SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES ACT OF 1933
Release No. 9689 / December 15, 2014

SECURITIES EXCHANGE ACT OF 1934
Release No. 73840 / December 15, 2014

INVESTMENT ADVISERS ACT OF 1940
Release No. 3981 / December 15, 2014

INVESTMENT COMPANY ACT OF 1940
Release No. 31374 / December 15, 2014

Admin. Proc. File No. 3-14081

In the Matter of

JOHN P. FLANNERY and
JAMES D. HOPKINS

OPINION OF THE COMMISSION

CEASE-AND-DESIST PROCEEDING

INVESTMENT ADVISER PROCEEDING

INVESTMENT COMPANY PROCEEDING

Grounds for Remedial Action

Antifraud Violations

Respondent, who was a Chief Investment Officer associated with an investment adviser, willfully violated Section 17(a)(3) of the Securities Act of 1933 by engaging in a course of business that operated as a fraud on investors in an unregistered fixed income fund. *Held*, it is in the public interest to suspend Respondent for one year from association with any investment adviser or investment company; to impose a cease-and-desist order; and to assess a $6,500 civil money penalty.

Respondent, who was a vice president and product engineer associated with an investment adviser, willfully violated Section 17(a)(1) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934, and Exchange Act Rule 10b-5 thereunder by misrepresenting material facts concerning an unregistered fixed income fund. *Held*, it is in the public interest to suspend Respondent for one year from association with any investment adviser or investment company; to impose a cease-and-desist order; and to assess a $65,000 civil money penalty.

APPEARANCES

Mark W. Pearlstein, *Frederic D. Firestone*, and *Laura McLane* of *McDermott Will & Emery LLP*, for John P. Flannery.

John F. Sylvia, *McKenzie E. Webster*, *Jessica C. Sergi*, and *Marbree D. Sullivan* of *Mintz, Levin, Cohn, Ferris, Glovsky and Popeo, P.C.*, for James D. Hopkins.

Deena Bernstein, *Kathleen Shields*, and *Robert Baker*, for the Division of Enforcement.

Appeal filed:	November 21, 2011
Last brief received:	June 13, 2012
Oral Argument:	July 25, 2014

I.

The Division of Enforcement appeals from an administrative law judge's initial decision in this proceeding against Respondents James D. Hopkins and John P. Flannery (collectively, "Respondents"), former employees of State Street Bank and Trust Company ("State Street") and its sister company, State Street Global Advisors ("SSgA").[1] The law judge found that Hopkins and Flannery did not violate the antifraud provisions of Section 17(a) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934, and Exchange Act Rule 10b-5 through communications made in connection with the offer and sale of State Street's Limited Duration Bond Fund ("LDBF").[2] We base our findings on an independent review of the record, except with respect to those findings not challenged on appeal.[3]

II.

State Street, a Massachusetts trust company and bank, is a wholly owned subsidiary of State Street Corporation, a publicly held financial services holding company. State Street services and manages assets on behalf of institutional clients. SSgA, which is not itself a legal entity, is the investment management division of State Street Corporation. It provides management and advisory services to State Street-affiliated registered mutual funds, as well as unregistered bank collective trust funds.[4]

LDBF was an unregistered fixed-income fund that was invested in various fixed income products.[5] It was offered and sold only to institutional investors, such as pensions, endowments, charitable trusts, and defined-contribution and defined-benefit plans. From its inception in 2002, LDBF was heavily invested in asset-backed securities ("ABS"), one component of which was residential mortgage-backed securities ("RMBS"). The fund's composition changed continuously over time, and, by 2006 and 2007, it became increasingly concentrated in subprime RMBS. For example, in June 2007, the portfolio was over 80% invested in subprime RMBS.

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[1] *John P. Flannery*, Initial Decision Release No. 438, 2011 WL 5130058 (Oct. 28, 2011).

[2] 15 U.S.C. § 77q(a); *id.* § 78j(b); 17 C.F.R. § 240.10b-5.

[3] On June 11, 2013, Respondents filed (and on November 6, 2013, they renewed) a motion to schedule a status conference. Because our Rules of Practice do not provide for such a conference during the pendency of an appeal and we have since held oral argument, we deny Respondents' motion. Further, we note that Rule of Practice 451(d), 17 C.F.R. § 201.451(d), permits a member of the Commission who was not present at oral argument to participate in the decision of the proceeding if that member has reviewed the oral argument transcript prior to such participation. Commissioner Gallagher has made the requisite review.

[4] Although State Street and SSgA are technically distinct, the record shows that, throughout the proceeding, they often have been referred to interchangeably. Indeed, as Hopkins testified, both he and Flannery worked for SSgA "as a functional matter," and both were listed on SSgA organizational charts, even though at least Flannery's paycheck was issued by State Street.

[5] Technically, LDBF was made up of two unregistered fixed-income funds that followed the same investment strategy. For purposes of this opinion, we treat them as a single fund.

LDBF's use of leverage also increased through 2006 and 2007, which increased the fund's exposure to subprime RMBS.

Investments in LDBF came from a number of sources. First, some other State Street Funds (the "Related Funds") invested directly in LDBF themselves. Second, SSgA provided investment advice to clients through various internal advisory groups; on SSgA's recommendation, clients of those groups invested in LDBF. Finally, a number of independent investors who were not affiliated with either the Related Funds or SSgA's internal advisory groups also invested directly in LDBF.

When the subprime mortgage crisis hit in late July and August of 2007, many—but not all—of LDBF's investors fled the fund. State Street's Related Funds redeemed essentially all of their investments, and several of SSgA's internal advisory groups recommended that their clients seek redemptions, as well. But the other, independent, LDBF investors received no such advice from SSgA, and many of them remained in the fund throughout the Summer of 2007.

From at least 2006 through the subprime mortgage crisis in 2007—the relevant time period for this proceeding—both Flannery and Hopkins were responsible, in part, for communicating with LDBF investors. The Division alleges that the two either made or were responsible for the communications that are the subject of this proceeding.

A. Hopkins

During the relevant period, Hopkins was the Vice President and head of North American Product Engineering at SSgA and a member of SSgA's senior management group. As a product engineer, he served as a liaison between portfolio managers and client-facing personnel, including the sales force and those responsible for client relationships. He was responsible for explaining to the client-facing personnel the strategy and analysis portfolio managers used to manage investment funds.

1. Hopkins's Responsibilities for LDBF's Promotional Materials

Hopkins became LDBF's product engineer in 2005. In this role, he often communicated directly with LDBF investors, participating in presentations to current and prospective investors about LDBF's performance and investment strategy. Hopkins was also responsible for reviewing and ensuring the accuracy of (i) SSgA's "standard PowerPoint slides," which were used in presentations to existing and prospective LDBF investors, and (ii) the information in quarterly fact sheets about LDBF, which were also given to current and prospective investors.

a. Typical Portfolio Slide

SSgA used a standard PowerPoint presentation when presenting information about LDBF or the Related Funds to clients and prospective clients. From September 2006 through June 2007, Hopkins used the standard PowerPoint presentation in numerous meetings with current and prospective investors about LDBF. Either before or at each meeting, the attendees received a copy of the presentation that listed the presenters, including Hopkins, on the front cover.

In 2006 and 2007, the presentation included a slide describing LDBF's "Typical Portfolio Exposures and Characteristics" (the "Typical Portfolio Slide"). This slide presented a breakdown of LDBF's "typical" portfolio by sector, stating, in relevant part, that the fund was only 55% invested in ABS. That breakdown did not change from at least July 2006 through the summer of 2007, even when LDBF's actual investment in ABS far exceeded that depicted in the slide. Because he was responsible for the slides' accuracy, Hopkins was periodically asked by various SSgA and State Street personnel if he wanted to update any of them. He was also required to review the slides for accuracy each quarter. In each instance, Hopkins made no changes to the Typical Portfolio Slide.

In preparation for meetings with investors, Hopkins wrote by hand on his copy of the Typical Portfolio Slide LDBF's *actual* sector allocations—which frequently varied significantly from those listed in the slide.[6] But Hopkins's notes were not distributed to meeting attendees, and there is no evidence that Hopkins otherwise provided accurate information on LDBF's portfolio composition during his presentations.[7] When asked during testimony about his handwritten notes, Hopkins explained that they contained information he *might* present or address, perhaps in response to a question, but he did not necessarily cover the information during any particular presentation.

b. Fact Sheets

The purpose of SSgA's fact sheets, generally, was to inform and provide updates to clients and prospective clients about State Street's funds. LDBF's Fact Sheets, in particular, followed a standard template, which included both a narrative section describing the fund's investment objective, strategy, and risk management, and a data section with statistics on the fund's sector allocation, among other things. As relevant here, the Fact Sheets described LDBF's strategy as "utiliz[ing] an expanded universe of securities that goes beyond typical money markets" and stated that, "[w]hen compared to the typical . . . regulated money market portfolio,

6 For instance, on July 11, 2006, Hopkins made a presentation to Johns Hopkins University, then a prospective client. On his personal copy of the presentation, Hopkins noted that ABS represented 90% (not 55%) of LDBF's portfolio. On December 18, 2006, Hopkins made a presentation to the consultant Kalson & Associates, noting on his copy of the presentation that LDBF was 80% invested in ABS. On February 13, 2007, Hopkins made a presentation to the Los Angeles County Employees' Retirement Association ("LACERA"), noting on his copy of the presentation that LDBF was 90% invested in ABS.

7 The record is undisputed that at least Johns Hopkins, Kalson, and LACERA did not receive a copy of Hopkins's annotated version of the Typical Portfolio Slide. As to most of the presentations, Hopkins did not recall whether he even discussed the slide or LDBF's portfolio breakdown, and the record does not reflect anyone else's recollection of the meetings. That said, when testifying about the meeting with Johns Hopkins, in particular, Hopkins gave inconsistent, and arguably conflicting, testimony, at one point stating categorically that he "never addressed the[] sector breakdowns" in the slide and "was never asked a question on them," even though he had previously testified that he did not recall whether he used or was asked a question about the Typical Portfolio Slide during the Johns Hopkins presentation.

[LDBF] has better sector diversification." The Fact Sheets also contained a chart disclosing LDBF's "sector weights"—*i.e.*, the percentage of the fund's investments allocated to different market sectors, such as ABS. The Fact Sheets did not include a specific category for subprime RMBS, however; all RMBS investments were included within the ABS category.

2. Hopkins's Communications with LDBF's Investors

In late 2006, home prices began to decline nationally, leading to delinquencies and defaults in the subprime mortgage sector that constituted the bulk of LDBF's assets. As a result, in February 2007, LDBF suffered a serious decline in performance, a significant cause of which was its exposure to the BBB-rated portion of the ABX Home Equity Index (the "ABX Index"), one of the lowest rated tranches of subprime RMBS.[8] The subprime crisis persisted through the Spring and Summer of 2007, as prices continued to fall significantly across even the more highly rated tranches of subprime RMBS. Throughout all of these events, Hopkins played a significant role in communicating with investors and consultants about SSgA's funds' underperformance.

a. March 2007 Letter to Investors

In February 2007, Hopkins was designated as SSgA's point-person to address, generally, its funds' exposure to the BBB-rated tranche of the ABX Index. He drafted an internal memorandum on the subject, which, at the request of client-facing personnel, he converted into a letter to be sent to current and prospective investors and consultants (the "March 2007 letter"). The letter expressly noted that its "purpose" was "not to present an in depth treatise" on recent market events, but rather to discuss those events generally and their effect on SSgA's funds. It explained that SSgA had taken "modest exposure in" BBB-rated investments, "specifically the sub-prime home equity market." It also acknowledged that the price of the BBB-rated tranche had fallen significantly, and, as a result, SSgA's "active portfolios," including LDBF, "underperformed" in February 2007.

b. Presentation to Catholic Healthcare Partners in April 2007

In April 2007, Hopkins gave a presentation to investor Catholic Healthcare Partners about LDBF's losses arising from its exposure to BBB-rated securities. In that meeting, he used a new PowerPoint presentation containing a slide stating, in relevant part, that LDBF's BBB-rated holdings had been "reduced" by one-third (the "ABX Holdings Slide"). Although the slide touted the "reduced" exposure to BBB-rated securities, it omitted to mention that while LDBF's BBB-rated holdings *had* declined from December 2006 to February 2007, those holdings had subsequently *increased*, more than making up for the previous reduction.

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8 The ABX Index tracks price movements of subprime RMBS and is divided into five rating categories (AAA, AA, A, BBB, and BBB-). From January through February 2007, the BBB-rated tranche declined by approximately 18%. During the same period, the AAA- and AA-rated tranches declined by less than 1%.

c. Conference Call with Yanni Partners in April 2007

On April 9, 2007, Hopkins participated in a conference call with representatives from investment consulting firm Yanni Partners (including its chief strategist, David Hammerstein) about State Street's Enhanced Dow Jones-AIG Commodities Index Fund (the "Commodities Fund")—specifically, the fund's exposure to the BBB-rated tranche of the ABX index. Yanni Partners advised several investors in the Commodities Fund, which itself invested in LDBF.

Although Hopkins testified that he did not recall what was said during the call, Hammerstein prepared a memorandum shortly after the call summarizing the discussion. The memorandum noted, in part, that LDBF's "current exposure to the sub-prime issues is now 2%." In testimony, Hammerstein confirmed that he understood from the call that LDBF's *total* subprime RMBS exposure was 2%—and that this exposure was limited to the BBB-rated tranche of the ABX Index. After the call, Yanni Partners recommended that its clients remain in the Commodities Fund.

d. Meeting with National Jewish Medical and Research Center and Yanni Partners on May 10, 2007

On May 10, 2007, Hopkins gave a presentation about LDBF's first-quarter performance to the National Jewish Medical and Research Center, which was a client of Yanni Partners. Before the meeting, National Jewish was given presentation materials that included both the ABX Holdings Slide (stating that LDBF's exposure to the BBB-rated tranche of the ABX Index had been reduced by one-third) and the Typical Portfolio Slide (stating that LDBF's "typical" ABS exposure was 55%).

Hopkins did not recall what he said during the meeting, including whether he discussed either slide. But Hammerstein, who attended the meeting, provided specific testimony about Hopkins's presentation. Hammerstein testified that the presentation lasted for thirty minutes, that Hopkins did most of the talking, and that Hopkins had plenty of time and finished his entire presentation.

With respect to the presentation's content, Hammerstein testified that Hopkins used both the ABX Holdings and the Typical Portfolio slides during the presentation. As to the ABX Holdings Slide, Hammerstein testified that Hopkins both presented the slide and stated that LDBF's total exposure to the BBB-rated tranche of the ABX Index was "about 2 or 3 percent of the total portfolio."[9] Although (according to Hammerstein), Hopkins did not clarify that the "2 or 3 percent" figure reflected an increase in investment level that negated the reduction described in the slide, the figure appears to accurately reflect LDBF's exposure to the BBB-rated tranche of the ABX Index at the time of the meeting.

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[9] Meeting minutes prepared by National Jewish also indicate that Hopkins stated that "State Street had just fewer than 3% of BBB subprime investment exposure; 2.5% of that was in BBB ABX."

As for the Typical Portfolio Slide, Hammerstein testified that Hopkins did specifically address the slide. Hammerstein explained that Hopkins used the slide to demonstrate that LDBF "was very high quality" and "very diversified by sector." And Hammerstein understood, from Hopkins's presentation, that LDBF's portfolio was allocated according to the percentages listed in the slide. Hammerstein testified that he found the information on LDBF's sector breakdown important because "[i]t led to the impression that the fund was well diversified, and therefore that State Street took steps to reduce the risks or control the risks." Contrary to the information presented, however, around that time LDBF's actual exposure to ABS was around 100%.[10] Hammerstein further testified that when Yanni Partners ultimately recommended that its clients liquidate their positions in the Commodities Fund, it did so because it felt that SSgA had not "adequately inform[ed] us of the risks in the portfolio, and we cited the example of the presentation that State Street made to National Jewish on May 10 when State Street stated that . . . the typical allocation was 55 percent to the ABS sector, but as recently as March 31 of 2007, the actual ABS allocation was 100 percent."

e. Conference Call with Yanni Partners in July 2007

By July 2007, credit rating agencies had begun to downgrade investments backed by subprime mortgages. And, by the end of the month, those downgrades intensified into a market-wide liquidity crisis; even highly rated tranches of subprime RMBS declined substantially in value. As a result, LDBF experienced another round of significant losses. SSgA held another conference call with Yanni Partners in late July to address the issue; both Hopkins and Hammerstein participated.[11] Hammerstein testified that, before the call, he had understood LDBF to be about 55% invested in ABS, as the Typical Portfolio Slide had represented. He also testified that it was only during the July call that he learned that LDBF's actual ABS exposure was much higher—approaching 100% at one point, with 82% invested in subprime RMBS as of June 30, 2007.

