual information I gave him, but Mark Duggan had been at the investment committee meeting the week before where we went through in agonizing detail what was planned, the potential redemptions and how we came up with that figure, and, you know, Mark Duggan had a lot of exposure to -- to other members of the fixed income team. So -- and he also, by the way, had been the one signing off on the FAQ's all the way through. So Mark Duggan had a lot of facts, and certainly had -- had every opportunity to ask for more if he needed more. But I don't know what I provided him in terms of facts beyond this." Flannery Tr. at 1096:10-1097:6. He further said in response to the question: "You never had any discussions with Mr. Duggan about those two groups' decisions, did you?" that "I don't know if I did or I didn't." *Id.* at 1509:3-5. Finally, Mr. Flannery actually said in response to "Had you had a conversation with Mr. Duggan in the context of editing the August 14 letter about the SSgA funds getting out of LDBF?" that "I don't recall one but it's obvious enough to me ***that he did know***." *Id.* at 1509:19-23 (emphasis added). • Mr. Flannery did not believe that Mr. Duggan's "many judicious investors" language was at all inconsistent with the decisions by the advisory groups GAA, OFA, and CAM to recommend redemption, because "many judicious investors" plainly did not mean that every judicious investor would remain invested. *E.g.*, *id.* at 1098:8-1098:23, 1387:25-1389:12, 1412:16-1413:7. GAA's redemption recommendation had already been disclosed to clients in the FAQs, and Mr. Duggan had reviewed the FAQs, along with other members of his team and

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		outside securities counsel Liz Fries. *E.g.* Flannery Exs. 133, 135, 167, 172, 175, 211; Duggan Test. Stip. at 485:11-20; 487:1-8. Similarly, OFA's recommendation had been communication to Legal by July. Donovan Tr. at 1804:20-1805:19.
412	"Shames was not involved in drafting or editing or approving the August 14 letter because he was out of the office during the time this letter was being finalized. (Shames Stip. Test. at Tr. 110:2-21, 78:13-14 ("the second one in August I had very little involvement with, so I can't comment who that was intended to"), 251:22-25 ("My memory is I was out of the office, so I have no memory of the August 14th letter.").)	• Mr. Shames did discuss the August 14 letter with Mr. Duggan. Shames Test. Stip. at 188:7-19.
414	"On August 7, 2007, Duggan sent an email to Elizabeth Fries, SSgA's outside counsel, and attached a draft of the August 14, 2007 letter with handwritten edits. (Div. Ex. 166.) Flannery recognized Duggan's handwritten edits. (Tr. 1097:18-1098:1 (Flannery).) In this draft, the "our advice is" language from Division Exhibit 165 is crossed out and changed to "we believe that many judicious investors will." (Division Ex. 166 at SS-SEC 000118350.) Flannery did not know if he discussed the edit with Duggan. (Tr. 1098:8-18 (Flannery).) Flannery testified that he thought Duggan told him he made the edit because SSgA did not normally give out investment advice. (Tr. 1098:24-1100:4 (Flannery).) ***Flannery testified that he was okay with the edit because it did not materially change his draft and it was not incorrect.*** (Tr. 1100:16-20 (Flannery).)"	• The Division misstates the record evidence it cites for the highlighted proposition. Mr. Flannery states: > Q So you understood that the reason Mr. Duggan was making that change was simply to avoid the appearance of giving investment advice? > A I -- you know, I'm not an attorney, so I -- and I -- and I already said I don't recall a particular conversation about this. I do remember that in general that was a preference. But I, you know -- I guess it's clear when you put advice in that you're offering advice. But I didn't want to be interpreting legal standards, and so I, you know -- I guess I don't recall processing it much further than that. He made an edit. I know that if Mark made an edit, it's because he needed to or felt it was the prudent thing to do, and it didn't materially change, I don't think -- it didn't make it incorrect, and so I was okay with it. Flannery Tr. at 1100:16-20. Mr. Flannery's testimony reflects that he does not remember the reasons Mr. Duggan gave for making the edit, but that he relied on

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		Mr. Duggan's legal advice regarding the edit, and that he did not believe that the edit made the letter inaccurate or misleading. • Mr. Flannery believed that the language inserted by Mr. Duggan was true, and that many judicious investors would hold their positions. Flannery Tr. at 1387:25-1388:5. He, along with many market participants, believed that the events of the summer of 2007 were principally driven by a sudden shortage of liquidity. Sirri Report at ¶ 80; Flannery Tr. at 1245:18-1246:16; Tr. 1382:5-1383:17; 1457:20-22. • The amount of in-kind redemptions was more than six times the redemption activity by OFA, GAA, and CAM *combined*. *See* Flannery Post-Hearing Reply Br. at Section III.A.1. This is consistent with the statement that "many judicious investors" would remain invested in anticipation of future liquidation because an in-kind redemption reflects a decision by the investor to remain exposed to the LDBF strategy rather than redeeming their investment for cash. *Id.*
415	"On August 8, 2007 at 7:59 AM, Flannery sent Duggan an email with the subject line "Draft CIO letter. (Div. Ex. 168.) In the email, Flannery attached a revised draft of the letter and stated, in pertinent part: "I also want to draw your attention to the 3rd paragraph on the second page where I say we think it is unwise to sell under the current conditions. We softened the language on the last page as agreed, but I want to make sure you are comfortable with this as well. As you know, my preference would be to leave that in." (Id. At SS-SEC 118355.) Flannery's reference to softened language was a reference to changing "our advice is" to many judicious investors will." (Tr. 1103:13-17 (Flannery).) Because of that change, Flannery wanted to draw Duggan's attention to a statement in the draft letter that: "We feel that forced selling in this chaotic and illiquid market is unwise." (Tr. 1103:21-104:15 (Flannery).)"	• Mr. Flannery directed Mr. Duggan's attention to the language in the draft that read: "[w]hile we believe that the subprime markets clearly convey far greater risk than they have historically, we feel that forced selling in this chaotic and illiquid market is unwise," in an effort to have Mr. Duggan double check that the language was still acceptable in light of the legal advice concerning the "many judicious investors" that Mr. Duggan had provided the day before. Flannery Tr. at 1390:25-1392:8. In response to Mr. Flannery's e-mail, Mr. Duggan did change the language in the third paragraph on the second page to language that was akin to his "many judicious investors" language. Div. Exs. 168 and 169; Flannery Tr. at 1394:8-1395:11. This Exhibit (Div. Ex. 168) is evidence that Mr. Flannery was actively seeking to follow the advice of the legal team reviewing the letter.
416	"On August 8, 2007 at 10:16 AM, Flannery emailed Duggan, Reardon, Carlson, Kohler, and Fitzgerald attaching a draft of the August 14 letter, and stated that the draft "incorporates	• Mr. Duggan changed the language in response to Mr. Flannery's prior e-mail, which reflected that Mr. Flannery was trying to follow the legal advice that Mr.

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	[Duggan's] final edits." (Div. Ex. 169 at SS-SEC 118403.) Flannery testified that Duggan edited the letter between 7:59 AM and 10:16 AM on August 8. (Tr. 1106:8-11 (Flannery).) The sentence that had read "We feel that forced selling in this chaotic and illiquid market is unwise" was changed to "While we believe that the subprime markets clearly convey far greater risk than they have historically, we feel that investors must take into account the downside of forced selling in this chaotic and illiquid market." (Div. Exs. 168 at SS-SEC 118357 & 169 at SS-SEC 118405.) Flannery believed that Duggan changed the sentence in response to Flannery's email to Duggan about the sentence in Division Exhibit 168. (Tr. 1106:16-25 (Flannery).)"	Duggan had previously rendered to him. *See* Response to ¶ 415, *supra*.
418	***"Like the August 2 letter, the August 14 letter omitted that State Street had already sold LDBF's most liquid AAA-rated bonds and used the cash from those sales to meet investor redemptions. Therefore, even to the extent that Flannery believed on August 14 that judicious investors should hold their positions in the Fund and related funds, it was misleading to omit the basis for this belief – LDBF was now concentrated in only illiquid subprime investments. A judicious investor (i.e., investors in State Street's advisory groups) may have wanted to redeem from LDBF when the fund still had cash from the AAA bond sales, but may no longer want to redeem when State Street would have to sell the Fund's illiquid holdings to meet the redemption request.*** Duggan explained 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." (Duggan Test. Stip. at Tr. 482:1-14.)"	• *See* Response to ¶ 124, *supra* (regarding the AAA bonds and the credit quality of LDBF's portfolio); *see also* Flannery Post-Hearing Reply Br. at Section II.A.1 (regarding the Division's claim concerning the cash from the AAA sale). The Division's claim is unsupported by the record.
419	"The letter's statement that State Street believed judicious investors would continue to hold their investments omitted that, as Flannery was aware, State Street, through its internal advisory groups, had already recommended that certain clients exit the funds. Flannery was also aware that State Street's other funds had decided to redeem from LDBF. Flannery misled investors	• *See* Flannery Post-Hearing Mem. at 95-97; Flannery Post-Hearing Reply Br. at Section III.A.1. • Mr. Flannery did not believe that Mr. Duggan's "many judicious investors" language was at all inconsistent with the decisions by the advisory groups GAA,

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	by making a statement that State Street believed many judicious investors would hold their positions in the Fund while omitting that State Street's advisory groups, and State Street's other funds, had decided not to hold their positions. The statement purported to convey State Street's view that a judicious investor should hold the Fund when the view of all of State Street's advisory groups directly contradicted that view."	OFA, and CAM to recommend redemption, because "many judicious investors" plainly did not mean that every judicious investor would remain invested. *E.g.*, Flannery Tr. at 1098:8-1098:23, 1387:25-1389:12, 1412:16-1413:7. Indeed, GAA's redemption recommendation had already been disclosed to clients in the FAQs, and Mr. Duggan had reviewed the FAQs, along with other members of his team and outside securities counsel Liz Fries. *E.g.*, Flannery Exs. 133, 135, 167, 172, 175, 211; Duggan Test. Stip. at 485:11-20, 487:1-8. Similarly, OFA's recommendation had been communication to Legal by July. Donovan Tr. at 1804:20-1805:19. If the redemption recommendations needed to be included in the letter (something which Mr. Flannery does not believe he even thought about at the time), Mr. Flannery expected that Mr. Duggan and the Legal Department would have included it. Flannery Tr. at 1389:6-12. • The amount of in-kind redemptions was more than six times the redemption activity by OFA, GAA, and CAM *combined*. *See* Flannery Reply Br. at Section III.A.1. This is consistent with the statement that "many judicious investors" would remain invested in anticipation of future liquidation because an in-kind redemption reflects a decision by the investor to remain exposed to the LDBF strategy rather than redeeming their investment for cash. *Id.* • OFA and GAA did not want their recommendation disclosed publicly in the letter and it was not SSgA's practice to disclose what clients were doing. Donovan Tr. at 1806:16-1808:10; Lowe Tr. at 2020:6-2021:7. • GAA's recommendation was available to Relationship Managers to disclose to clients in the FAQs. • Numerous people at SSgA reviewed the letter after Mr. Duggan inserted the "many judicious investors" language and before it went out to clients, including Mr. Carlson, Ms. Reardon, Ms. Kohler (*see* Div. Ex. 168), Mr. Brown, and Mr. Hunt (*see* Div. Ex. 168) and attorneys Ms. Fries and Mr. Duggan. Shames Test. Stip. at 156:9-12; Duggan Test. Stip. at 484:25-485:9. Mr. Flannery "wanted to