Hammerstein's testimony is supported by a Yanni Partners memorandum (prepared shortly after the July call by a Yanni Partners analyst and edited by Hammerstein) stating that LDBF "was much less diversified than" the May 10 presentation to National Jewish had indicated, and the July call "was the first time" Yanni Partners had "learned that the entire [LDBF] was exposed to the sub-prime market as recently as [March 2007]." This is "remarkable," the memorandum concluded, "given SSgA's presentation to our client on May 10, 2007." The memorandum noted that in "previous discussions," SSgA representatives had "concentrated" on the portion of LDBF's portfolio "invested in BBB sub-prime instruments while

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[10] The record shows that, at various times, Hopkins also provided accurate information about LDBF's exposure to ABS (including RMBS) in response to requests from client-facing personnel, investors, and consultants. But there is no evidence that he did so during his presentation to National Jewish. Indeed, Hammerstein's testimony indicates that, during the meeting, Hopkins did *not* correct the information in the Typical Portfolio Slide.

[11] The record is not clear as to the exact date of the call, but it appears to have occurred on July 25 or 26.

commenting that the remainder of their portfolio was invested in high quality issues. SSgA never disclosed that those issues were also tied to sub-prime mortgages."[12]

On August 3, 2007, Yanni Partners recommended that all of its clients liquidate their positions in the Commodities Fund. Hammerstein testified that his clients suffered a "peak-to-trough" loss of close to 40% by investing in LDBF through the Commodities Fund.

f. July 26, 2007 Letter to Investors

In early July 2007, Hopkins drafted a memorandum to client-facing personnel about SSgA's active fixed income portfolios, which was subsequently converted into a letter to investors (the "July 26 letter"). Hopkins reviewed for accuracy some of the comments legal counsel made to an early draft, helped coordinate edits by others, and himself commented on a draft.

In its final form, the letter (which Flannery also reviewed and edited) acknowledged that falling prices across "the three ABX Indexes . . . linked to pools of subprime mortgage debt" had contributed to the poor performance of SSgA's "active fixed income portfolios." But it also alluded to *reductions* in SSgA's portfolios' risk profiles, stating: "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."

B. Flannery

During the relevant period, Flannery was the Fixed Income Chief Investment Officer ("CIO") for the Americas at SSgA. He reported directly to SSgA's President and CEO. SSgA's portfolio managers (including the manager responsible for LDBF) reported indirectly to Flannery.

1. July 25, 2007 Investment Committee Meeting, Asset Liquidation, and Investor Redemptions

As noted above, the subprime crisis deepened significantly in July 2007, and prices fell not only in the BBB-rated tranche of the ABX Index, but also in the AAA- and AA-rated tranches. SSgA anticipated that, as a result, many investors would seek redemptions from LDBF. SSgA's Investment Committee, which had ultimate authority over all SSgA investments, addressed the issue at its July 25, 2007 meeting.

Draft meeting minutes reveal that Flannery, who filled in as the chair for the meeting (as the regular chairman was unable to attend), framed the discussion by explaining that the primary

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[12] Minutes from a Yanni Partners Investment Policy Committee meeting held on August 2, 2007 similarly state that the "typical" sector breakdown presented by SSgA "suggest[ed] a much more diversified strategy than was actually being employed."

issue the committee faced was how "to provide liquidity if our clients want to leave the fund."[13] He estimated that the additional liquidity would be required by the end of July. And, in his view, it could be raised in one of two ways: (i) sell LDBF's AAA-rated bonds, its most liquid assets, or (ii) sell a pro-rata share of assets across the portfolio. But, Flannery warned, if the committee followed the first approach and redemptions occurred (as expected), LDBF would be "stuck with a lower quality portfolio" that was "less liquid" and "valued less." He therefore endorsed the second approach. In contrast, Robert Pickett, LDBF's portfolio manager, advocated the first approach, noting that the AA-rated securities were "very illiquid" as compared to the AAA-rated ones. But, Pickett acknowledged, selling just the AAA-rated securities would "change [LDBF's] risk profile."

Numerous other attendees also remarked about the effect that liquidating just the AAA-rated bonds (versus selling a pro-rata share of assets) would have on LDBF's risk profile. One observed that anticipated redemptions would leave LDBF with just the "illiquid" and "riskier" AA-rated investments. Another asked whether selling just the AAA-rated bonds would "expos[e]" committee members "to fiduciary risk since [they] are changing the risk profile of [LDBF's] portfolio"—to which an attendee responded that if no redemptions occurred, "then no; but if a client withdraws [they] will need to revalue the portfolio." And yet another attendee hypothesized a "[w]orse [sic] case scenario" in which SSgA's own (Related) funds exited LDBF and remaining "clients in the fund . . . suffer."

Ultimately, the committee decided upon an approach between those recommended by Flannery and Pickett, instructing the portfolio management team first to build 30 to 40% liquidity in LDBF by the end of July (within less than a week); then, if redemptions occurred, to sell a pro-rata share of the fund's assets to satisfy additional demand for liquidity. But any redemptions would be first-come, first-served.

On July 26 and 27, the portfolio management team sold from LDBF approximately $1.6 billion in AAA-rated bonds and about $200 million in AA-rated bonds. By August 2, all but between $175 million and $195 million of the proceeds had been used for investor redemptions and to repay repurchase commitments. As a result of these transactions, from July 26 to August 2, LDBF's portfolio composition changed from approximately 48% invested in AAA-rated securities to less than 5%, and from approximately 46% invested in AA-rated securities to over 80%.

Russell Wermers, an expert witness for the Division, testified that LDBF's risk profile increased across that period. He explained that the liquidation of AAA-rated bonds temporarily brought more liquidity—and therefore less risk—to LDBF. But, as the cash from the sales "was largely gone within a few days" to pay redeeming investors, LDBF "became more risky almost immediately, because it had sold its highest-rated and most-liquid securities, and what remained was riskier, illiquid securities."[14] Respondents' expert witness, Ezra Zask, opined that the July

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13 Flannery testified that these draft meeting minutes are a reasonably accurate reflection of what occurred. The final meeting minutes omitted much of the detail contained in the draft.

14 Pickett concurred with Wermers, testifying that, if the cash from the sale of the AAA-rated bonds were used to meet redemptions, then LDBF's risk level would increase.

26 and 27 transactions *reduced* LDBF's risk profile because cash is less risky than AAA-rated bonds. But Zask did not address the effect on LDBF's risk profile of using the cash to pay investor redemptions.

2. August 2, 2007 Letter to Investors

In late July 2007, as SSgA was liquidating AAA-rated bonds, its executives began drafting a new letter to investors about the effects of the subprime mortgage crisis on "SSgA's active fixed income and active derivative-based strategies," including LDBF (the "August 2 letter"). After receiving an early draft, Flannery edited the letter's last paragraph, which addressed the funds' risk profiles.[15] In its final form, that paragraph stated:

> [T]he downdraft in valuations has had a significant impact on the risk profile of our portfolios, prompting us to take steps to seek to reduce risk across the affected portfolios. To date, in the Limited Duration Bond Strategy, we have reduced a significant portion of our BBB-rated securities and we have sold a significant amount of our AAA-rated cash positions. Additionally, AAA-rated exposure has been reduced as some total return swaps rolled off at month end. Throughout this period, the Strategy has maintained and continues to be AA in average credit quality according to SSgA's internal portfolio analytics. The actions we have taken to date in the Limited Duration Bond Strategy simultaneously reduced risk in other SSgA active fixed income and active derivative-based strategies.

3. August 14, 2007 Letter to Investors

In early August, Flannery drafted (and ultimately signed) another investor letter addressing LDBF's continued poor performance (the "August 14 letter"). Given the magnitude of the challenges facing LDBF, Flannery believed that investors should hear directly from SSgA's CIO. His initial draft stated, in pertinent part:

> While 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. . . . [W]e believe that liquidity will slowly re-enter the market and the segment will regain its footing. While we will continue to liquidate assets for our clients when they demand it, our advice is to hold the positions for now.

Flannery's draft was reviewed by in-house and outside counsel. In its final form, the letter contained an edit from in-house attorney Mark Duggan, who changed the final sentence quoted above to read: "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." Flannery did not object to the change, he explained, as he believed the revised language was accurate and did not alter the recommendation in his draft that investors should remain in LDBF.

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[15] Flannery also reviewed a subsequent version of the letter before it was sent on August 2. Other senior SSgA personnel and legal counsel also reviewed and edited the letter.

III.

The Division alleges that through the conduct described above, Hopkins and Flannery violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, as well as Section 17(a) of the Securities Act. Before turning to the Division's particular allegations, we explain our understanding of those provisions, including our reasons for rejecting the interpretations Hopkins and Flannery advance. We find it important to do so now for several reasons.

Notwithstanding intermittent guidance from the Supreme Court, lower courts have adopted varying approaches to liability under Rule 10b-5 (which implements Section 10(b)) and Section 17(a). The Supreme Court's recent decision in *Janus Capital Group v. First Derivative Traders* resolved some of the differences among the lower courts, as it clarified—and limited—the scope of liability under Rule 10b-5(b).[16] The decision was silent, however, as to Rule 10b-5(a) and (c) and Section 17(a), creating confusion in the lower courts as to whether its limitations apply to those provisions, as well. Moreover, *Janus*'s narrowing of liability under Rule 10b-5(b) has shifted attention to Rule 10b-5(a) and (c), as well as Section 17(a), making the lower courts' divergence of views on the scope of those provisions especially evident.[17]

We appreciate the challenges lower courts have faced, and we recognize the ambiguity in Section 10(b), Rule 10b-5, and Section 17(a). Further, we note that, to date, Commission opinions have provided relatively little interpretive guidance regarding the meaning and inter-relationship of these provisions. By setting out our interpretation of these provisions—which is informed by our experience and expertise in administering the securities laws—we intend to resolve the ambiguities in the meaning of Rule 10b-5 and Section 17(a) that have produced confusion in the courts and inconsistencies across jurisdictions.

Although we also look to the history and policies of the provisions at issue, our analysis begins with the text. Section 10(b) makes it "unlawful for any person directly or indirectly . . . to use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of" Commission rules.[18] Rule 10b-5 implements the Commission's authority under Section 10(b).[19] It does so through three

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[16] 131 S. Ct. 2296 (2011).

[17] *Compare, e.g., IBEW Local 90 Pension Fund v. Deutsche Bank AG*, No. 11-4209, 2013 WL 1223844, at *1 (S.D.N.Y. Mar. 27, 2013) (stating that "a series of alleged misstatements" that would be "separately actionable" under Rule 10b-5(b) may also be charged as a "course of conduct" amounting to a "fraudulent scheme" in violation of Rule 10b-5(a) or (c)) *with SEC v. Langford*, No. 8:12CV344, 2013 WL 1943484, at *8 (D. Neb. May 9, 2013) (stating that Rule 10b-5(a) and (c) may be used only to charge conduct that is "beyond" or "distinct from" any "alleged misrepresentation or omission") *and SEC v. Kelly*, 817 F. Supp. 2d 340, 345 (S.D.N.Y. 2010) (stating that, in misstatement cases, as long as the defendant did not "make" the misstatement, even conduct "beyond" the misstatement cannot be charged under Rule 10b-5(a) or (c)).

[18] 15 U.S.C. § 78j(b).

[19] *See United States v. Zandford*, 535 U.S. 813, 816 n.1 (2002).

subsections that are, as we have explained, "mutually supporting rather than mutually exclusive."[20] Rule 10b-5(a) prohibits "directly or indirectly . . . employ[ing] any device, scheme, or artifice to defraud."[21] Rule 10b-5(b) prohibits "directly or indirectly . . . mak[ing] any untrue statement of a material fact or [omitting] to state a material fact necessary in order to make the statements made . . . not misleading."[22] And Rule 10b-5(c) prohibits "directly or indirectly . . . engag[ing] in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person."[23] Liability under all three subsections requires a showing of scienter.[24]

Section 17(a) makes it unlawful to engage in certain conduct "directly or indirectly" in "the offer or sale of securities."[25] Like Rule 10b-5, Section 17(a) expresses its prohibitions in three "mutually supporting" subsections.[26] Section 17(a)(1) prohibits "employ[ing] any device, scheme, or artifice to defraud."[27] Section 17(a)(2) prohibits "obtain[ing] money or property by means of any untrue statement of a material fact or any [material] omission."[28] And Section 17(a)(3) prohibits "engag[ing] in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser."[29] A showing of scienter is required

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20 *Cady, Roberts & Co.*, Exchange Act Release No. 6668, 40 SEC 907, 1961 WL 60638, at *4 (Nov. 8, 1961).

21 17 C.F.R. § 240.10b-5(a).

22 *Id.* § 240.10b-5(b).

23 *Id.* § 240.10b-5(c).

24 *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 194, 213 (1976). Scienter is an "intent to deceive, manipulate, or defraud." *Id.* at 193 & n.12. It may be established through a heightened showing of recklessness. *Rockies Fund, Inc. v. SEC*, 428 F.3d 1088, 1093 (D.C. Cir. 2005); *SEC v. Ficken*, 546 F.3d 45, 47 (1st Cir. 2008); *see also Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 319 n.3 (2007) (noting that "[e]very Court of Appeals that has considered the issue has held that a plaintiff may meet the scienter requirement by showing that the defendant acted intentionally or recklessly" but that standards vary). "Extreme recklessness is an 'extreme departure from the standards of ordinary care, . . . which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it.'" *Rockies Fund*, 428 F.3d at 1093 (quoting *SEC v. Steadman*, 967 F.2d 636, 641 (D.C. Cir. 1992)); *accord Ficken*, 546 F.3d at 47-48.

25 15 U.S.C. § 77q(a).

26 *Cady, Roberts & Co.*, 1961 WL 60638, at *4.

27 15 U.S.C. § 77q(a)(1).

28 *Id.* § 77q(a)(2).

29 *Id.* § 77q(a)(3).

under Section 17(a)(1), but a showing of negligence suffices under subsections (a)(2) and (a)(3).[30]

A. Primary Liability Under Rule 10b-5(b) and Section 17(a)(2)

Rule 10b-5(b) and Section 17(a)(2) both specifically address liability for false statements and omissions.[31] In *Janus*, the Supreme Court interpreted Rule 10b-5(b)'s prohibition against "mak[ing] any untrue statement of a material fact."[32] After concluding that liability could extend only to those with "ultimate authority" over an alleged false statement, the Court held that an investment adviser who drafted misstatements that were later included in a separate mutual fund's prospectus could not be held liable under Rule 10b-5(b).[33] The adviser could not be said to have "made" the misstatements, the Court reasoned, because it was the mutual fund, not the adviser, who actually filed the prospectus.[34] The Second Circuit, one of the few appellate courts to consider *Janus*'s "ultimate authority" standard to date, has held that liability under Rule 10b-5(b) extends to defendants who "retain[] ultimate control over both the content of the communication and the decision" to communicate it, even if others are "responsible for the act of communication."[35]

Unlike Rule 10b-5(b), liability under Section 17(a)(2) is not contingent on whether one has "made" a false statement. Under Section 17(a)(2), liability instead turns on whether one has obtained money or property "by means of" an untrue statement.[36] We, like a number of courts,

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[30] *Aaron v. SEC*, 446 U.S. 680, 697 (1980). Negligence requires a showing that the defendant failed to exercise reasonable care. *Ira Weiss*, Exchange Act Release No. 52875, 58 SEC 977, 2005 WL 3273381, at *12 (Dec. 2, 2005) (citing *SEC v. Hughes Capital Corp.*, 124 F.3d 449, 453-54 (3d Cir. 1997)), *pet. denied*, *Weiss v. SEC*, 468 F.3d 849 (D.C. Cir. 2006). As many courts have recognized, the Supreme Court's decision in *Aaron* makes clear that negligence is sufficient to establish liability under Section 17(a)(2) and (a)(3). *E.g.*, *Ficken*, 546 F.3d at 47; *Weiss*, 468 F.3d at 855. But the Court has never addressed whether negligence is *necessary* to prove a violation of those provisions. Indeed, *Aaron* itself suggests that, at least under Section 17(a)(3), the focus is only on the "*effect* of particular conduct on members of the investing public, rather than upon the culpability of the person responsible" for the conduct. 446 U.S. at 696-97 (emphasis in original).