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		make sure that everybody had a crack at it and felt like it was okay" (Flannery Tr. at 1392:21-1393:1) in an effort to make sure that anyone who needed to review the letter was given the opportunity to do so. Flannery Tr. at 1393:21-1394:7. Ultimately, Legal had to approve any changes to the letter. *Id.* at 1408:21-24. Mr. Duggan and the various Relationship Management team members that reviewed the letter were aware of OFA and GAA's recommendation when they reviewed the letter. *See* Flannery Post-Hearing Mem. at 101-04.
421	"***OFA decided to recommend that its clients redeem from LDBF on July 26, 2007.*** Qin, an OFA analyst, attended the July 25, 2007 Investment Committee meeting, which began at approximately 8:30 AM. (Div. Exs. 132 & 134; Tr. 2014:18-19 (Lowe).) On July 25, 2007 at 9:29 AM the OFA group circulated an email listing the OFA clients invested in LDBF or funds invested in LDBF because OFA was "trying to get a list, an investor, if you will, of all the clients in OFA that were exposed to the Limited Duration Bond Fund." (Div. Ex. 130; Tr. 1776:12-19 (Donovan).) The OFA team members making this decision on July 25 included Qin. (Tr. 1770:6-24 (Donovan); 1815:5-9 (Donovan).)"	• The Division does not provide any citation to the record for the highlighted proposition and instead is trying to pass off its own unsupported and unsubstantiated assertions as fact. • The evidence actually shows that OFA, like GAA and CAM, made its own independent investment recommendations and decisions. *E.g.*, Lowe Tr. at 2042:22-2043:4, 2021:8-21, 2045:4-5; Johnson Tr. at 2372:17-2375:3; Flannery Tr. at 1388:11-1389:12. There was no consensus at SSgA that redemption was the right move, as redemption created the possibility of "locking in losses" should the market recover as it had done two months before. Lowe Tr. at 2016:7-2017:3, 2019:19-2020:5, 2049:18-2050:12. OFA's recommendation was based on LDBF's underperformance and volatility and not actual or anticipated redemption activity. Donovan Tr. at 1809:4-19.
424	"On July 27, 2007, OFA informed Flannery of its decision to recommend redemption from LDBF, and Flannery informed OFA that there was adequate liquidity in the fund to meet their redemptions. Donovan testified she called Flannery on the afternoon of Friday, July 27 and left him a message. Then, around 5 or 6 PM, Flannery called Donovan back and Donovan testified about this conversation: Q Tell us everything you can remember about that conversation in terms of what you said and what he said. Just play it out for	• Mr. Flannery's statement concerning liquidity in the fund was made in the context of LDBF being a daily redemption fund. Flannery Tr. at 877:6-883:6. There was no requirement that OFA wait until August 1, which Ms. Donovan had advised Mr. Flannery OFA intended to do, in order to redeem. Donovan Tr. at 1801:1-16. Mr. Flannery reminded Ms. Donovan of that because Ms. Donovan had told Mr. Flannery that members of the Fixed Income team, Messrs. Greff and Wands, had told OFA that they could redeem on August 1. Flannery Ex. 105 at SSgA-SEC 000380697 (entry for 7/26/2007); Flannery Tr. at 877:6-18. As Mr. Flannery explained:

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	us. JUDGE MURRAY: Which conversation was this? MR. BAKER: The conversation Mr. Flannery on July 27, 2007, when he called her back. A So my recollection was that I called and I said that I was calling on behalf of Kathleen just as a courtesy to let him know that OFA was going to terminate the Limited Duration Bond Fund. And he said, "Thank you for letting me know." And I at some point during the conversation mentioned that we were gathering sort of our clients' approvals and would most likely exit on August 1st, and in our conversation with portfolio managers, they had some securities, some wasp that were maturing on August 1st, so that kind of worked for us in terms of what we thought time to get answers back to clients and to liquidate would be. And Sean said, you know, "You need to do what you need to do, and if you need to get out sooner, you certainly can. You don't have to wait until the 1st to get out." BY MR. BAKER: Q Did he tell you that if you didn't wait until the 1st, that there was liquidity in the fund? A I remember – I remember him saying there was – there was liquidity, "You can get out whenever you need to get out." And to me that meant "We would accommodate your sale whenever you need to make your sale." Q You wouldn't have to wait until the swaps rolled off at the end of the month? A Right.	My point was I was concerned that she was delaying the implementation of a trade that they wanted to do until August 1 because the head of fixed income and the head of North America [Mr. Wands] had asked her to wait until that date. And, you know, while that may be convenient for them, she had a job and a fiduciary and ethical responsibility to act on the -- in the best interest of her clients. And I didn't want those interests to be subjugated to what it is that the bond team would prefer. And so -- so I -- you know, so I just tried to make it clear to her that if her decision was to wait until then, that's fine, but if she felt a need to get out earlier, it's a daily liquidity fund, like any other client, they could do that. So that's really what I tried to convey to her. Flannery Tr. at 878:10-879:4. • Ms. Donovan did not sense that Mr. Flannery was trying to provide her with any informational advantage when they spoke. Donovan Tr. at 1809:23-1810:3. Mr. Flannery never knew how much cash was in LDBF and there is no evidence demonstrating that he was told how much cash was in LDBF. Flannery Tr. at 1007:1. OFA represented a very small portion of the total assets in LDBF. *See* Flannery Post-Hearing Reply Br. at Section III.A.1. In fact, there were only five OFA clients invested in LDBF.

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	(Tr. 1800: 4-1801:25 (Donovan).)"	
426	"Flannery also testified that he was aware of how Martha Donovan testified in her investigative testimony concerning her conversation with Flannery on July 27, 2007. (Tr. 875:16-877:5 (Flannery).) Flannery testified that in reviewing documents he had his recollection refreshed that he talked to Donovan on either July 27 or August 1 and told her that Donovan's clients could redeem earlier than August 1 because it was a daily liquidity fund. (Tr. 877:6-883:6 (Flannery).) However, Flannery agreed that he previously testified during the investigation that he did not remember a conversation with Donovan about OFA redeeming. (Tr. 880:9-14 (Flannery).)"	• *See* Response to ¶ 424, *supra*. • Mr. Flannery did not remember the conversation with Ms. Donovan during his investigative testimony because "it was suggested" during his investigative testimony that he was telling Ms. Donovan to get out now (quickly), which was inconsistent with Mr. Flannery's mindset of treating the advisory groups like any other client. Flannery Tr. at 879:5-880:7.
428	"GAA reported to Flannery. (Tr. 894:15-16 (Flannery).) Of OFA, GAA, and CAM (the Charitable Asset Management group), Flannery understood that GAA was "by far the biggest of those [advisory] groups." (Tr. 894:18-19 (Flannery).) GAA learned from the fixed income team in March 2007 that subprime investments, in addition to the small ABX investment, were a significant focus of LDBF. Once the subprime market fell into turmoil in July 2007, GAA thus knew that its investments in LDBF were affected, and promptly recommended redemption."	• *See* Responses to ¶¶ 383, 395, *supra* (regarding exposure to subprime). • GAA had access to the same information about LDBF's composition as every other LDBF client. *E.g.*, Carlson Tr. at 2728:20-2729:7, 2744:22-2745:12; Sirri Report at ¶ 22; Peavy Direct Test. at A.45; Flannery Tr. at 1310:11-1311:1, 1363:19-1364:5; Duggan Tr. at 326:11-17. The CAR Alert, for example, provided Relationship Managers with information that they could use to address investor questions and concerns. *See* Hopkins Ex. 35. As with other institutional investors, GAA had its own unique investment guidelines based on its particular needs and objectives. Flannery Tr. at 868:7-870:5. Although the head of GAA did report to Mr. Flannery, Mr. Flannery exercised no decision-making power over GAA's investment/redemption decisions, instructed the head of GAA to simply make the best decisions he could on behalf of GAA's clients, and did not want to know what GAA ultimately decided. Lowe Tr. at 2045:7-9, 2018:5-13, 2045:13-20; Johnson Tr. at 2374:7-13.
430	"On February 28, 2007, Brent Bell emailed the GAA group and forwarded Hopkins' internal February 28, 2007 CAR Alert which described LDBF's underperformance in February because of its exposure to the BBB ABX index. (Div. Ex. 45.) The Bell email's subject was "Prelude to Paul Greff meeting tomorrow morning" and Bell stated: "Here is a precursor of what we will probably here [sic] from Paul tomorrow morning." (Id. At SS	• See Response to ¶ 429, *supra*; *see also* Flannery Post-Hearing Mem. at 14-15.