[31] Throughout this opinion, we use the terms "misstatement" and "misrepresentation" to encompass both affirmatively false statements and misleading omissions.

[32] *Janus*, 131 S. Ct. at 2302.

[33] *Id.* at 2302-05.

[34] *Id.* at 2305.

[35] *SEC v. Pentagon Capital Mgmt.*, 725 F.3d 279, 285-86 (2d Cir. 2013), *cert. denied*, 2014 WL 2921728 (U.S. June 30, 2014) (affirming liability under Rule 10b-5(b) for late-trading scheme where defendants directed the entry of trades using trade sheets containing misleading time-stamps, but the actual trades were executed by a broker).

[36] 15 U.S.C. § 77q(a)(2).

find these textual differences significant and conclude that, at least in this respect, Section 17(a)(2) "covers a broader range of activity" than Rule 10b-5(b).[37] In particular, like the First Circuit, we interpret Section 17(a)(2)'s "by means of" requirement to mean that a defendant may be held primarily liable if he *uses* a misstatement to obtain money or property, even if he "has not himself made a false statement in connection with the offer or sale of a security."[38]

Further, we conclude that because the word "make," is "absent from the operative language" of Section 17(a)(2), *Janus*'s limitation on primary liability under Rule 10b-5(b) does not apply to claims arising under Section 17(a)(2).[39] The vast majority of lower courts to consider the issue agree, reasoning that *Janus*'s holding "may not be extended to statutes lacking the very language that *Janus* construed."[40] Indeed, as one court observed, the Supreme Court's emphasis on the text of Rule 10b-5(b) "serves, if anything, to highlight the importance of the difference in the language between the two provisions."[41]

Finally, we note that our reading of Section 17(a)(2) is strongly supported by our consideration of relevant policy objectives. To be sure, it might reduce the complexity of our enforcement actions to construe Rule 10b-5(b) and Section 17(a)(2) to encompass identical conduct (apart from Rule 10b-5(b)'s scienter requirement) and to read *Janus* to apply equally to both provisions. But such an approach would conflict with the remedial purposes of the Securities Act, as well as our long-held position that the securities laws "should not be construed

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[37] *See, e.g.*, *SEC v. Stoker*, 865 F. Supp. 2d 457, 464-66 (S.D.N.Y. 2012); *see also SEC v. Tambone*, 550 F.3d 106, 127-28 (1st Cir. 2008), *opinion withdrawn*, 573 F.3d 54 (1st Cir. 2009), *reinstated in relevant part*, 597 F.3d 436 (1st Cir. 2010) (en banc).

[38] *Tambone*, 550 F.3d at 127-28 ("Liability attaches so long as the statement is *used* 'to obtain money or property,' regardless of its source." (emphasis in original)); *Stoker*, 865 F. Supp. 2d at 465 (a defendant "may be held liable under 17(a)(2)" if "he obtains money or property *by use* of a false statement, whether prepared by himself or by another" (emphasis in original)).

[39] *See SEC v. Daifotis*, No. C11-00137 WHA, 2011 WL 3295139, at *5 (N.D. Cal. Aug. 1, 2011); *see also Stoker*, 865 F. Supp. 2d at 464-66 & n.8 (collecting cases limiting *Janus*'s holding to Rule 10b-5(b) and criticizing the reasoning of the Initial Decision in its application of *Janus* to the Commission's Section 17(a) claims).

[40] *SEC v. Mercury Interactive LLC*, No. 5:07-cv-02822-WHA, 2011 WL 5871020, at *3 (N.D. Cal. Nov. 22, 2011); *accord SEC v. Monterosso*, 756 F.3d 1326, 1334 (11th Cir. 2014); *SEC v. Garber*, 959 F. Supp. 2d 374, 2013 WL 1732571, at *4 (S.D.N.Y. 2013); *Stoker*, 865 F. Supp. 2d at 464-66; *SEC v. Sells*, No. C 11-4941 CW, 2012 WL 3242551, at *7 (N.D. Cal. Aug. 10, 2012); *SEC v. Sentinel Mgmt. Group, Inc.*, No. 07 C 4684, 2012 WL 1079961, at *14-15 (N.D. Ill. Mar. 30, 2012); *SEC v. Radius Capital Corp.*, No. 2:11-cv-116-FtM-29DNF, 2012 WL 695668, at *4 n.7 (M.D. Fla. Mar. 1, 2012); *Daifotis*, 2011 WL 3295139, at *5. *But see Kelly*, 817 F. Supp. 2d at 345 (applying *Janus* to claims brought under Section 17(a) on the theory that "[a]lthough the language of [Section 17(a)(2)] is not identical to that of [Rule 10b-5(b)], both provisions have the same functional meaning").

[41] *Stoker*, 865 F. Supp. 2d at 465.

technically and restrictively, but flexibly to effectuate [those] remedial purposes."[42] Were we to construe Section 17(a)(2) more narrowly—as at least one district court has done[43]—it would eliminate even the possibility of liability under that provision for individuals who plainly use or employ, but are not themselves the "makers" of, material misstatements that defraud investors. We cannot endorse such a result.

B. Primary Liability Under Rule 10b-5(a) and (c)

1. Rule 10b-5(a) and (c) proscribe employing any manipulative or deceptive device or engaging in any manipulative or deceptive act, including the drafting or devising of fraudulent misstatements.

Unlike Rule 10b-5(b), Rule 10b-5(a) and (c) do not address only fraudulent misstatements. Rule 10b-5(a) prohibits the use of "*any* device, scheme, or artifice to defraud," while Rule 10b-5(c) prohibits "engag[ing] in *any* act, practice, or course of business which operates or would operate as a fraud or deceit."[44] The very terms of the provisions "provide a broad linguistic frame within which a large number of practices may fit."[45] We have explained that Rule 10b-5 is "designed to encompass the infinite variety of devices that are alien to the climate of fair dealing . . . that Congress sought to create and maintain."[46] The Supreme Court, too, has recognized that Section 10(b) and Rule 10b-5 "are broad and, by repeated use of the word 'any' are obviously meant to be inclusive."[47] The Court also has noted that the provisions "must be read flexibly, not technically or restrictively" in order to achieve the remedial purposes of Section 10(b) and Rule 10b-5.[48]

Nonetheless, liability under Rule 10b-5 cannot "extend beyond conduct encompassed by Section 10(b)'s prohibition."[49] And Section 10(b)'s prohibition encompasses only acts that are

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[42] *E.g.*, *John Kilpatrick*, Exchange Act Release No. 23251, 48 SEC 481, 1986 WL 626187, at *5 (May 19, 1986) (citing *Tcherepnin v. Knight*, 389 U.S. 332, 336 (1967); *Affiliated Ute Citizens of the State of Utah v. United States*, 406 U.S. 128, 151 (1972); and *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 195 (1963)).

[43] *Kelly*, 817 F. Supp. 2d at 345.

[44] 17 C.F.R. § 240.10b-5(a), (c) (emphasis added).

[45] *SEC v. Clark*, 915 F.2d 439, 448 (9th Cir. 1990) (noting the breadth of the terms "'fraud,' 'deceit,' and 'device, scheme, or artifice'").

[46] *Collins Sec. Corp.*, 46 SEC 20, 33 (1975) (internal quotation marks omitted).

[47] *Affiliated Ute*, 406 U.S. at 151.

[48] *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 475-76 (1977); *Affiliated Ute*, 406 U.S. at 151.

[49] *United States v. O'Hagan*, 521 U.S. 642, 651 (1997) (citing *Hochfelder*, 425 U.S. at 214, and *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 173 (1994)).

"themselves manipulative or deceptive."[50] Accordingly, only conduct that is itself manipulative or deceptive violates Rule 10b-5.[51]

Respondents contend that Rule 10b-5(a) and (c) are subject to additional limitations. We disagree. Rather, we conclude that primary liability under Rule 10b-5(a) and (c) extends to one who (with scienter, and in connection with the purchase or sale of securities) employs *any* manipulative or deceptive device or engages in *any* manipulative or deceptive act.[52] As various courts have recognized, that standard certainly would encompass the falsification of financial records to misstate a company's performance,[53] as well as the orchestration of sham transactions designed to give the false appearance of business operations.[54] As one court explained, those

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50 *Central Bank*, 511 U.S. at 177-78; *accord Santa Fe*, 430 U.S. at 473; *Hochfelder*, 425 U.S. at 214.

51 *See Robert W. Armstrong, III*, Exchange Act Release No. 51920, 58 SEC 542, 2005 WL 1498425, at *6 (June 24, 2005); *Leslie A. Arouh*, Exchange Act Release No. 50889, 57 SEC 1099, 2004 WL 2964652, at *5 (Dec. 20, 2004).

52 Of course, the meaning of the terms "manipulative" and "deceptive" is not self-evident. "Manipulative," the Supreme Court has explained, is "a term of art when used in connection with securities markets," referring to practices "such as wash sales, matched orders, or rigged prices, that are intended to mislead investors by artificially affecting market activity." *Sante Fe*, 430 U.S. 462, 476 (1977). The Court has not made a similar pronouncement on the meaning of "deceptive," though other courts have held that the term encompasses "a wide spectrum of conduct involving cheating or trading in falsehoods." *SEC v. Dorozkho*, 574 F.3d 42, 50 (2d Cir. 2009). Those courts have relied on dictionaries in use at the time Congress passed the Exchange Act that define "deceptive" as "having power to mislead" or "[t]ending to deceive," and define "deceive" as "[t]o cause to believe the false or to disbelieve the true." *Id.*; Webster's International Dictionary 679 (2d ed. 1934); *see also Hochfelder*, 425 U.S. at 199 nn. 20, 21 (consulting the 1934 edition of Webster's International Dictionary to define other terms in Section 10(b)). In light of these precedents and the definitions on which they rely, we conclude that to employ a "deceptive" device or to commit a "deceptive" act is to engage in conduct that gives rise to a false appearance of fact.

53 *E.g.*, *Monterosso*, 756 F.3d at 1334-36 (holding that falsification of financial records can suffice for primary liability under Rule 10b-5(a)); *SEC v. Familant*, 910 F. Supp. 2d 83, 86-88, 93-97 (D.D.C. 2012) (agreeing that such conduct suffices for primary liability under both Rule 10b-5(a) and (c)); *Langford*, 2013 WL 1943484, at *8 (same); *Sells*, 2012 WL 3242551, at *6-7 (same); *Mercury Interactive*, 2011 WL 5871020, at *2 (same).

54 *E.g.*, *In re Parmalat Sec. Litig.*, 376 F. Supp. 2d 472, 504 (S.D.N.Y. 2005) (holding that banks could be liable under Rule 10b-5(a) and (c) for engaging in transactions with issuer that lacked economic substance and allowed the issuer to misstate its financial condition); *In re Global Crossing Ltd. Sec. Litig.*, 322 F. Supp. 2d 319, 336-37 (S.D.N.Y. 2004) (holding that auditor could be liable under Rule 10b-5(a) and (c) for masterminding sham swap transactions that were used to circumvent GAAP and inflate and misstate company's revenue); *In re Lernout & Hauspie Sec. Litig.*, 236 F. Supp. 2d 161, 173-74 (D. Mass. 2003) (holding that companies that created and financed sham entities that entered into bogus transactions with another company to

(continued…)

who engage in such conduct are independently liable for their own deceptive acts, "even if a material misstatement by another person creates the nexus between the scheme and the securities market."[55]

But we believe that primary liability under Rule 10b-5(a) and (c) extends even further than many of those courts have suggested.[56] In particular, we conclude that primary liability under Rule 10b-5(a) and (c) *also* encompasses the "making" of a fraudulent misstatement to investors, as well as the drafting or devising of such a misstatement. Such conduct, in our view, plainly constitutes employment of a deceptive "device" or "act."[57] Indeed, the Supreme Court recently indicated that it agreed with this understanding—at least to the extent that Rule 10b-5(a) encompasses the "making" of a material misrepresentation.[58]

We note that, contrary to what some district courts have suggested,[59] *Janus* does not require a different result. In *Janus*, the Court construed only the term "make" in Rule 10b-5(b), which does not appear in subsections (a) and (c); the decision did not even mention, let alone construe, the broader text of those provisions.[60] And the Court never suggested that because the "maker" of a false statement is primarily liable under subsection (b), he cannot *also* be liable under subsections (a) and (c). Nor did the Court indicate that a defendant's failure to "make" a

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inflate and misstate that company's profits could be liable under Rule 10b-5(a) and (c)). These examples of deceptive acts are not exclusive. For instance, a defendant who does not "make" a misstatement for purposes of Rule 10b-5(b), but who does breach a fiduciary duty in furtherance of a fraud—perhaps by concealing the fraud from the company's board of directors—may be liable under Rule 10b-5(a) and (c) if the breach involved deception. *Cf.*, *Ryan v. Gifford*, 935 A.2d 258, 272 (Del. Ch. 2007) (concealment of a fraud from shareholders is a "deception" in breach of a fiduciary duty).

55 *Parmalat*, 376 F. Supp. 2d at 502; *see also Monterosso*, 756 F.3d at 1334-36.

56 *E.g.*, *Familant*, 910 F. Supp. 2d at 97 (suggesting that Rule 10b-5(a) and (c) are limited to conduct "beyond mere misstatements and omissions").

57 17 C.F.R. § 240.10b-5(a), (c).

58 *Chadbourne & Parke LLP v. Troice*, 134 S. Ct. 1058, 1063 (2014) (stating that Rule 10b-5 "forbids the use of any 'device, scheme, or artifice to defraud' (*including* the making of 'any untrue statement of a material fact' or any similar 'omi[ssion]') 'in connection with the purchase or sale of any security'" (alterations in original; emphasis added)).

59 *E.g.*, *SEC v. Benger*, No. 09 C 676, 2013 WL 1150587, at *5 (N.D. Ill. Mar. 21, 2013) ("*Janus* cannot be skirted simply by artful pleading and rechristening a 10b-5(b) claim as a claim under 10b-5(a) and (c)."). *But see, e.g.*, *Monterosso*, 756 F.3d at 1334 (stating that "*Janus* only discussed what it means to 'make' a statement for purposes of Rule 10b–5(b), and did not concern . . . Rule 10b–5(a) or (c)"); Arnold S. Jacobs, *Disclosure and Remedies under the Securities Laws* § 12:113.99 (agreeing that *Janus* "does not control any suit under" Rule 10b-5(a) or (c)).

60 *See generally Janus*, 131 S. Ct. 2296.

misstatement for purposes of subsection (b) precludes primary liability under the other provisions.

Moreover, our approach is fully consistent with the rationales on which *Janus* rests. The Court began its analysis with a textual basis for its holding, concluding that one who merely "prepares" a statement necessarily is not its "maker," just as a mere speechwriter lacks "ultimate authority" over the contents of a speech.[61] Our approach does not conflict with that logic: Accepting that a drafter is not primarily liable for "making" a misstatement under Rule 10b-5*(b)*, our position is that the drafter would be primarily liable under subsections *(a)* and *(c)* for employing a deceptive "device" and engaging in a deceptive "act."

Our approach is also consistent with the Court's second justification for its holding—that a drafter's conduct is too remote to satisfy the element of reliance in private actions arising under Rule 10b-5. Investors, the Court explained, cannot be said to have relied on "undisclosed act[s]," such as merely drafting a misstatement, that "preced[e] the decision of an independent entity to make a public statement."[62] Again, our analysis fully comports with that logic. Indeed, we do not suggest that the outcome in *Janus* itself might have been different if only the plaintiffs' claims had arisen under Rule 10b-5(a) or (c). As *Janus* recognizes, those plaintiffs may not have been able to show reliance on the drafters' conduct, regardless of the subsection of Rule 10b-5 alleged to have been violated. Thus, our interpretation would not expand the "narrow scope" the Supreme Court "give[s to] the implied private right of action."[63]

But to say that a claim will not succeed in every case is not to say that there is no claim at all. In contrast to private parties, the Commission need not show reliance as an element of its claims.[64] Thus, even if *Janus* precludes private actions against those who commit "undisclosed" deceptive acts, it does not preclude Commission enforcement actions under Rule 10b-5(a) and (c) against those same individuals.