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	7006818.) Bell was part of the product engineering group who supported GAA. (Tr. 1991:16-18 (Lowe).) GAA was looking for an update "on what was going on and [to] answer our questions so if clients asked us, we would be better equipped to answer them." The meeting with Greff was in person at State Street's headquarters. (Tr. 1992:2-22 (Lowe).) The CAR Alert described LDBF's BBB ABX investment, but Lowe came to understand from the meeting with Greff that LDBF also held subprime bonds, mostly rated AAA, in addition to the ABX investment. (Tr. 1994:21-1995:14 (Lowe).) Lowe got a better understanding of LDBF's direct investments in subprime bonds as a result of the meeting with Greff and others on the fixed income team in early March, and he also learned that subprime investments were one of the "core competencies" of LDBF. (Tr. 1999:2-2000:15 (Lowe).)"	
431	"Minutes of GAA's July 25, 2007 team meeting reflect that GAA "decided unanimously to sell the active fixed income bond products and move [clients] into a passive strategy." (Div. Ex. 129 at SSgA-SEC 371543.) The minutes reflect that "[t]he deciding factor" for this decision "was concern that the downside risk was not reasonable relative to the small outperformance potential." (Id.) Lowe found that the decision to terminate LDBF was "very difficult" and involved "basically giv[ing] up faith in colleagues that we liked and respected and their investment strategy." (Tr. 2016:7-2017:7 (Lowe).) When GAA decided to terminate LDBF in July 2007; 1) Lowe was more negative on subprime than the fixed income team; 2) Lowe knew that the subprime market was blowing up; 3) Lowe knew that subprime investments were highly correlated and performing negatively; 4) junior people in GAA were telling Lowe that there were daily downward moves in SSgA's bond funds; and 5) Lowe knew that subprime was a "core holding" of LDBF, (Tr. 2047:5-2049:10 (Lowe).)"	• This Proposed Finding of Fact is irrelevant as to Mr. Flannery. The Division has repeatedly represented to the Court that this is not a case about whether LDBF was a good investment strategy. *E.g.*, Div. Pre-Hearing Br. at 39-40 ("The wisdom of investing in subprime in 2007 is not an issue for this tribunal to decide."); Flannery Tr. at 839:5-840:13, 1180:4-10, 1484:1-1488:9. • With respect to the Division's claim that Mr. Lowe "knew," subprime was blowing up, he testified that the decision to recommend redemption was a difficult one because GAA was concerned that, if the market rebounded, as it had done after the February dislocation, GAA's clients would have locked in losses and missed out on the upside they would have realized had they remained invested. Flannery Post-Hearing Mem. at 38 (citing Lowe Tr. at 2016:7-2017:3, 2019:19-2020:5). Mr. Lowe and GAA were "terrified" that they were making the wrong recommendation. *Id.* (citing Lowe Tr. at 2049:18-2050:12).
433	"The final version of the July 25, 2007 Investment Committee minutes, state, in pertinent part: "After consulting with Mark Duggan, Ali Lowe removed himself from the meeting because of his fiduciary responsibilities to his clients and the sensitivity of the subject matter. As the manager of fund of funds which	• This Court and the Chair of the Investment Committee stated at trial that Mr. Flannery was not responsible for the fact that Jie Qin chose to stay at the July 25 Investment Committee meeting after Mr. Lowe left. Flannery Tr. at 995:9-998:4; Johnson Tr. at 2396:25-2397:22; *see also* Lowe Tr. at 2005:17-2010:21 (the Court

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	were invested in some of the funds about to be discussed, Mr. Lowe wanted to avoid any appearance of bias or impropriety." (Div. Ex. 132 at SSgA-SEC 252901.) The draft minutes state, in pertinent part: "After consulting with Mark Duggan, Ali Lowe removed himself from the meeting because of his immediate fiduciary responsibilities to his clients and the sensitivity of the subject matter." (Div. Ex. 134 at SSgA-SEC 252909.) Lowe testified that the summary contained in the draft minutes is consistent with what he told the Investment Committee when he left the meeting. (Tr. 2005:14-16 (Lowe).) Qin of OFA was present at the meeting and did not leave with Lowe. (Tr. 2010:13-15 (Lowe).)"	reiterating its prior ruling). • Mr. Flannery did not determine who sat on the Investment Committee; that determination, including the decision to include representatives from OFA and GAA on the Committee, was made by the Chair of the Investment Committee. Johnson Tr. at 2365:21-2366:14. • There is no evidence that Mr. Flannery was aware as of July 25 that OFA was evaluating LDBF as a strategy. Donovan Tr. at 1800:5-19 (testifying she notified Mr. Flannery of OFA's recommendation on July 27); Flannery Tr. at 877:2-878:3 (same); Div. Ex. 222 at SSgA-SEC 000380698. • The Division did not call Mr. Qin as a witness. The only OFA witness who did testify, Ms. Donovan, testified that OFA's decision with respect to recommending redemption in LDBF was based solely on underperformance and volatility, and had nothing to do with any anticipated or actual redemption activity. Donovan Tr. at 1809:4-11; *see also* Div. PFOF ¶ 422; Div. Post-Hearing Br. at 30 (conceding OFA's decision to redeem was based on underperformance and volatility).
434	"Lowe met with Flannery later on July 25 for one of their regular update meetings and Lowe told Flannery that GAA "had a scheduled meeting to decide what to do and evaluate and fixed income funds." Flannery replied that Lowe "should go ahead, make the best decision on behalf of [GAA's] clients, but he did not want to know what the decision was. (Tr. 2017:16-2018:13 (Lowe).)"	• Though Mr. Lowe reported to him, Mr. Flannery never interfered with GAA's independence during his entire tenure as CIO. Lowe Tr. at 2045:7-9; Donovan Tr. at 1809:23-1810:3. The investment recommendations and decisions made by GAA were independent investment decisions because "[t]hat's what they get paid for." Flannery Tr. at 1388:11-1389:12 (OFA and GAA did not speak for SSgA and had different investment objectives and risk constraints).
435	"Question 31 of "Internal Use Only" subprime FAQs circulated to Flannery on August 1, 2007 at 4:41 PM stated: "What affect has this had on your Asset Allocation Funds? What is your GAA Team doing to address this?" (Div. Ex. 153 at SS 4379050.) The answer stated: "Our GAA team has reviewed the situation, relative to whether they should continue to hold various strategies (Active Core Bonds/Limited Duration Bond fund) and	• The purpose of the FAQs was to assist Relationship Managers and Consultant Liaisons in responding to actual and anticipated questions from clients. Flannery Tr. at 1310:4-10. While the Legal Department had determined that the FAQ document itself could not be distributed to clients, Relationship Managers could share any information in the FAQs with clients, either in response to questions or if they believed that such information might be useful to a particular client.