2. Rule 10b-5 is not subject to the limitations Hopkins and Flannery suggest.

Hopkins and Flannery contend that, where a fraud is ultimately effected through misstatements, if the defendant did not himself "make" those misstatements, then primary liability under Rule 10b-5(a) and (c) can be established only through a showing of "additional" deceptive conduct "apart from" the misstatements. Respondents rely, in part, on *SEC v. Kelly*, a district court case that itself proposes an even narrower window for primary liability under Rule 10b-5(a) and (c). The court suggested that whenever a fraud involves misstatements made by someone other than the defendant, the defendant can *never* be held liable under Rule 10b-5(a) or

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[61] *Id.* at 2302.

[62] *Id.* at 2303-04 (citing *Stoneridge Inv. Partners v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 161 (2008)).

[63] *Id.* at 2303.

[64] *See, e.g.*, *SEC v. Morgan Keegan & Co.*, 678 F.3d 1233, 1244 (11th Cir. 2012) (noting that reliance is not an element of a Commission enforcement action).

(c), regardless of whether he engaged in deceptive conduct distinct from the misstatements.[65] We reject both constructions of our rule.

To begin with, neither reading of Rule 10b-5 can be reconciled with the text of the rule. As previously noted, Rule 10b-5(a) proscribes deceptive "device[s]," "scheme[s]," and "artifice[s] to defraud," and Rule 10b-5(c) proscribes, among other things, deceptive "act[s]." It would require a wholly arbitrary reading of those terms to construe them as *excluding* the making, drafting, or devising of a misstatement. And, as noted, the Supreme Court has recently indicated that it, too, would reject such a narrow reading of subsections (a) and (c).[66]

What is more, we have never suggested that the subsections of Rule 10b-5 must be read exclusively, such that conduct that falls within the purview of one—*e.g.*, misstatements, within subsection (b)—cannot also fall within another. To the contrary, we have explicitly advised that we consider the subsections of the rule "mutually supporting rather than mutually exclusive."[67] And, as discussed above, we have repeatedly emphasized our policy of construing the securities laws—and the rules promulgated thereunder—broadly and "flexibly[,] to effectuate [their] remedial purposes," rather than "technically and restrictively."[68] Reading the subsections of Rule 10b-5 to overlap, as we do, ensures that the Division has appropriate flexibility to charge—and protect investors from—manipulative and deceptive conduct in connection with the purchase or sale of securities.

Several courts *have* adopted the "beyond-a-misstatement" approach that Hopkins and Flannery propose, effectively holding that any misstatement-related conduct is exclusively the province of subsection (b).[69] For multiple reasons, we disagree with those decisions. First, as

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65 *See Kelly*, 817 F. Supp. 2d at 344.

66 *See Troice*, 134 S. Ct. at 1063.

67 *Cady, Roberts & Co.*, 1961 WL 60638, at *4. And in *Capital Gains*, the Supreme Court explained that because the Securities Act of 1933 was "the first experiment in federal regulation of the securities industry," it "was understandable" that Congress "include[d] both a general proscription against fraudulent and deceptive practices and, out of an abundance of caution, a specific proscription against nondisclosure." 375 U.S. at 197-98. Because Rule 10b-5 was modeled on Section 17(a) of the Securities Act, we find the same logic applicable to Rule 10b-5. It is thus reasonable to construe Rule l0b-5(a) and (c) as encompassing "all acts within the purview of Rule 10b-5[(b)]." *See* Jacobs, *Disclosure and Remedies under the Securities Laws* § 6:22 (citing *Capital Gains*); *Troice*, 134 S. Ct. at 1063.

68 *Kilpatrick*, 1986 WL 626187, at *5; *see also Rita J. McConville*, Exchange Act Release No. 51950, 58 SEC 596, 2005 WL 1560276, at *13 (June 30, 2005) ("The securities laws are to be construed broadly to effectuate their remedial purpose."), *pet. denied*, 465 F.3d 780 (7th Cir. 2006).

69 *See, e.g.*, *WPP Luxembourg Gamma Three Sarl v. Spot Runner, Inc.*, 655 F.3d 1039, 1057-58 (9th Cir. 2011) (collecting cases); *Public Pension Fund Grp. v. KV Pharm. Co.*, 679 F.3d 972, 987 (8th Cir. 2012) (following *WPP Luxembourg*); *Lentell v. Merrill Lynch & Co.*, 396 F.3d 161, 177-78 (2d Cir. 2005) (applying similar rule).

noted above, their conclusion contravenes the plain text of the rule. In addition, we understand their approach to have arisen from a misunderstanding of the Supreme Court's decision in *Central Bank of Denver, N.A. v. First Interstate Bank of Denver*. In *Central Bank*, the Court explained that only defendants who themselves employ a manipulative or deceptive device or make a material misstatement may be primarily liable under Rule 10b-5; others are, at most, secondarily liable as aiders and abettors.[70] Lower courts appropriately read *Central Bank* to require that, in cases involving fraudulent misstatements, defendants could not be primarily liable under Rule 10b-5(a) or (c) merely for having "assisted" an alleged scheme to make a fraudulent misstatement.[71] But they then began to articulate this "more-than-mere-assistance" standard imprecisely, stating that primary liability under Rule 10b-5(a) and (c) must require proof of particular deceptive conduct "beyond" the alleged misstatements.[72]

We cannot agree with this construction of our rule, particularly given how far removed it is from its origins in *Central Bank*. And *Central Bank* itself certainly does not hold that primary liability under Rule 10b-5(a) and (c) turns on whether a defendant's conduct is "beyond" a misstatement.[73] Moreover, we note that *Janus* also does not independently justify such a test. As discussed, *Janus* does not address Rule 10b-5(a) or (c), let alone suggest that primary liability under those provisions is limited to deceptive acts "beyond" misstatements. Indeed, reading *Janus* to require such an approach would be inconsistent with the decision's own emphasis on adhering to the text of the rule.[74]

Having rejected the "beyond a misstatement" approach, we necessarily also reject the even more untenable reading of Rule 10b-5(a) and (c) adopted in *Kelly*.[75] The court in that case

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70 511 U.S. at 191.

71 *E.g., Parmalat*, 376 F. Supp. 2d at 503 (explaining that Rule 10b-5(a) and (c) are violated if the "defendant's challenged conduct in relation to [the] fraudulent scheme constitutes the use of a deceptive device or contrivance"); *Lernout & Hauspie*, 236 F. Supp. 2d at 173-74.

72 *E.g.*, *In re Alstom SA*, 406 F. Supp. 2d 433, 475-76 (S.D.N.Y. 2005).

73 We believe that our approach appropriately distinguishes between primary and secondary liability, as *Central Bank* requires. Defendants who merely obtain or transmit legitimate documents knowing that they would later be falsified in order to misstate a company's financial condition would not be primarily liable under Rule 10b-5(a) and (c). Rather, such individuals would be, at most, aiders and abettors of a Rule 10b-5 violation, as they themselves did not commit a deceptive act. Similarly, defendants who engage in legitimate, rather than sham, transactions would not be primarily liable under Rule 10b-5(a) and (c), even if they "knew or intended that another party would manipulate the transaction to effectuate a fraud." *See, e.g., Simpson v. AOL Time Warner Inc.*, 452 F.3d 1040, 1047-50 (9th Cir. 2006), *vacated on other grounds sub nom. Avis Budget Group, Inc. v. Cal. State Teachers' Ret. Sys.*, 552 U.S. 1162 (2008). Again, such individuals could be liable only for aiding and abetting, as their own conduct was not itself deceptive.

74 131 S. Ct. at 2302-04.

75 817 F. Supp. 2d at 344.

concluded that, in any case involving misstatements, *Janus* precludes primary liability under Rule 10b-5(a) and (c) for all defendants who do not themselves "make" the misstatements, regardless of whether they engaged in deceptive conduct "beyond" the misstatements. That reading of *Janus* is without merit. It mistakenly assumes both that the Court intended to construe provisions that it never even mentioned and that the Court intended to give primacy to Rule 10b-5(b) at the expense of subsections (a) and (c). Indeed, as one court observed, "*Kelly* cast subsection (b) in Rule 10b–5's lead role and then crippled subsections (a) and (c) to ensure that they would never overshadow the star."[76]

C. Primary Liability Under Section 17(a)(1) and (a)(3)

1. Section 17(a) does not require conduct that is itself manipulative or deceptive.

As previously noted, Section 17(a) makes it unlawful, in the offer or sale of any security, "directly or indirectly . . . (1) to employ any device, scheme, or artifice to defraud"; (2) "to obtain money or property by means of any untrue statement of a material fact or any [material] omission"; or (3) "to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser."[77] Absent from these provisions is the language of Section 10(b) requiring that the proscribed conduct be "manipulative or deceptive."[78] There is therefore no textual basis for concluding that Rule 10b-5's requirement that the defendant's violative conduct itself be "manipulative or deceptive" also applies to Section 17(a).[79]

Our conclusion that Section 17(a) differs from Section 10(b) and Rule 10b-5 in this way is consistent with how the Supreme Court has approached these provisions. In *Ernst & Ernst v. Hochfelder*, the Court held that the "words 'manipulative or deceptive' used in conjunction with 'device or contrivance' strongly suggest that Section 10(b) was intended to proscribe knowing or

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76 *Familant*, 910 F. Supp. 2d at 95. A number of district court have disagreed with *Kelly*'s reading of *Janus*. *E.g.*, *Sells*, 2012 WL 3242551, at *6-7; *Langford*, 2013 WL 1943484, at *8; *Garber*, 2013 WL 1732571, at *4; *SEC v. Geswein*, No. 5:10CV1235, 2011 WL 4541308, at *17 n.3 (N.D. Ohio Aug. 2, 2011), *adopted in relevant part*, 2011 WL 4565861 (N.D. Ohio Sept. 29, 2011).

77 15 U.S.C. § 77q(a).

78 *See id.* § 78j(b).

79 Nevertheless, some courts have, without meaningful analysis, described Section 17(a)'s proscriptions as "substantially identical" to those in Rule 10b-5. *E.g.*, *Landry v. All Am. Assurance Co.*, 688 F.2d 381, 386 (5th Cir. 1982); *SEC v. Monarch Funding Corp.*, 192 F.3d 295, 308 (2d Cir. 1999) ("Essentially the same elements are required under Section 17(a)(1)-(3) in connection with the offer or sale of a security" as under Rule 10b-5, "though no showing of scienter is required . . . under [Section 17](a)(2) or (a)(3)."); *SEC v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1467 (2d Cir. 1996) ("With respect to § 17(a)(1), essentially the same elements [as in a Rule 10b–5 claim] must be established in connection with the offer or sale of a security.").

intentional"—rather than negligent—misconduct.[80] The Court acknowledged that portions of Rule 10b-5—subsections (b) and (c)—"could be read" to proscribe merely negligent behavior, but concluded that the language of the statute necessarily limited all three of the rule's subsections to scienter-based misconduct.[81] Just a few years later, in *Aaron v. SEC*, the Court determined that Section 17(a)(2) and (a)(3)—on which the language of Rule 10b-5(b) and (c) was patterned—do not require scienter.[82] Notably, the Court treated Section 17(a)(2) and (a)(3) differently from Rule 10b-5(b) and (c) because Section 17(a) lacked the language in Section 10(b) limiting it to "manipulative or deceptive device[s] or contrivance[s]."[83]

The Court's analysis in these cases—and its recognition of the textual differences between Section 17(a) and Section 10(b)—is consistent with our conclusion that Section 17(a) does not proscribe only conduct that is itself manipulative or deceptive.[84] Of course, as the Court explained in *Aaron*, Section 17(a)(1) requires a showing of scienter, or deceptive *intent*,[85] but we find that mental-state requirement distinct from the need to show, under Section 10(b), that the defendant's violative conduct is itself deceptive (or manipulative). And none of this is to suggest that liability may attach under Section 17(a) without any investors having been actually or potentially defrauded. Indeed, in any case brought under Section 17(a), there would need to be a showing that investors were or could have been defrauded. But that requirement too is distinct from the need to show that the defendant's *own conduct* was deceptive.[86]

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[80] 425 U.S. at 197.

[81] *Id.* at 212-14.

[82] 446 U.S. at 695-97.

[83] *See id*.

[84] Leading commenters have also recognized that Section 17(a) may cover conduct that is not itself manipulative or deceptive because it does not contain the language of Section 10(b). *E.g.*, 4 Thomas Lee Hazen, *Treatise on the Law of Securities Regulation* § 12.22 ("Section 17(a) does not contain the phrase 'manipulative or deceptive device' that is found in Section 10(b) of the Exchange Act and has formed a basis of the scienter and deception requirements."); Donald C. Langevoort, *Fraud and Deception by Securities Professionals*, 61 Tex. L. Rev. 1247, 1293 (1983) ("Aside from [S]ection 10(b), [S]ection 17(a) of the Securities Act of 1933 is the broadest section prohibiting fraud 'in the offer or sale' of any security. It is not limited to deception or manipulation . . . .").

[85] 446 U.S. at 695-97.

[86] *Accord Klamberg v. Roth*, 473 F. Supp. 544, 556 (S.D.N.Y. 1979) (noting that because Section 17(a) "is in many respects broader than [S]ection 10(b)," the Section 17(a) claims could survive even absent deceptive conduct by the defendant himself). We can conceive of a number of ways that a defendant might contribute to a fraud through conduct that is not itself deceptive or manipulative. For example, if a defendant company executed legitimate transactions with another entity knowing that the other entity would use the transactions to misstate its revenue, the defendant company could be liable under Section 17(a) even though the transactions were not themselves deceptive. *See, e.g.*, *Simpson*, 452 F.3d at 1050.

Policy considerations reinforce our reading of Section 17(a). As discussed, our approach is consistent with our longstanding policy of reading the securities laws broadly and flexibly—and rejecting technical or restrictive views that would unnecessarily limit our enforcement authority.[87] Further, our approach ensures that investors are appropriately protected from conduct in the offer or sale of securities that is not itself manipulative or deceptive—but nevertheless would operate as a fraud on those investors.

Finally, we note that nothing in *Janus* contradicts our understanding of Section 17(a). Indeed, we conclude—and nearly all courts to consider the issue agree—that *Janus* has no bearing on Section 17(a).[88] As previously noted, the term "make," which was central to the Court's analysis, is not in the operative language of any of Section 17(a)'s provisions. And in *Janus* the Court specifically explained that its reading of Rule 10b-5(b) was motivated, in part, by the need to "give narrow dimensions to" the scope of private actions under Rule 10b-5.[89] That concern is entirely inapplicable to claims brought under Section 17(a), for which there is no private right of action.[90]

2. Section 17(a)(1), like Rule 10b-5(a) and (c), encompasses misstatements and misstatement-related misconduct.

Like Rule 10b-5(a) and (c), we read the language of Section 17(a)(1) to encompass all scienter-based, misstatement-related misconduct. Indeed, Section 17(a)(1) is identical to Rule 10b-5(a) in prohibiting the "employ[ment]" of a "device," "scheme," or "artifice to defraud."[91] And, as explained above, a misstatement is undoubtedly a "device" or "artifice" to defraud.[92] Thus, one who (with scienter) "makes" a material misstatement in the offer or sale of a security has violated Section 17(a)(1)—such conduct surely constitutes "employ[ing]" a "device, scheme,

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87 *See, e.g.*, *Kilpatrick*, 1986 WL 626187, at *5.

88 *E.g.*, *Monterosso*, 756 F.3d at 1334 (stating that *Janus* addressed only "what it means to 'make' a statement for purposes of Rule 10b–5(b), and did not concern 17(a)(1) or (3)"); *Sentinel Mgmt. Group*, 2012 WL 1079961, at *14-15; *Stoker*, 865 F. Supp. 2d at 465-66 (collecting cases); 5 Alan R. Bromberg et al., *Bromberg & Lowenfels on Securities Fraud* § 7:306.58 (2d ed.) (collecting cases); *see also* Jacobs, *Disclosure and Remedies under the Securities Laws* § 12:113.99 (concurring that *Janus* does not affect the scope of liability under Section 17(a)). *But cf. Kelly*, 817 F. Supp. 2d at 345 (holding that *Janus*'s limitation on primary liability under Rule 10b-5(b) applies to Section 17(a)(2)).

89 131 S. Ct. at 2301-02, 2303 (internal quotation marks and alterations omitted).

90 Notably, we find irrelevant to our analysis of Section 17(a) (in particular, subsections (a)(1) and (a)(3)) the case law requiring conduct "beyond" a misstatement for claims arising under Rule 10b-5(a) and (c). Not only is that authority unpersuasive, as discussed, but the fact that the test arose from the requirement that Rule 10b-5 reach only manipulative or deceptive conduct renders it wholly inapplicable to Section 17(a) claims.

91 15 U.S.C. § 77q(a)(1).

92 *See Troice*, 134 S. Ct. at 1063.

or artifice to defraud." In our view, so too has any defendant who (with scienter) drafts or devises a misstatement or uses a misstatement made by others to defraud investors. In each case, the person has "employ[ed]" a "device" or "artifice to defraud."

We thus reject any suggestion that because Section 17(a)(2) expressly prohibits certain negligent misstatements, that limits the reach of Section 17(a)(1) by excluding from its purview all intentional, misstatement-related conduct.[93] To begin with, Section 17(a)(1) and (a)(2) address very different types of conduct—Section 17(a)(1) proscribes all scienter-based fraud, whereas Section 17(a)(2) prohibits negligent misrepresentations that deprive investors of money or property. And we have recognized that the subsections of Section 17(a) are "mutually supporting rather than mutually exclusive."[94] As the Supreme Court has expressly observed, "[e]ach succeeding prohibition [in Section 17(a)] is meant to cover additional kinds of illegalities—not to narrow the reach of the prior sections."[95]

We find that to read the provisions as mutually exclusive would inappropriately limit the Division's ability to charge fraudulent conduct and thereby protect investors. It would also effectively immunize under the Securities Act intentionally fraudulent misstatements (and misstatement-related conduct) that did not result in the defendant's obtaining money or property. We find such a result inconsistent with the text of the statute and the policy underlying it. Accordingly, we read Section 17(a)(1) to encompass the making, drafting, and devising of a misstatement, as well as other forms of conduct that contribute to a fraud.

3. Section 17(a)(3) encompasses misstatements only to the extent they can be deemed fraudulent transactions, practices or courses of business.

Section 17(a)(3) prohibits all "transaction[s]," "practice[s]," and "course[s] of business" that "operate[] or would operate as a fraud."[96] Although its language closely resembles Rule 10b-5(c), Section 17(a)(3) uses the term "transaction" rather than the broader term "act." We find that difference significant—while a misstatement (or misstatement-related activity) may fairly be characterized as an "act," a misstatement is not a "transaction."[97] Accordingly, we read Section 17(a)(3) to be narrower than Rule 10b-5(c) in this respect—*i.e.*, Section 17(a)(3) does

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93 *See, e.g.*, *Kelly*, 817 F. Supp. 2d at 345-46.

94 *Cady, Roberts & Co.*, 1961 WL 60638, at *4.

95 *United States v. Naftalin*, 441 U.S. 768, 774 (1979). Reading Section 17(a)(1) to encompass misstatements also does not cause Section 17(a)(2) to be wholly subsumed by Section 17(a)(1), because Section 17(a)(2) permits liability for negligence, whereas Section 17(a)(1) requires a showing of scienter. *See Aaron*, 446 U.S. at 695-97.

96 15 U.S.C. § 77q(a)(3).

97 *Compare* Webster's New International Dictionary 25 (def. 1) (2d ed. 1934) (defining "act" broadly as "[t]hat which is done or doing; the exercise of power, or the effect whose cause is power exerted; a performance; a deed") *with id.* 2688 (def. 2a) (defining "transaction" as "[a] business deal; an act involving buying and selling").

not encompass those "acts" proscribed by Rule 10b-5(c) that are not "transactions," "practices" or "courses of business."[98]

As a result, whereas Rule 10b-5(a) and (c) and Section 17(a)(1) all would proscribe even a single act of making or drafting a material misstatement to investors, Section 17(a)(3) is not susceptible to a similar reading. Of course, one who *repeatedly* makes or drafts such misstatements over a period of time may well have engaged in a fraudulent "practice" or "course of business," but not every isolated act will qualify.[99] And none of this is to suggest that the word "transaction" is not also an operative term in the statute—a transaction that itself operated or would operate as a fraud certainly could serve as the basis for primary liability, as well.

Despite being narrower than Rule 10b-5(c) in some respects, Section 17(a)(3) is broader than Rule 10b-5(c) (and Section 17(a)(1)) in others. As discussed above, Section 17(a)(3) does not require that the defendant have engaged in conduct that is itself deceptive (or manipulative). Nor does Section 17(a)(3) require a showing of scienter. Indeed, *Aaron* instructs that "the language of [Section] 17(a)(3)] . . . quite plainly focuses upon the effect of particular conduct on members of the investing public, rather than upon the culpability of the person responsible."[100] Section 17(a)(3)'s prohibition could apply, therefore, where, as a result of a defendant's negligent conduct, investors receive misleading information about the nature of an investment or an issuer's financial condition. It also might apply where, as a result of a defendant's negligence, prospective investors are prevented from learning material information about a securities offering.[101]

Once again, policy concerns support our conclusion. Our reading of Section 17(a)(3) affords the Division appropriate flexibility in charging—and protecting investors from—fraudulent transactions, practices, and courses of business in the offer or sale of securities. But it also stops short of granting the Division what some might view as unfettered authority to charge even an isolated, negligent misstatement that does not result in the receipt of money or property.

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98 *See* Jacobs, *Disclosure and Remedies under the Securities Laws* § 3:248 (suggesting that "the word 'transaction' in Section [17(a)(3)] is less broad than 'act' in [Rule 10b-5(c)]").

99 *See id.* at 1937 (def. 1b) (defining "practice," when used as a noun, in terms suggesting repeated conduct engaged in over time: "often, repeated or customary action; usage; habit; custom; . . . the usual mode or method of doing something"); *id.* 610 (def. 5) (defining "course," when used in phrases like "course of conduct," to mean "a succession of acts or practices" or "[a] series of motions or acts").

100 *Aaron*, 446 U.S. at 697 (emphasis omitted).

101 *See, e.g.*, *Johnny Clifton*, Securities Act Release No. 9417, 2013 WL 3487076, at *10 (July 12, 2013) (finding a Section 17(a)(3) violation because defendant "conceal[ed] material adverse information" from "sales representatives" and "ensure[d] that sales representatives who learned such information also withheld it from prospective investors").

IV.

Under the standards set forth above, we find Hopkins liable under Rule 10b-5(a), (b), and (c), as well as Section 17(a)(1). We find Flannery liable under Section 17(a)(3).[102]

A. Hopkins

The Division alleges that Hopkins violated Section 10(b), Rule 10b-5(b), and Section 17(a)(2) by making misrepresentations in three different communications: the Typical Portfolio Slide, the ABX Holdings Slide, and oral statements to Hammerstein during the April 9, 2007 conference call. The Division also alleges that Hopkins violated Section 17(a)(2)—but not Section 10(b) or Rule 10b-5(b)—through his use of misrepresentations in two separate communications: the Fact Sheets and the March 2007 letter. Finally, the Division claims that through all of these communications—as well as his involvement with the July 26, 2007 letter—Hopkins "engaged in a scheme to defraud, and a course of business [that] operated as a fraud" in violation of Rule 10b-5(a) and (c) and Section 17(a)(1) and (a)(3).

We address each alleged instance of misconduct in turn, considering whether it meets the criteria set forth above for liability under the subsections of Rule 10b-5 and Section 17(a). We conclude that Hopkins violated Rule 10b-5(a), (b), and (c), as well as Section 17(a)(1), with respect to the Typical Portfolio Slide, but we find him not liable for his conduct relating to the other communications.

1. The Typical Portfolio Slide

a. The Typical Portfolio Slide Was Misleading.

As previously explained, the PowerPoint presentation provided to existing and prospective LDBF investors included a slide describing LDBF's "typical" portfolio by sector. The slide consistently represented that only 55% of the fund was invested in ABS, when, in reality, LDBF was substantially more invested in ABS. Indeed, notwithstanding the information on the slide, LDBF's *actual* ABS exposure was: (i) 68.5% on September 30, 2006; (ii) 85.7% on December 31, 2006; (iii) 100% on March 31, 2007; and (iv) 81.3% on June 30, 2007. Given the magnitude of the difference between the represented "typical" versus actual exposure levels across this time period, we find the slide misleading.

Hopkins contends that the slide was not misleading because it showed LDBF's "typical," rather than "actual," sector breakdown—and, he claims, the 55% investment level *was* fairly typical, at least through 2004. That argument is unconvincing, as the slide did not even come close to truthfully representing LDBF's "typical" portfolio during the relevant time period—late 2006 through mid-2007. Moreover, the only testimony on this point demonstrates that at least

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[102] We apply a preponderance of the evidence standard in determining whether the record supports the Division's claims. *See Steadman v. SEC*, 450 U.S. 91, 102 (1981). We note that the law judge found the Respondents to be credible witnesses; none of our conclusions are inconsistent with that finding.

one consultant was in fact misled as to LDBF's exposure level: Hammerstein testified that he believed that LDBF was about 55% invested in ABS after he was shown the Typical Portfolio Slide in his May 10, 2007 meeting with Hopkins. At that time, LDBF's actual exposure to ABS was around 100%.

b. The Misrepresentations in the Typical Portfolio Slide Were Material.

For a misleading statement to be material, "there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available."[103] We have held that omissions about changes to portfolio composition meet this standard because "reasonable investors would have considered it important" to know that a fund had changed its portfolio composition and thereby increased its risk profile.[104] Here, we similarly conclude that reasonable investors would have viewed disclosure of the fact that, during the relevant period, LDBF's exposure to ABS was substantially higher than was stated in the slide as having significantly altered the total mix of information available to them.

Hopkins makes three primary arguments against such a finding. *First*, he contends that, even if the omitted facts *were* material, they became so only *after* the financial crisis hit in July 2007. In support, he notes that, in early 2007, investors who were given more accurate information about LDBF's risk profile did not immediately redeem their shares. But, as discussed above, we consider misleading statements about the nature of investments to be material to investors *regardless* of when they are made.[105] Moreover, a misrepresentation can be material as long as a reasonable shareholder would deem it "important" to his deliberations; the standard does not require proof "that disclosure of the omitted fact would have caused the reasonable investor to change" his behavior.[106] Thus, the fact that some investors learned the

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[103] *Basic Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988).

[104] *Fundamental Portfolio Advisors, Inc.*, Exchange Act Release No. 48177, 56 SEC 651, 2003 WL 21658248, at *11-12 (July 15, 2003) (fund's changes to its portfolio resulting in increased interest rate risk and longer duration were material), *pet. denied sub nom.*, *Brofman v. SEC*, 167 F. App'x 836, 838 (2d Cir. 2006) (finding that "[s]ubstantial evidence supports the SEC's finding of materiality"); *see also, e.g.*, *Freudenberg v. E*Trade Fin. Corp.*, 712 F. Supp. 2d 171, 182-84 (S.D.N.Y. 2010) (allegations that defendant misrepresented its loan portfolio as containing "superprime" or safer-than-prime loans, when the loans were subprime or of lower quality, satisfied materiality pleading requirements); *In re MoneyGram Int'l, Inc. Sec. Litig.*, 626 F. Supp. 2d 947, 975-78 (D. Minn. 2009) (finding that the "concealment of specific information related to the Portfolio's subprime exposure and contents" may have misled a reasonable investor).

[105] *Cf. Freudenberg.*, 712 F. Supp. 2d at 177, 182 (recognizing that misleading disclosures about subprime exposure were material even before July 2007); *In re MoneyGram Int'l, Inc. Sec. Litig.*, 626 F. Supp. 2d at 975-78 (same).

[106] *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976).

truth about LDBF's risk profile and did not immediately redeem their shares does not establish that the omitted information was necessarily immaterial.

Second, Hopkins states that the following "factor[s]" support a determination that the omitted information was not material: "(1) the slide 'on its face states that it is typical,' (2) State Street provided information upon request about its actual LDBF portfolio, (3) such information was available from a variety of sources, (4) enhanced cash strategies were widely discussed in the press and well known in the financial community, (5) Hopkins brought current information about the portfolio's allocation to his presentations, and (6) most investors did not inquire into the composition of a fund's portfolio." We take his argument to be that the information was not material because it was available to LDBF investors had they sought it out (as some, but not all, did), and the financial community was sufficiently apprised of investment strategies like LDBF's that investors would have inquired about LDBF's actual portfolio composition if it was important to them.

We are not persuaded. None of the facts Hopkins cites establishes that a reasonable investor who received the Typical Portfolio Slide would not consider information about LDBF's actual portfolio composition as having altered the total mix of information available to them. Indeed, in *SEC v. Morgan Keegan & Co., Inc.*, the Eleventh Circuit rejected the argument that accurate disclosures that would have been "available to any 'reasonably diligent investor'" rendered certain oral misrepresentations about an investment immaterial.[107] There, like here, the misrepresentations were made directly to prospective investors, and corrective information was available only upon request or through the investors' own research efforts. Other courts have reached analogous conclusions, similarly rejecting claims that once financial information enters the public domain (albeit in a very limited fashion), that alone relieves the speaker of any duty to disclose information necessary to make his statements not misleading.[108] It would send an extraordinarily dangerous message to say that Hopkins was free to make any misstatements about LDBF he wished in his presentations, so long as he could later claim that investors could have obtained accurate information about the fund if they had only known to ask.

Third, Hopkins claims that because most LDBF investors were relatively sophisticated, any details about the fund's holdings and risk profile that were omitted from the Typical Portfolio Slide were not material to them. The Supreme Court, however, has long instructed that "[t]he question of materiality . . . is an objective one, involving the significance of an omitted or

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107 678 F.3d at 1252-53.

108 *E.g.*, *New Jersey Carpenters Health Fund v. Royal Bank of Scotland*, 709 F.3d 109, 127 (2d Cir. 2013) (explaining that "'[t]here are serious limitations on a corporation's ability to charge its stockholders with knowledge of information omitted from a document such as a . . . prospectus on the basis that the information is public knowledge and otherwise available to them'"); *Dolphin & Bradbury, Inc. v. SEC*, 512 F.3d 634, 641 (D.C. Cir. 2008) (rejecting argument that defendant did not have a duty to disclose information that was necessary to make statements not misleading given that information "was technically in the public domain," as the information "was not reasonably available to investors").

misrepresented fact to a reasonable investor."[109] It has reiterated that position on multiple occasions, finding "no authority in the statute, the legislative history, or [its] previous decisions, for varying the standard of materiality depending on" the recipient of "the withheld or misrepresented information."[110]

Indeed, the Court recently confirmed that view in *Amgen Inc. v. Connecticut Retirement Plans and Trust Funds*, a case holding that proof of materiality is not a prerequisite for certifying a securities-fraud class action.[111] Crucial to its holding was the Court's conclusion that "because materiality is judged according to an objective standard," the "alleged misrepresentations and omissions, whether material or immaterial, would be so equally for all investors composing the class."[112] The Court emphasized that "[i]n no event will the individual circumstances of particular class members bear on the [materiality] inquiry."[113]

Further, the courts of appeals do not consider investor sophistication when evaluating the materiality of misrepresentations and omissions.[114] *SEC v. Happ*[115] and *Alton Box Board Co. v. Goldman, Sachs & Co.*,[116] which Respondents cite, are not to the contrary.[117] In *Happ*, the court

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[109] *TSC Indus.*, 426 U.S. at 445; *see Basic*, 485 U.S. at 232 (explicitly adopting the *TSC Industries* materiality standard for Section 10(b) actions).

[110] *Basic*, 485 U.S. at 240 & n.18; *see also Matrixx Initiatives, Inc. v. Siracusano*, 131 S. Ct. 1309, 1318, 1321-22 (2011) (emphasizing that materiality is weighed from the perspective of the "reasonable investor"); *Virginia Bankshares, Inc. v. Sandberg*, 501 U.S. 1083, 1097-98 (1991) (same; rejecting the proposition that materiality should be evaluated from the perspective of a "financial analyst").

[111] 133 S. Ct. 1184, 1195 (2013).

[112] *Id.* at 1191.

[113] *Id.*

[114] *See, e.g.*, *Folger Adam Co. v. PMI Indus., Inc.*, 938 F.2d 1529, 1535 (2d Cir. 1991) (holding that, although the court was "sympathetic to appellees' claim that Folger Adam is a sophisticated investor," "reasonable minds could differ as to whether a *reasonable investor* in Folger Adam's position would have considered appellees' omissions and alleged misstatements" to be material (emphasis added)).

[115] 392 F.3d 12 (1st Cir. 2004).

[116] 560 F.2d 916 (8th Cir. 1977).