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	are recommending a move to passive fixed income. Their concern is that turmoil in the ABX segment of the market may continue for several months and they would like to limit, to the extent possible, any further losses." (Id.) By "Internal Use Only," Flannery understood that these FAQs were not to be sent outside of SSgA. (Tr. 890:1-14 (Flannery).) A July 26, 2007 email from Staci Reardon to SSgA's client-facing personnel, copied to Hopkins, Flannery and others, instructed everyone not to send the FAQ's "to anyone outside the firm. Any written communication to clients/consultants must be approved through the proper channels prior to being sent." (Div. Ex. 145 at SS 9446380.)"	Flannery Tr. at 1310:11-1311:1, 1363:19-1364:5; Carlson Tr. at 2744:22-2745:12; Duggan Test. Stip. at 326:11-17. Mr. Flannery understood that the FAQs were to be used with clients. Flannery Tr. at 1310:11-1311:1, 1363:19-1364:5. • Mr. Flannery played no role in SSgA's decision to not distribute the FAQ document to clients. That decision was made by the Legal Department. Carlson Tr. at 2744:10-2744:22; Flannery Tr. at 1214:1-14 (testifying he had no role in determining how to respond to client questions or what information to push out to them), 1040:2-9 (testifying as to his "understanding" of how FAQs could be used).
437	"When he signed the August 14 letter, Flannery was also aware of significant redemptions of LDBF by other State Street funds. At the July 26 Investment Committee meeting, Flannery remarked that providing 40% liquidity in LDBF would "benefit" State Street's "other fund/strategies using LDBF[.]" (Div. Ex. 134 at SSgA-SEC 252909.) Also, on August 13, 2007, Mavro forwarded Flannery version 4 of the "internal use only" subprime FAQs in response to Flannery's request for a version of the document he could use for "some pretty significant updating of the FAQs." (Flannery Ex. 211 at SS 004999366.) This version of the FAQs reflected that "[w]e have had redemptions in the strategies affected." (Id. At SS 004999380.) The FAQs included a chart listing each of State Street's active fixed income funds that had exposure to LDBF and the remaining exposure of each of these funds to LDBF as to July 3, 2007. (Id. At SS 00499381-82.) The chart reflected that three of these funds had redeemed all of their LDBF holdings as of July 31. (Id.) Finally, on August 15, Flannery informed the staff of the Federal Reserve that other State Street funds had redeemed $700 million from LDBF. (Div. Ex. 177 at FLAN01124.)"	• The Division's Proposed Finding of Fact is confusing because it is unclear whether it refers to cash or in-kind redemptions or both. The August 6 letter to clients, sent over a week before the August 14 letter, disclosed that Related Funds would be redeeming in-kind. Moreover, an in-kind redemption demonstrates the reasonableness of the "many judicious investors" language because an in-kind redemption reflects that the investor wanted to maintain its exposure to the LDBF strategy. *See* Flannery Post-Hearing Reply Br. at Section II.A.3.a. • The Division has failed to prove its Proposed Finding of Fact. The Division did not ask Mr. Flannery what he meant when he said "Other funds and strategies using LDBF will benefit from extra liquidity in the fund." Flannery Tr. at 999:19-1000:9. Consistent with the testimony of Mr. Zask, raising liquidity in LDBF benefited the Related Funds—and all of the investors invested in LDBF—because it reduced risk in the portfolio. *See* Flannery Post-Hearing Mem. at 75-79. The language in the draft minutes from the July 25 Investment Committee also, on its face, does not stand for the proposition that Mr. Flannery knew that there had been significant redemptions by the Related Funds. The discussion at the July 25 meeting concerned anticipated redemptions in the future, not actual redemption activity (significant or otherwise).

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		• With respect to the FAQs needing updating, the Division has failed to prove that this e-mail had anything to do with significant redemption activity by the Related Funds. The Division did not even ask Mr. Flannery about Flannery Ex. 211 and the e-mail does not reference Related Funds or redemption activity at all. Flannery Exhibit 211 demonstrates, however, that Mr. Flannery wanted to keep the FAQs up to date so that information could be available to clients. Flannery Tr. at 1368 20-1369:3 (Mr. Flannery sent the e-mail to Mr. Mavro even though it was not his job to do so because he wanted to "pump out more information" to investors and it was important the information be accurate).
438	"When asked in August 2007 whether he thought LDBF could just weather the storm so that ultimately its investments were going to be money good, Flannery testified: "I thought the market would come back substantially, as it did by mid-September." (Tr. 1514:2-7 (Flannery).)"	• The evidence also shows that the Fixed Income team believed that the housing-related ABS sector remained fundamentally strong and would substantially recover. Wands Tr. at 2853:16-22; 2856:6-12.
439	"Flannery admitted that SSgA fired him in part because of the problems in the subprime market and their effect on the performance of the active fixed income funds in 2007 (Tr. 796:11-20 (Flannery).) He stated: "Look, I've been in the business for 27 years and it's – it's a performance-based culture, and when something like this happens, it's generally paid for in scalps. So – so I can't say that I'm surprised by it, no." (Id.)"	• Mr. Flannery was not told that he was being fired nor does his separation agreement reflect that he was fired. Flannery Tr. at 790:20-22.
440	"William Lyons, a 20-year veteran of the investment industry and a former CEO who managed CIO's like Flannery, offered expert testimony about the issues facing a CIO dealing with poor performance of a collective investment fund under his supervision and how those issues affect that CIO's motivations. (Div. Ex. 256.) Lyons opined that a CIO facing the disclosure of poor performance would be motivated to take actions to retain investors and assets in the portfolio so that the portfolio managers could try to improve the fund's performance record. (Id. At 10-11.) "[R]etaining assets and limiting redemptions are important to a portfolio manager of an underperforming fund for investment performance reasons – retaining assets and limiting redemptions increase his potential to improve performance." (Id. At 11.)"	• Mr. Lyons has never served as a CIO nor does he hold himself out the public as someone with the knowledge of a CIO or investment advisor. Lyons Tr. at 1837:13-1838:5. • Like Mr. Flannery, Mr. Lyons testified that he has relied on the accuracy of information provided to him by others within the organization when issuing public documents. Lyons Tr. at 1828:15-1830:10. In March 2010, Mr. Lyons signed and filed a 10-K in his capacity as a member of the Board of Directors of NIC. *Id.* That 10-K stated that NIC had conducted its own thorough and independent internal investigation through its audit committee in connection with an expense report issue by the former Chairman of the Board of NIC. *Id.* The Division disagrees with Mr. Lyons' representations in the 10-K, claiming that the