[117] Other cases Respondents cite are inapposite because they consider investor sophistication not for purposes of materiality, but only in the context of reliance or scienter. *E.g.*, *Banca Cremi, S.A. v. Alex. Brown & Sons, Inc.*, 132 F.3d 1017, 1032 (4th Cir. 1997) (considering investor sophistication in context of reliance argument); *Myzel v. Fields*, 386 F.2d 718, 735-37 (8th Cir. 1967) (same); *Martin v. Steubner*, 485 F. Supp. 88, 97 (S.D. Ohio 1979) (considering defendant's perception of investor's sophistication when evaluating defendant's scienter), *aff'd*, 652 F.2d 652 (6th Cir. 1981); *Berger v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 505 F. Supp. 192, 194 (S.D.N.Y. 1981) (same). Similarly, *Scarfarotti v. Bache & Co., Inc.*, 438 F.

(continued…)

observed that the defendant's financial sophistication might have caused him to recognize the importance of the inside information he received, but it still applied the "reasonable investor" standard when concluding that the information in question was material.[118] In *Alton Box*, the court noted that the facts of the case involved sophisticated institutional purchasers but held that the relevant question for the trier of fact was the materiality of the information to a "reasonable shareholder."[119] And to the extent the district court cases Respondents cite consider investor sophistication when analyzing materiality, we find such approach in tension with the Supreme Court's guidance in *TSC Industries*, *Basic*, and *Amgen*.[120]

Finally, we note that even if LDBF investors were relatively sophisticated about investing, generally, the evidence does not establish that they (or the consultants many of them employed to assist with investment decisions) were uniformly sophisticated about fixed income investing, in particular. Thus, even under the subjective materiality inquiry Hopkins proposes, we still would find that disclosure of the information omitted from the Typical Portfolio Slide

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(…continued)
Supp. 199, 205-06 (S.D.N.Y. 1977), discussed investor sophistication but found the plaintiffs' claims unavailing *not* because the statements made were immaterial, but because they were not misleading and were not the cause of the plaintiffs' alleged losses. Finally, *Seibert v. Sperry Rand Corp.*, 586 F.2d 949, 951-52 (2d Cir. 1978), held that omitted facts were immaterial because they were "trivial" and "already in the public domain," not because the investors were sophisticated.

118 *Happ*, 392 F.3d at 21-22 (stating that because the defendant "was a financial expert and had closely followed the affairs of" the company, the jury could "find him capable of drawing reasonable inferences" from information received from" the company's CEO); *id.* at 23 n.4 ("[I]n the circumstances here . . . there is a substantial likelihood that a reasonable investor would consider the" tipped information "significant."). Moreover, *Happ* is especially inapposite here because it did not *impute* financial sophistication to a large set of investors—as Respondents argue we should do here—but rather looked to the facts that a single defendant *actually knew* when evaluating his response to receiving inside information. *See* 392 F.3d at 22-23.

119 *Alton Box*, 560 F.2d at 922.

120 Nonetheless, those cases are distinguishable. In *SEC v. Rorech*, 720 F. Supp. 2d 367, 372 (S.D.N.Y. 2010), the court found alleged inside information not material because it was publicly available, not because the investors were sophisticated. And while *Drobbin v. Nicolet Instrument Corp.*, 631 F. Supp. 860, 891 (S.D.N.Y. 1986), and *Quintel Corp. v. Citibank, NA*, 596 F. Supp. 797, 802 (S.D.N.Y. 1984), consider investor sophistication when evaluating "the adequacy of disclosure" to investors (as well as reliance), at least two appellate courts have held that materiality and "the adequacy of disclosure" are analytically distinct concepts. *See Isquith v. Middle S. Utilities, Inc.*, 847 F.2d 186, 207-08 (5th Cir. 1988) (distinguishing "adequacy of disclosure" from materiality and holding that both are objective inquiries); *Durning v. First Boston Corp.*, 815 F.2d 1265, 1268 (9th Cir. 1987) (same).

(LDBF's *actual* investment level in ABS) would have "significantly altered the 'total mix' of information made available" to LDBF's investors.[121]

c. Hopkins Acted with Scienter with Respect to the Misrepresentations in the Typical Portfolio Slide.

Under Rule 10b-5 and Section 17(a)(1), Hopkins may be held liable if he acted with extreme recklessness; he need not have had actual knowledge that his misrepresentations would mislead investors.[122] That said, the preponderance of the evidence establishes that Hopkins did know that the Typical Portfolio Slide was misleading when it was provided to investors and consultants. Hopkins admitted that he knew the allocations listed on the slide were not "typical" (as the slide claimed), and his own notes on his copies of the slide demonstrate his knowledge of LDBF's actual portfolio composition when he gave the presentations. For example: for the July 2006 presentation to Johns Hopkins, Hopkins noted that 90% of LDBF's assets were in ABS; for the December 2006 presentation to Kalson, Hopkins noted that 80% of LDBF was invested in ABS; and for the February 2007 presentation to LACERA, Hopkins noted that 90% of LDBF was in ABS. At the very least, we find this evidence shows that Hopkins must have known that the Typical Portfolio Slide would mislead LDBF investors, and he recklessly disregarded that fact.[123]

Hopkins argues, in effect, that even if he knew the slide was misleading, the Division still failed to demonstrate that he knew or recklessly disregarded the *materiality* of the slide's misrepresentations because "nobody at the time thought the omitted information was important." As discussed above, however, we find that the omitted information was in fact material to investors at the time of the presentations, notwithstanding that the industry did not yet fully appreciate the danger of subprime investments. Moreover, we find that the Division adequately established that Hopkins knew (or at least recklessly disregarded) that the Typical Portfolio Slide's misleading omissions were material *to LDBF investors*. Hopkins found information about the fund's actual portfolio composition sufficiently important that he made note of it on his copies of the presentation slides. And the record shows that, on numerous occasions in 2006 and 2007, he responded to requests from investors, consultants, and client-facing SSgA personnel about LDBF's actual subprime RMBS exposure. The very fact of these inquiries—and his responses—shows that Hopkins must have appreciated that the information was important to LDBF investors.[124]

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121 *See Basic*, 485 U.S. at 232.

122 *See Rockies Fund*, 428 F.3d at 1093; *Ficken*, 546 F.3d at 47-48.

123 As previously noted, there is no evidence that Hopkins corrected the misleading information in the Typical Portfolio Slide during the presentations in which he participated.

124 *See Dolphin & Bradbury*, 512 F.3d at 643 (finding that investor inquiries demonstrated that the defendant "must have known the information was important to investors" (internal quotation marks omitted)).

In sum, we find that Hopkins acted with the requisite scienter because he knew that omitting the information at issue from the Typical Portfolio Slide posed a danger of misleading investors and, in any event, that danger was so obvious that he must have been aware of it.[125]

d. Hopkins "Made" the Statement in the Typical Portfolio Slide.

We find that, at least with respect to the May 10, 2007 presentation to National Jewish, Hopkins "made" the misrepresentations in the Typical Portfolio Slide and therefore is liable under Rule 10b-5(b). Hammerstein testified specifically that Hopkins presented the slide during the meeting, that he did so without divulging LDBF's actual portfolio composition, and that Hammerstein understood from the slide that LDBF was very diversified by sector.[126] The evidence also shows that: (i) Hopkins was responsible for ensuring the accuracy of the information in the Typical Portfolio Slide; (ii) Hopkins's name appeared on the cover of PowerPoint presentations containing the slide that were provided to investors and consultants for meetings in which Hopkins was one of the lead presenters; and (iii) Hopkins made handwritten notes on the Typical Portfolio Slide in preparation for the presentations, suggesting that he was responsible for the portion of the presentation that covered the information in the slide. From this evidence, we conclude that Hopkins had "ultimate authority over the statement, including its content and whether and how to communicate it"[127]—at least with respect to the May 10, 2007 presentation.[128]

The only evidence that Hopkins did *not* present the Typical Portfolio Slide is his own testimony that he "never addressed the[] sector breakdowns [in the Typical Portfolio Slide] and . . . was never asked a question on them." But Hopkins *also* testified that he did not recall whether he discussed or was ever "asked a question about" the Typical Portfolio Slide. If he

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125 *Cf. id.* (rejecting argument that defendant lacked scienter because he, personally, did not believe omitted facts would be material to investors and because, he claimed, "the danger of non-disclosure was not obvious" at the time of the investment decision); *Fundamental Portfolio Advisors*, 2003 WL 21658248, at *13 (rejecting argument that nondisclosure of changes to portfolio cannot be reckless if defendant's approach was consistent with industry practice at the time).

126 The law judge found Hammerstein to be a credible witness, and we found no compelling evidence in the record contradicting Hammerstein's account of the May 10 meeting. *See Flannery*, 2011 WL 5130058, at *40 n.78.

127 *Janus*, 131 S. Ct. at 2302 ("One 'makes' a statement by stating it.").

128 Although Hopkins may have personally presented the Typical Portfolio Slide during other investor presentations, the record does not establish that he did. We therefore cannot conclude that he "made" misrepresentations in connection with those presentations. Moreover, because we find that he "made" only the one misrepresentation, we need not address Hopkins's argument that it would be inappropriate to attribute to him statements made in *other* presentations where the only evidence in support of such a finding is that his name appears on the cover of the slide presentation.

does not recall any discussion at all about the slide, then his certainty that he never addressed or was questioned about the "sector breakdowns" is questionable—and certainly not compelling.[129]

e. Hopkins's Misrepresentation in the Typical Portfolio Slide Constitutes a Deceptive "Device" and "Artifice to Defraud," as well as a Deceptive "Act."

For the reasons discussed above, we believe that the "maker" of a misstatement necessarily has employed a "device" or "artifice to defraud" for purposes of liability under Rule 10b-5(a) and Section 17(a)(1), and that such conduct is "deceptive" as required by Rule 10b-5(a). "Making" a misstatement also constitutes engaging in a deceptive "act" for purposes of liability under Rule 10b-5(c). Therefore, having found that Hopkins "made" the misstatement in the Typical Portfolio Slide, at least with respect to the National Jewish presentation, we conclude that he also employed a device or artifice to defraud, in violation of Section 17(a)(1) and Rule 10b-5(a), that he engaged in an "act" which operated or "would operate as a fraud or deceit," in violation of Rule 10b-5(c), and that his conduct was deceptive, in violation of Section 10(b).

As for the other presentations before which attendees received copies of the Typical Portfolio Slide, we find that the record does not support holding Hopkins liable under Rule 10b-5(a) or (c) or Section 17(a)(1) for having employed a "device" or "artifice to defraud" or having engaged in a deceptive "act." As discussed above, Hopkins *could* be liable under those provisions for his decision not to revise the Typical Portfolio Slide before it was distributed to meeting attendees, regardless of whether he, personally, presented the information and therefore "made" the misleading statements to investors. His conduct—approval of the misleading language—certainly *could* constitute a deceptive "device" or "artifice to defraud," as well as a deceptive "act." But, on this record, it is unclear precisely how the information in the slide was presented and whether Hopkins or anyone else corrected the misrepresentations in the slide during the meetings. Accordingly, we cannot hold Hopkins liable under Rule 10b-5(a) or (c) or Section 17(a)(1) with respect to those presentations.

f. Hopkins Did Not "Obtain Money or Property by Means of" the Misrepresentation in the Typical Portfolio Slide.

Hopkins argues that the Division failed to establish, as Section 17(a)(2) requires, that he "obtain[ed] money or property by means of" the misstatements in the Typical Portfolio Slide. We agree that the Division failed to show that any money or property was obtained "by means of" the misrepresentations in the Typical Portfolio Slide.[130] We are persuaded by courts that

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[129] We also find not compelling Hopkins's claim that *if* he presented the Typical Portfolio Slide to investors, then "it is as likely as not that he also supplied the actual, current sector allocations to his audience." He points to no evidence in support of such claim.

[130] We note that the few district courts that have addressed the scope of Section 17(a)(2)'s requirement that a defendant "obtain money or property" are split on whether the defendant must have personally "obtain[ed]" money or property, or whether a benefit to his employer suffices. *Compare SEC v. Syron*, 934 F. Supp. 2d 609, 639-40 (S.D.N.Y. 2013) (requiring a showing that the defendant "personally gained money or property from" the alleged fraud); *Daifotis*, 2011 WL

(continued…)

have held that liability under Section 17(a)(2) requires that a defendant obtain money or property "by use of" misleading information, suggesting the need for a causal link between the misrepresentation and the acquisition of money or property.[131] Accordingly, we conclude that a misrepresentation must be at least relevant to, if not the cause of, the transfer of money or property from an investor to the defendant (or perhaps his employer).[132]

The Division claims that merely because Hopkins "made" the misstatement in the Typical Portfolio Slide, he "therefore 'used'" that misstatement to obtain money or property. But the Division failed to show any connection between Hopkins's use of the misleading information and either Hopkins's or SSgA's acquisition of money or property. Accordingly, we find that Hopkins cannot be held liable under Section 17(a)(2) with respect to the Typical Portfolio Slide.[133]

(…continued)
2183314, at *10 (same); *SEC v. Burns*, No. 84-0454, 1986 WL 36318, at *3-4 (S.D. Cal. Feb 19, 1986) (same) *with Stoker*, 865 F. Supp. 2d at 463 (holding that under Section 17(a)(2), it would be sufficient to show *either* that a defendant "personally obtained money indirectly from the fraud" *or* that he "obtained money or property for his employer while acting as its agent"); *SEC v. Mudd*, 885 F. Supp. 2d 654, 669-70 (S.D.N.Y. 2012) (adopting *Stoker* test); *SEC v. Delphi Corp.*, No. 06-14891, 2008 WL 4539519, at *20 (E.D. Mich. Oct. 8, 2008) (holding that "Section 17(a)(2) does not require that" a defendant "obtain money or property for themself"). But we need not resolve that question today, given our finding that the Division did not show that any money or property was obtained "by means of" the misrepresentations.

131 *Stoker*, 865 F. Supp. 2d at 465; *cf. Tambone*, 550 F.3d at 127-28 (requiring that the misrepresentation be "*used* 'to obtain money or property'"). We note that *Stoker*, which embraced the more expansive test for whether one has "obtain[ed]" money or property, still required a showing that the money or property be obtained "by use of" the misstatement. 865 F. Supp. 2d at 465.

132 *Cf. Loughrin v. United States*, 134 S. Ct. 2384, 2393-94 (2014) (explaining that the phrase "by means of" in the federal bank fraud statute, 18 U.S.C. § 1344(2), which makes it a crime to "knowingly execut[e] a scheme . . . to obtain" property owned by, or under the custody of, a bank "by means of false or fraudulent pretenses," imposes a "significant *textual* limitation on § 1344(2)'s reach": "It demands that the defendant's false statement is the mechanism naturally inducing a bank (or custodian) to part with its money").

133 The Division arguably asserts that SSgA and Hopkins "obtained money or property" by inducing investors who otherwise might have redeemed their shares in LDBF to remain in the fund. But the Division does not explain how such a claim would satisfy the requirement that Hopkins "*obtain*[ed]" money or property by means of his misrepresentations and did not pursue this theory at oral argument. Rather, at oral argument, counsel for the Division suggested that Hopkins's receipt of salary and/or bonus payments during the course of his employment could satisfy the "obtained money or property" requirement, on the theory that Hopkins successfully "obtained" money for his employer, some of which was passed on to him. However, under the assumption that an employer's receipt of money or property would suffice for liability, the Division has nevertheless failed to explain how, if at all, State Street's receipt of money or property was tied to, or dependent upon, Hopkins's alleged misconduct.

g. Hopkins's Conduct with Respect to the Typical Portfolio Slide Does Not Constitute a "Practice" or "Course of Business" that Operated as a Fraud on LDBF Investors.

As previously explained, while not every isolated act of making, drafting, or employing a misstatement will qualify as a "practice" or "course of business" with a deceptive "effect . . . on member[s] of the investing public,"[134] an individual's repeated use of a misleading statement may satisfy that standard. If the record were clear that Hopkins personally presented the information in the Typical Portfolio Slide to investors on more than one occasion, or that others presented the information he had approved—and that, in either case, the information was presented without disclosure of LDBF's actual portfolio composition—this might be such a case. But the evidence establishes only that Hopkins made one such presentation, and the record is unclear as to how the information was presented at the other meetings. Accordingly, we find that Hopkins's conduct does not rise to the level of a "practice" or "course of business" that operated (or would have operated) as a fraud on LDBF's investors. He therefore is not liable under Section 17(a)(3) for his conduct relating to the Typical Portfolio Slide.