FOF #	Division's Proposed Finding of Fact	Flannery Response and Counterstatement
		internal view was not thorough and that the majority of the former Chairman's perquisites were not been repaid or disclosed. *Id.* • Mr. Lyons has never met Mr. Flannery. Lyons Tr. at 1833:9-13. Mr. Lyons also did not meet with anyone who worked with Mr. Flannery during his time as CIO with SSgA despite the fact that SSgA gave the Division access to its employees. *Id.* at 1833:18-1834:12. • Mr. Lyons testified that certain parts of his expert report were poorly drafted by him. *Id.* at 1834:13-1835:11. For example, Mr. Lyons appears to opine in his report about what motivated Mr. Flannery, but admitted during his testimony that he does not know what motivated Mr. Flannery. *Id.* at 1835:13-1837:12. • As a way for clients to remain exposed to the LDBF strategy without being affected by the redemption activity of other clients, in late July, Mr. Flannery developed the idea for a fund called LDBF II. Flannery Tr. at 1293:19-1295:25, 1358:19-1359:11. • LDBF II was intended to minimize the impact of a potentially high level of redemptions on those investors who wished to remain exposed to the LDBF strategy. *Id.* at 1293:23-1294:6, 1295:1-3. To the extent they wanted to do so, LDBF clients would be permitted to transfer their investments in kind to LDBF II, and LDBF II, unlike LDBF, would not allow daily withdrawals. *Id.* at 1293:22-1294:6. Rather than freezing LDBF, SSgA created LDBF II in order to provide investors with three options: they could either stay in LDBF, move to LDBF II, or redeem their investments altogether. *Id.* at 1294:7-1295:13, 1357:4-1358:4. • The decision to freeze a fund or create a fund such as LDBF II was not Mr. Flannery's, but he was an advocate for a reduced liquidity fund such as LDBF II as opposed to freezing LDBF — a step which would have deprived investors of

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FOF #	Division's Proposed Finding of Fact	Flannery Response and Counterstatement
		the daily liquidity that SSgA had promised. *See id.* at 1287:8-1289:5. • Mr. Lyons testified that LDBF II would have been harmful to Mr. Flannery's reputation as a CIO. Lyons Tr. at 1867:7-1868:1. Notwithstanding the harm to his reputation, Mr. Flannery believed that LDBF II was the best approach for investors, and advocated for it to be created. Flannery Tr. 1294:24-1295:4. On August 6, a letter was sent to all investors announcing that LDBF II had been created. Flannery Exs. 161, 162, 174. • Mr. Flannery is a person of impeccable character, integrity, and honest, both personally and professionally. According to Ms. Shegog, "that's what was best about Sean is he didn't do what was best for him or me, he did what was right." Shegog Tr. at 2820:23-2821:6. Mr. Flannery was always focused on being fair to clients, he always sought diverse opinion from those around him, and was one of the most honest individuals Mr. Armstrong had ever met. Armstrong Tr. at 2213:12-2214:16. Mr. Flannery was "one of the most honorable guys in the business, period," (Johnson Tr. at 2381:1-2383:12), an honest person of high integrity (Shames Test. Stip. at 2), "and one of the most moral, ethical people that I'm aware of." Donovan Tr. at 1811:15-19. Mr. Shames believed in Mr. Flannery's integrity and character that he continued to build a business venture with Mr. Flannery even after Mr. Flannery received a Wells notice. Flannery Tr. at 1136:17-1138:2; Shames Test. Stip. at 13:24-14:10; 50:16-54:01.
441	"Lyons further testified that it is an important business activity of investment professionals to "spend time face-to-face with clients or using other means of communication to try to convince them of the continuing merits of a particular investment strategy, and the objective of that activity is to retain assets." (Tr. at 1854:24-1855:5 (Lyons).) LDBF posed a significant problem for SSgA in the summer of 2007 because "if LDBF experienced a performance or other problem in its portfolio, this problem rippled or radiated out to the other State Street funds that invested in it and to their investors ... LDBF, in effect, "exported" its underperformance and other issues to the	• *See* Response to ¶ 440, *supra.* Mr. Lyons testified that he does not know what motivated Mr. Flannery, but that Mr. Flannery took steps harmful to his reputation and career prospects.

FOF #	Division's Proposed Finding of Fact	Flannery Response and Counterstatement
	other funds. The larger the percentage that the LDBF investment represented in the other State Street fund, the larger the problem LDBF created for the other fund. If LDBF experienced problems providing liquidity to investors who wished to redeem, this problem would also affect the other State Street funds investing in it. If the other funds needed to raise cash to meet their own redemption demands, and they elected not to liquidate their shares of LDBF, they might be in the position of having to sell other investments that were performing well. They might also be left with shares in LDBF that represented an even less liquid LDBF portfolio than before." (Div. Ex. 256 at 12-13.)"	
442	"Lyons opined that a CIO in Flannery's position during the summer of 2007 would have been motivated to "keep the asset base in the Fund as stable as possible by discouraging redemption activity in the Fund" and to "maintain a period of stability in the assets in the Fund for a long enough period of time to allow the valuation of the underlying securities in the Fund to recover and to being trading in an orderly manner in a liquid market." (Id. At 13.) A CIO in Flannery's position would have been motivated to take these actions to preserve his reputation and his prospects for future employment. (Id. At 14.) As Lyons opined, if "the [more] liquid, fairly-valued securities in the portfolio are sold, but redemption requests continue without additional inflows to the fund, the remaining portfolio runs the risk of becoming even more concentrated with the securities that have the least liquidity and the least attractive prices relative to their perceived value." (Id. At 15.) LDBF in the summer of 2007 was an "extreme version" of such a portfolio."	• *See* Response to ¶ 440, *supra*. Mr. Lyons testified that he does not know what motivated Mr. Flannery, but that Mr. Flannery took steps harmful to his reputation and career prospects.
443	"Lyons stated that a performance problem of the type experienced by LDBF in the Summer of 2007 could significantly diminish the good reputation and career prospects of someone in Flannery's position, and that someone in Flannery's position would have understood that he would have been held personally accountable for LDBF's performance. (Id. At 17-19.)"	• *See* Response to ¶ 440, *supra*. Mr. Lyons testified that he does not know what motivated Mr. Flannery, but that Mr. Flannery took steps harmful to his reputation and career prospects.

APPENDIX B

to

John Patrick ("Sean") Flannery's Post-Hearing Reply Brief

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of: JOHN P. FLANNERY and JAMES D. HOPKINS	))))))	ADMINISTRATIVE PROCEEDING FILE NO. 3-14081

AFFIDAVIT OF MARK W. PEARLSTEIN IN SUPPORT OF JOHN PATRICK ("SEAN") FLANNERY'S POST-HEARING REPLY BRIEF

I, Mark W. Pearlstein hereby depose and state as follows:

1. I am a partner at the law firm of McDermott Will & Emery LLP. I am lead counsel for John Patrick ("Sean") Flannery in the above-referenced proceeding.

2. I submit this Affidavit in support of Mr. Flannery's Post-Hearing Reply Brief. All of the statements made herein are based upon my personal knowledge.

3. On October 12, 2010, I spoke with Deena Bernstein, Kathy Shields and Robert Baker of the Division of Enforcement (the "Division") via teleconference. During that conversation, I asked counsel for the Division to confirm that Mr. Flannery was not being charged in connection with the July 26, 2007 letter sent by SSgA to investors. Ms. Bernstein confirmed that Mr. Flannery was not being charged in connection with the July 26 letter.

I declare under the pains and penalties of perjury that the foregoing is true and correct.

Dated: May 4, 2011

Mark W. Pearlstein

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UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of:	)	
	)	ADMINISTRATIVE PROCEEDING
JOHN P. FLANNERY and	)	FILE NO. 3-14081
JAMES D. HOPKINS	)	

AFFIDAVIT OF PETER M. ACTON, JR. IN SUPPORT OF JOHN PATRICK ("SEAN") FLANNERY'S POST-HEARING REPLY BRIEF

I, Peter M. Acton, Jr., hereby depose and state as follows:

1. I am a partner at the law firm of McDermott Will & Emery LLP in Boston, Massachusetts. I am counsel for John Patrick ("Sean") Flannery in the above-referenced proceeding.

2. I submit this Affidavit in support of Mr. Flannery's Post-Hearing Reply Brief. All of the statements made herein are based upon my personal knowledge.

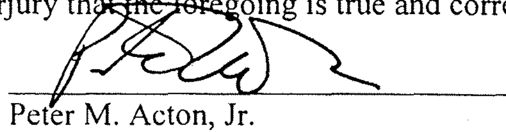
3. After the Order Instituting Proceeding was filed against Mr. Flannery, Joshua Munn (an attorney who was previously representing Mr. Flannery but is no longer an attorney at the firm) and I spoke by telephone with Deena Bernstein and Robert Baker of the Division of Enforcement (the "Division") concerning the claims being made against Mr. Flannery. During that telephone conversation and in response to a question that I asked, Ms. Bernstein and Mr. Baker stated that Mr. Flannery was not being charged in connection with the July 26, 2007 letter sent to investors by SSgA.

4. On October 12, 2010, Mark Pearlstein (lead counsel for Mr. Flannery) informed me that he had spoken on that date with Ms. Bernstein, Mr. Baker, and Kathy Shields via teleconference, and that during that conversation, counsel for the Division confirmed that Mr.

Flannery was not being charged in connection with the July 26, 2007 letter sent by SSgA to investors.

I declare under the pains and penalties of perjury that the foregoing is true and correct.

May 4, 2011



Peter M. Acton, Jr.

Notary Public:

My Commission expires:

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