2. The Fact Sheets

The Division alleges that Hopkins provided misleading information to investors through LDBF's quarterly Fact Sheets. Specifically, the Division claims that the Fact Sheets were misleading because: (i) they "falsely represented that LDBF was sector diversified" when "Hopkins knew the fund was virtually all subprime RMBS"; (ii) they described LDBF's exposure to ABS but fraudulently omitted that all of the ABS exposure was actually subprime RMBS; and (iii) they "misleadingly concealed the risk of LDBF by omitting LDBF's significant use of leveraged subprime investments."[135] The record does not support the Division's claims.

First, the Division takes issue with the statement in the narrative section of LDBF's Fact Sheets that the fund's "[s]trategy has better sector diversification" than "a typical 2 A-7 regulated money market portfolio."[136] To determine whether that was false or misleading, it would be necessary to know how LDBF's strategy differed from that of "a typical 2 A-7 regulated money market" fund. But the Division made no such showing.

Second, the Division takes issue with the chart in the Fact Sheets' data section that displayed LDBF's "sector weights," showing the percentage of the fund's investments allocated to different market sectors, including ABS. The Fact Sheets did not define the market sector categories or elaborate on LDBF's holdings within each category. Nor did they include a specific category for subprime RMBS; rather, all RMBS investments were included within the

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134 *Aaron*, 446 U.S. at 697 (emphasis omitted).

135 In the OIP, the Division made additional allegations as to why the Fact Sheets were misleading. *See* OIP, 2010 WL 3826277, at *4-5. It does not press those arguments on appeal, so we do not address them here.

136 A "2A A-7 regulated money market portfolio" is a fund regulated under Investment Company Act Rule 2a-7. *See* 17 C.F.R. § 270.2a-7.

ABS category. The Division claims that by classifying all of the RMBS investments as ABS, the Fact Sheets misled investors. But the Division does not dispute that such classification was technically correct—it just insists that it was nevertheless misleading to omit the *additional* fact that the investments were RMBS. We disagree; the Fact Sheets did not become misleading simply because a chart illustrating LDBF's ABS exposure failed also to show ABS subcategories (such as RMBS, securities backed by credit cards, auto loans, airplane leases, etc.).[137]

Finally, the Division contends that the Fact Sheets should have acknowledged "LDBF's significant use of leveraged subprime instruments" and that the chart described above improperly failed to show the fund's "actual" investment risk. Had the Fact Sheets described the "sector weights" of the fund's holdings by "notional value," instead of "market value," the Division contends, it would have revealed LDBF's extensive use of leverage, which significantly increased its exposure to ABS.[138] But, again, information that was provided accurately did not become misleading simply because it could have been presented differently.[139] Thus, we conclude that Hopkins cannot be held liable with respect to the Fact Sheets.

3. The March 2007 Letter

The Division asserts that Hopkins is liable for statements in the March 2007 letter, which, according to the Division, misleadingly downplayed LDBF's exposure to RMBS. But we find it significant that the purpose of the letter was not to address LDBF in particular but rather to discuss all of SSgA's "active funds." And the letter was clear that it was not intended "to present an in-depth treatise of" LDBF's performance, but rather "to broadly outline the reasons for and magnitude of" recent events and "to outline the impact of [those events] on the market generally and . . . [SSgA's] Funds more specifically." Moreover, it is not surprising that the letter omitted

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137 *Cf. Matrixx Initiatives*, 131 S. Ct. at 1321 (Rule 10b-5(b) "do[es] not create an affirmative duty to disclose any and all material information"; "[d]isclosure is required . . . only when necessary 'to make . . . statements made, in the light of the circumstances under which they were made, not misleading'"); *Basic*, 485 U.S. at 237 n.17 ("Silence, absent a duty to disclose, is not misleading under Rule 10b-5."). Notably, the Division does not allege (and the record does not suggest) that the Facts Sheets misrepresented the percentage of LDBF's ABS exposure.

138 *See* OIP, 2010 WL 3826277, at *5-6. "Notional value" refers to the total value of a leveraged position's exposure. Through the use of leverage, market participants are able to acquire exposure to a large dollar amount of an asset (the notional value) with only a small down payment. *See, e.g.*, *Use of Derivatives by Investment Companies Under the Investment Company Act of 1940*, Investment Company Act Release No. 29776, 2011 WL 3855065, at *28 n.32 (Aug. 31, 2011) (concept release).

139 Although we do not find liability based on this allegation, we reiterate our general belief that omission of material information about the use of leverage and its associated risks can provide a basis for liability. *Cf. Philip L. Spartis*, Exchange Act Release No. 64489, 2011 WL 1825026, at *9 (May 13, 2011) (finding customer communications to be materially misleading by presenting an unduly optimistic picture of the potential gains that would result under an investment strategy and by omitting downside risk analysis including the potential adverse consequences of financing the transactions on margin).

information about LDBF's exposure to RMBS, as it is undisputed that the cause of LDBF's underperformance at the time was its exposure to BBB-rated investments—*not* its total exposure to subprime RMBS. Accordingly, we find Hopkins not liable in connection with the March 2007 letter.

4. The April 9, 2007 Conference Call

The Division contends that Hopkins made oral misrepresentations to Hammerstein and others from Yanni Partners during the April 9, 2007 conference call. Specifically, the Division alleges that Hopkins misleadingly stated that LDBF's total exposure to subprime RMBS was only 2%, when in fact it was far higher (80% or more). The record does suggest that call participants may have been confused about whether Hopkins's comments about LDBF's 2% exposure to *BBB-rated investments* encompassed LDBF's exposure to *all* subprime RMBS. But the evidence does not indicate that Hopkins made the categorically broad—and misleading—statements the Division alleges. We therefore find Hopkins not liable with respect to the April 9 conference call.

5. The ABX Holdings Slide

The Division alleges that the ABX Holdings Slide used in presentations to Catholic Healthcare and National Jewish on April 25 and May 10, 2007, respectively, contained materially misleading information. By failing to correct the slide, the Division claims, Hopkins violated Rule 10b-5 and Section 17(a). We disagree. The slide itself may have been misleading in that it reported a *reduction* in exposure to BBB-rated investments without acknowledging that a subsequent *increase* in investment level effectively offset that reduction. But the record indicates that Hopkins nonetheless provided correct information about LDBF's BBB-rated holdings, at least during his presentation to National Jewish, thus indicating the subsequent increase. And because the record does not indicate what Hopkins said during the presentation to Catholic Healthcare,[140] we cannot conclude that he did not also correct the information in the ABX Holdings Slide during that presentation. Accordingly, we find Hopkins not liable for misleading investors by using the ABX Holdings Slide.

6. The July 26, 2007 Letter

Finally, the Division alleges that Hopkins is liable for misrepresentations in the July 26 letter. It asserts that the letter was misleading because: (i) it implied that LDBF's risk profile had been reduced when it had actually increased; and (ii) it omitted important details about LDBF, including its subprime concentration, use of leverage, inconsistent credit quality, and SSgA's views about whether investors should remain invested in the fund. Both of those theories fail for the same reason. Like the March 2007 letter, the July 26 letter was not specifically addressed to LDBF or any other single fund; rather, its purpose was to discuss generally

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[140] Hopkins's handwritten notes on his copy of the Catholic Healthcare presentation included up-to-date statistics for LDBF's BBB-rated holdings, but Hopkins did not recall whether he conveyed the updated information to Catholic Healthcare. The record does not reflect anyone else's recollection of the meeting.

"problems in the subprime mortgage market" that had affected SSgA's "active fixed income portfolios." Thus, we find that the statement about efforts "to reduce risk in those portfolios where . . . appropriate" reflects a general observation about SSgA's overall strategy for all of its funds, not a statement about actions taken with regard to LDBF, in particular. Moreover, because the letter was not specifically focused on LDBF, nothing in the letter became misleading solely because it omitted certain details about the fund. Accordingly, we find that Hopkins may not be held liable with regard to the July 26 letter.

B. Flannery

In addition to alleging liability for the July 26 letter, which we have already found not misleading, the Division alleges that Flannery contributed to and/or approved misleading statements in the August 2 and August 14 client letters. More generally, the Division argues that Flannery "played a management role in SSgA's scheme to sell" LDBF's higher-quality assets to satisfy redemptions and "mislead investors who had not yet decided to redeem." For that asserted misconduct, the Division contends that Flannery is liable under Rule 10b-5(a) and (c) and Section 17(a)(1), (a)(2), and (a)(3).[141] We conclude that Flannery violated Section 17(a)(3) but not the other provisions.

1. Flannery's Alleged "Scheme" to Defraud LDBF Investors

Before turning to the particular misrepresentations alleged, we briefly explain the Division's overall theory of Flannery's liability. According to the Division, Flannery orchestrated a fraudulent course of business that misled investors by understating the risk of LDBF after July 25, 2007. Flannery knew, the Division claims, that as the subprime market was collapsing in July 2007, other officials at SSgA had begun to view LDBF as a poor investment. SSgA's own funds intended to redeem their interests in LDBF, and SSgA's internal advisory groups were recommending to their clients that they also withdraw their investments. Thus, fearing a run on the fund—and wanting to allow the SSgA funds and SSgA-advised investors to redeem their shares—Flannery allegedly set in motion a plan to sell off LDBF's highest-rated and most liquid assets in order to fund the anticipated redemptions. According to this plan, independent LDBF investors (those whose investments were not controlled by SSgA) would be encouraged to remain in the fund with the hope that the securities would recover. But, in reality, those investors would be stuck with a fund invested in illiquid, subprime bonds.

Under this theory, Flannery's participation in the July 25, 2007 Investment Committee meeting is crucial—not because it independently operated as a fraud on investors, but because it served as a backdrop against which the other violations occurred. As previously discussed, draft meeting minutes confirm that Flannery framed the committee's discussion around either (i) selling just the AAA-rated securities in the fund to satisfy redemptions, or (ii) selling "a pro-rata share" of assets across the portfolio. After debating the merits of each approach, the committee adopted a strategy that blended the two options: By the end of July 2007, they would

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[141] The Division does not allege that Flannery acted with scienter with respect to the August 14 letter.

increase liquidity by selling AAA-rated securities; then, as the redemptions came in, they would attempt to make pro-rata sales across the rest of the portfolio.

The record shows that, by August 2, Flannery knew that LDBF had sold approximately $1.6 billion in AAA-rated bonds, and he expected that some of the sale proceeds would be used for investor redemptions. For instance, on July 27, the head of one of SSgA's internal advisory groups informed Flannery that she would advise the group's clients to liquidate their LDBF positions by August 1. Flannery also learned by August 1 that another internal advisory group had recommended that its clients withdraw from LDBF. By August 2, redemptions by clients of both of those advisory groups were largely complete.

The Division does not allege (and the record does not suggest) that the committee's decision was itself unlawful or that the transactions involved in liquidating bonds and satisfying redemptions were improper. Rather, the Division claims that Flannery is liable for communications to LDBF investors that followed the July 25 meeting.[142]

2. The August 2 and August 14, 2007 Letters

As explained below, we find that the August 2 and August 14 letters were materially misleading, particularly when their cumulative effect is taken into account; that Flannery acted negligently when contributing to or approving the letters; and that his conduct constitutes a course of business that operated as a fraud on LDBF investors. But we find that the evidence does not establish that Flannery acted with scienter or obtained money or property by means of the letters. Accordingly, he is liable only under Section 17(a)(3).

a. The August 2 and August 14 Letters Were Misleading.

We find that the August 2 and August 14 client letters misled recipients about their investments in LDBF. When considered together—and as part of a larger effort to convince investors to remain in the poorly performing LDBF—the letters misleadingly downplayed LDBF's risk and encouraged investors to hold onto their shares, even though SSgA's own funds and internal advisory group clients were fleeing the fund.

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142 As previously noted, the Division also makes the more general allegation that Flannery "played a management role" in SSgA's "scheme" to defraud certain LDBF investors. But, as we have explained, liability under Rule 10b-5(a) and (c) and Section 17(a)(1) and (a)(3) cannot be established simply by alleging an overarching "scheme" to defraud investors; indeed, that is particularly true as to Rule 10b-5(c) and Section 17(a)(3), which do not even use the term "scheme." Rather, liability under any of these provisions can be established only through a showing of particular instances of misconduct by the defendant. *Accord, e.g., SEC v. Collins & Aikman Corp.*, 524 F. Supp. 2d 477, 487 (S.D.N.Y. 2007) (explaining that alleged "participation" in a fraudulent "scheme" can suffice for liability only if the defendant made "an actual misrepresentation or [employed] a fraudulent device" and that absent "such an allegation, a claim based on mere 'participation' is legally insufficient").

i. The August 2 Letter

The August 2 letter stated, in relevant part:

> [T]he downdraft in valuations has had a significant impact on the risk profile of our portfolios, prompting us to take steps to seek to reduce risk across the affected portfolios. To date, in [LDBF], we have reduced a significant portion of our BBB-rated securities and we have sold a significant amount of our AAA-rated cash positions. Additionally, AAA-rated exposure has been reduced as some total return swaps rolled off at month end. Throughout this period, the Strategy has maintained and continues to be AA in average credit quality according to SSgA's internal portfolio analytics. The actions we have taken to date in [LDBF] simultaneously reduced risk in other SSgA active fixed income and active derivative-based strategies.

In short, this passage explains that SSgA sought to reduce LDBF's risk profile following a decline in the subprime market, and it asserts that SSgA reduced that risk, in part, by selling "a significant amount" of its "AAA-rated cash positions."[143] That statement is misleading because LDBF's sale of the AAA-rated securities did not reduce risk in the fund. Rather, the sale ultimately *increased* both the fund's credit risk and its liquidity risk because the securities that remained in the fund had a lower credit rating and were less liquid than those that were sold. Indeed, SSgA personnel acknowledged, before selling the AAA-rated securities, that with respect to LDBF this would have the effect of selling the fund's highest rated assets. Pickett, LBDF's portfolio manager, stated that selling just the AAA-rated securities would "change [LDBF's] risk profile." Others observed that selling just the AAA-rated bonds could "expos[e]" committee members "to fiduciary risk since [the sales] are changing the risk profile of [LDBF's] portfolio," that anticipated redemptions would leave LDBF with just the "illiquid" and "riskier" AA-rated investments, and that the "[w]orse [sic] case scenario" would be if SSgA's own (Related) funds exited LDBF and remaining "clients in the fund . . . suffer." Finally, Flannery himself warned other members of the Investment Committee during the July 25, 2007 meeting that if the cash raised from the sale was "siphoned" by redemptions (as they expected it to be), LDBF would be "stuck with a lower quality portfolio" that was "less liquid" and "valued less."[144]

Nevertheless, Flannery asserts that the August 2 letter was truthful, relying largely on the expert testimony of Ezra Zask, who opined that the sale of the AAA-rated securities *did* reduce the fund's risk. Critically, however, Zask's testimony assumed that the net proceeds of the sale would be held in cash or cash-equivalent securities, which are less risky than RMBS. Under this assumption, nearly every sale of assets would necessarily reduce risk. But SSgA never intended

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143 In this regard, the August 2 letter differs from the July 26 letter, which described a general strategy and did not assert that particular actions had reduced any one fund's risk profile.

144 Pickett too cautioned that "rais[ing] cash through selling the AAA" to fund redemptions would "change [LDBF's] risk profile," and others raised similar concerns. Attendees also noted that the remaining securities (the "AA component") were "very illiquid" relative to those that were sold.

to hold cash or equivalent securities; instead, it sold the AAA-rated securities to fund expected redemptions in LDBF. Indeed, by the time the August 2 letter was sent, massive outflows of the sale proceeds were already well underway to early redeemers. We therefore find Zask's comments—and Flannery's corresponding claims—about the August 2 letter not compelling.[145] Accordingly, Zask failed to rebut the Division's showing that the ultimate effect of the sales was to increase risk.

ii. The August 14 Letter

The August 14 letter stated, in part: "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." We find that language misleading because it suggested that SSgA viewed holding onto the LDBF investment as a "judicious" decision when, in fact, officials at SSgA had taken a contrary view, redeeming SSgA's own shares in LDBF and advising SSgA advisory group clients to redeem their interests, as well.[146]

Flannery argues that he honestly believed judicious investors would remain invested in LDBF and that such belief was reasonable. He asserts, for instance, that others at SSgA also believed "that subprime securities would recover" and that "conventional wisdom" supported holding onto the investment until the market improved. Additionally, he argues that "regardless of the reasonableness of his belief," the language in question was a "forward-looking statement of opinion" and thus "can only constitute a misrepresentation if [he] did not sincerely hold the opinion."

Those arguments fail. To begin with, Flannery's argument that his "opinion" can constitute a misrepresentation only if it was not truly held falls short. Even if Flannery, himself, believed investors should remain invested in LDBF, the statement refers to *SSgA's* belief that investors would do so. And it is undisputed that others at SSgA considered LDBF a poor investment and were exiting the fund.[147] Moreover, courts have recognized that a statement of opinion may be misleading if it "knowingly omits undisclosed facts tending seriously to

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[145] We also reject Zask's assertion that the August 2 letter was not misleading because transactions other than the sales of the AAA-rated securities reduced risk in LDBF. Even if he is right about the effects of those other transactions, the August 2 letter still would have been misleading because it represented that *each* of the stated actions reduced risk, including the "s[ale] [of] a significant amount of [LDBF's] AAA-rated cash positions." Because the expected end result of that action did not reduce risk, it is irrelevant whether other transactions did.

[146] We are not persuaded by the Division's other claims about why the August 14 letter was misleading.

[147] In addition, we note that the cases Flannery cites in support of this argument address claims arising only under Section 10(b) and Rule 10b-5(b). Where, as here, liability is premised on an individual having engaged in a course of business that operates or would operate as a fraud, in violation of Section 17(a)(3), those cases are inapposite.

undermine the accuracy of the statement."[148] Courts have also emphasized that "professionals and others with similar access to information must disclose data that calls into question the accuracy of an opinion."[149] Here, Flannery was a securities professional who was well aware of his colleagues' negative views about LDBF. Disclosure of the SSgA-driven redemption activity unquestionably would have seriously undermined the accuracy of the statement about what "judicious investors" would do.

But Flannery disputes the need for additional disclosure, suggesting that the statement was accurate as made. He notes that it "referred to 'many,' not 'all,' judicious investors" and that some redemptions "occurred in-kind, rather than for cash," indicating that some investors did in fact want to remain invested in LDBF. Flannery also argues that the redemption activity had already been disclosed in a letter sent by SSgA on August 6 and was implicitly disclosed in the August 14 letter.

Again, we are not persuaded. First, the reference to "many," not "all," investors hardly constitutes an accurate disclosure given that the letter omits *any* recognition that many "judicious investors" (SSgA itself, as well as clients advised by SSgA) actually planned to exit (or had already exited) the fund. Second, the fact that some redemptions occurred in-kind does not justify the statement. Those investors who redeemed in-kind did so only after redeeming a large portion of their LDBF holdings for cash and after LDBF's cash largely had been exhausted. Moreover, the fact that some investors redeemed in-kind for the "assets in LDBF's *strategy*," as Flannery observes, does not establish that "judicious investors" wanted to hold onto shares of *LDBF itself*. Indeed, investors might have been wary about remaining in LDBF since, unless SSgA suspended redemptions, they would face the continuous risk that other shareholders would redeem their interests and siphon liquidity (again) from the fund. In fact, Flannery himself recognized and responded to this very problem when, in early August 2007, he created LDBF II, a monthly liquidity fund that followed the same investment strategy as LDBF but restricted redemptions, allowing investors to pursue longer-term strategies in the same assets.

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148 *Plumbers' Union Local No. 12 Pension Fund v. Nomura Asset Acceptance Corp.*, 632 F.3d 762, 775 (1st Cir. 2011) (recognizing that statement of opinion may be actionable under antifraud provisions); *In re Apple Computer Sec. Litig.*, 886 F.2d 1109, 1113 (9th Cir. 1989) (same); *Eisenberg v. Gagnon*, 766 F.2d 770, 776 (3d Cir. 1985) (same); *see also Dolphin & Bradbury*, 512 F.3d at 640-41 (finding disclosures in offering documents inadequate where professional broker-dealer omitted crucial facts from documents and "must have been aware they would mislead investors").

149 *Kline v. First W. Gov. Sec., Inc.*, 24 F.3d 480, 487 (3d Cir. 1994); *cf. Dolphin & Bradbury*, 512 F.3d at 640-41 (noting that defendant, "an experienced professional" had a duty to disclose "unusually important" information to investors in marketing materials (internal quotation marks omitted)); *Eisenberg*, 766 F.2d at 776 (noting that for representations "made by professionals or those with greater access to information or having a special relationship to investors," there is "an obligation to disclose data indicating that the opinion or forecast may be doubtful" (internal quotation marks omitted)).

Finally, we are not convinced that the redemption activity was adequately disclosed in either the August 6 or August 14 letter. The August 6 letter to which Flannery refers disclosed only that "[c]ertain SSgA" internal advisory groups "intend[ed] to redeem in-kind" their shares in LDBF—it did not reveal that those investors had *already* redeemed a large portion of their LDBF holdings for cash. Similarly, the oblique statement in the August 14 letter to which Flannery points—that SSgA would "continue to liquidate assets for [its] clients"—hardly constitutes a disclosure about the magnitude of the redemptions and implications for remaining investors.

b. The Misrepresentations in the Letters Were Material.

We find that the misstatements and omissions in the August 2 and August 14 letters were material. It would have significantly altered the total mix of information available to a reasonable investor had those letters disclosed the truth about (i) the ultimate impact of the sale of AAA-rated securities on LDBF's risk profile, and (ii) the fact that SSgA's own funds and SSgA-advised investors fled the fund in late July and early August.[150] Disclosure of either fact would have undercut especially Flannery's prediction in the August 14 letter that many judicious investors would continue to hold LDBF in the hope of a future recovery.

Flannery disputes the materiality of the challenged statements by arguing (like Hopkins) that the materiality analysis should take into account the sophistication of actual LDBF investors. For the reasons previously discussed, however, the materiality inquiry turns on the significance of misrepresentations to an *objective* "reasonable investor," not the particular individuals in question.[151] And, as also discussed previously, even if we were to conduct the sort of materiality analysis Flannery insists is appropriate, we find that LDBF's investors still would have wanted to know the facts that SSgA failed to disclose because those investors (and the consultants they employed) were not necessarily uniformly knowledgeable about fixed income investing.

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[150] *See generally SEC v. Fife*, 311 F.3d 1, 10 (1st Cir. 2002) (finding that misrepresentations and omissions regarding risk were material "because a reasonable investor would want to know the risks involved" in program at issue); *see also Fundamental Portfolio Advisors*, 2003 WL 21658248, at *12 ("A reasonable investor would have considered it important that the Fund was changing its portfolio from one predominately invested in the low risk securities described in the 1993 prospectus and sales literature to a portfolio with a substantial portion of the Fund's assets in CMOs that were highly exposed to interest rate risks and, thus, were highly volatile."); *cf. Freudenberg*, 712 F. Supp. 2d at 182-84 (as pleaded, misrepresentations relating to portfolio risk profile were material); *In re MoneyGram Int'l, Inc. Sec. Litig.*, 626 F. Supp. 2d at 978 (as pleaded, concealment of information relating to portfolio risk were material).

[151] *See Amgen*, 133 S. Ct. at 1195; *Matrix Initiatives*, 131 S. Ct. at 1321-22; *Basic*, 485 U.S. at 231-32, 240 & n.18; *TSC Indus.*, 426 U.S. at 445.

c. Flannery Acted with Negligence, But Not Scienter, with Respect to the August 2 and August 14 Letters.

The Division argues that Flannery was, at minimum, negligent with respect to his contributions to and approval of the August 2 and 14 letters. The record supports that claim. We find that Flannery was aware of the facts that made the letters misleading at the time they were finalized but nevertheless failed to correct the misleading statements or disclose the facts that would have given investors a correct impression about LDBF. We find, however, that Flannery did not act with scienter with regard to the August 2 letter, as the Division alleges.[152]

First, the record does indicate (and the Division effectively has conceded) that, on August 2, Flannery did in fact believe that LDBF's portfolio risk had been reduced. While Flannery's subjective state of mind is not dispositive to a finding that he lacked scienter, it is nevertheless relevant that he apparently did not fully appreciate the gravity of the risk that the August 2 letter would mislead investors.[153] Moreover, we find that the danger of misleading investors was not so obvious that Flannery "must have been" aware of it.[154] Accordingly, we cannot conclude that Flannery demonstrated extreme recklessness in approving the August 2 letter.[155]

Nonetheless, we find that Flannery *should* have been aware of the risk the letter posed, and thus his conduct was negligent under the circumstances. As noted, Flannery was aware that if the SSgA funds and SSgA-advised investors chose to redeem their shares, then the sale of the AAA-rated securities would leave LDBF with a "lower quality portfolio." Further, he knew that the very purpose of the sale was to generate liquidity for expected redemptions. He thus should have appreciated that the sale would increase risk for remaining investors, and that there was a significant danger that, as drafted, the August 2 letter would mislead investors.

We find particularly compelling, with respect to the August 2 letter, Flannery's acknowledgment at the Investment Committee meeting that, if "liquidity [were] siphoned" following the sale of the AAA-rated securities, LDBF would be "stuck with a lower quality portfolio." That statement demonstrates Flannery's understanding that, practically speaking, those sales—which were in fact immediately followed by massive redemptions—*did* adversely affect LDBF's risk profile. His subsequent approval of the statement in the August 2 letter that the sales *reduced* risk thus reflects a departure from the "reasonable care" he owed LDBF investors. And his conduct with respect to the August 14 letter evinces only a further departure from that standard: He represented that investing in LDBF was still a "judicious" decision, thereby compounding the likelihood that investors would be misled.

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152 The Division does not allege that Flannery acted with scienter with respect to the August 14 letter.

153 *See SEC v. Platforms Wireless Intern. Corp.*, 617 F.3d 1072, 1093-94 (9th Cir. 2010).

154 *See id.; see also supra* note 24.

155 Flannery therefore is not liable under Rule 10b-5 or Section 17(a)(1). *See Aaron*, 446 U.S. at 697 (scienter required under Section 17(a)(1)); *Hochfelder*, 425 U.S. at 193, 214 (scienter required under Rule 10b-5).

Flannery's principal challenge to a finding of negligence is that he reasonably relied on the involvement of counsel when editing and approving both letters. But even accepting Flannery's claims that counsel were heavily involved in the drafting of the letters, that does not make his approval and/or drafting of the challenged language reasonable under the circumstances.[156] That is because whether those particular statements were true was not a legal judgment but a business one—and one that Flannery was well equipped to make.[157] Moreover, Flannery was well aware of the facts that rendered the statements at issue misleading.[158] With regard to the August 2 letter, Flannery did not have to be an attorney to understand that the sale of AAA-rated securities, followed by massive redemptions, ultimately increased LDBF's risk. Indeed, he himself made this very observation at the Investment Committee meeting. Nor did he need legal training to understand with regard to the August 14 letter that, in truth, "judicious investors" thought it best to exit the fund, as his own colleagues had told him that they would be advising their clients to redeem their LDBF shares.

Flannery offers several additional reasons why his actions with regard to each letter were not negligent; we briefly address, but reject, those arguments. First, as to the August 2 letter,

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156 As at least one appellate court has recognized, reliance on counsel does not preclude a finding of negligence, which is an objective, not subjective, inquiry. *See Howard v. SEC*, 376 F.3d 1136, 1147-49 (D.C. Cir. 2004) (finding, despite a reliance on counsel defense, that the defendant nevertheless may have been negligent for failing to make certain disclosures that he arguably "should have" known were required); *Steadman*, 967 F.2d at 642 (finding, despite a reliance on counsel defense, that the defendants nevertheless may have been negligent for failing to disclose the lack of registration in their financial statements). And, even in cases of legal judgments, courts generally agree that reliance on counsel "is not a complete defense, but only one factor for consideration." *E.g.*, *Markowski v. SEC*, 34 F.3d 99, 105 (2d Cir. 1994); *Howard*, 376 F.3d at 1147-48.

157 That the judgments at issue were not the sort typically delegated to attorneys even further distinguishes this case from others in which the advice of counsel (or another professional) has been found to negate liability. *Compare, e.g.*, *Howard*, 376 F.3d at 1147-48 (finding scienter lacking where defendant relied on the advice of counsel in interpreting a Commission rule that was itself silent as to the particular transactions at issue and whose interpretive guidance even admitted that the law applicable to those transactions was unclear).

158 *Cf. Pittsburgh Terminal Corp. v. Balt. & Ohio R.R. Co.*, 680 F.2d 933, 943 (3d Cir. 1982) (rejecting reliance-on-counsel defense where defendants "know the materiality of the concealed information and intend the consequences of concealment"); *United States v. King*, 560 F.2d 122, 132 (2d Cir. 1977) ("[S]ignificant representations were made as to specific facts . . . [and] we cannot understand how a businessman who knows that such factual representations are untrue can screen himself by trying to rely on advice of counsel."); *Dolphin & Bradbury*, 512 F.3d at 642 (noting, in part, that where petitioner "could not have had a genuine belief in" his statements' "completeness and accuracy," he could not rely on a reliance-on-counsel argument to negate scienter); *SEC v. Goldfield Deep Mines Co. of Nev.*, 758 F.2d 459, 467 (9th Cir. 1985) (reliance-on-professional defense not available where defendants "knew" that statements made in public filings "were false or misleading").

Flannery contends that: (i) he believed in good faith the statement about the reduction in LDBF's risk; (ii) he suggested edits that would have enhanced the letter's accuracy; (iii) others at SSgA "were heavily involved in reviewing and editing the letter," whereas he had a more limited role; and (iv) he "was not a 'final approver' of the letter."

As indicated above, Flannery's "good faith" belief in the letter's accuracy may be relevant to his lack of scienter, but it is not relevant to whether he should have known the letter was misleading. As for Flannery's other arguments, even if he did suggest minor edits to the letter that were never incorporated, and even if others were "heavily involved" in its drafting, we find that those facts also do not excuse his decision to approve misleading language. Regardless of what others may have thought, he had an obligation to exercise his own, independent, judgment.[159] Moreover, whether or not Flannery lacked final approval authority, we find it sufficient that he was sent a draft of the August 2 letter, edited it, and made no changes to the language we find misleading. He was also copied on the final version that was to be sent to clients. Flannery was a senior official at SSgA, and his repeated decisions not to change the language at issue operated as tacit approval of its contents.

As for the August 14 letter, Flannery contends that several factors preclude a finding of negligence: (i) in-house counsel Duggan "was responsible for adding the 'judicious investors' language" to the letter; (ii) "Duggan and other SSgA attorneys, as well as . . . other senior executives, were heavily involved in reviewing and editing the letter, and none of them told Flannery that the letter was misleading"; and (iii) "Flannery understood that all of these people were armed with complete information about LDBF's situation."[160]

The record shows that, regardless of contributions by others, *Flannery* specifically intended the letter to encourage outside investors to remain in LDBF. His initial draft expressly "advi[sed]" investors "to hold the positions [in LDBF] for now." Duggan revised this language to read "we believe that many judicious investors will hold the positions in anticipation of greater liquidity in the months to come." But Flannery approved the change, having concluded that (according to his testimony) the "judicious investors" edit did not "materially change" the message in his initial draft. He agreed that the revision still expressed to SSgA clients "a negative view on selling their investments in [LDBF] at the time of the letter." We thus find it irrelevant that Duggan proposed the precise language at issue, because Flannery knew that the language would discourage investors from selling their shares in LDBF, as he intended.

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159 *Cf. Goldfield Deep Mines Co.*, 758 F.2d at 467 ("If a company officer knows that the financial statements are false or misleading and yet proceeds to file them, the willingness of an accountant to give an unqualified opinion with respect to them does not negate the existence of the requisite intent or establish good faith reliance." (*quoting United States v. Erickson*, 601 F.2d 296, 305 (7th Cir. 1979))).

160 To the extent Flannery also argues that he cannot be found negligent because he sincerely believed the "many judicious investors" statement, we reject that claim as well. We find it dubious that he actually believed the statement, and, in any event, we find such a belief unreasonable given Flannery's knowledge at the time that SSgA itself and its internal advisory group clients were redeeming shares in the fund.

We find it similarly irrelevant that others at SSgA reviewed the August 14 letter and did not tell Flannery that it was misleading. Whatever others may have thought (or said aloud to Flannery), Flannery still should have appreciated that the letter was misleading. Again, the fact that others (including attorneys) apparently sanctioned the language does not excuse Flannery's decision to do so.[161] Indeed, the record shows that the attorneys on whom Flannery contends he relied in fact relied on *Flannery* and the investment team to confirm the factual statements in investor communications. For instance, as one in-house attorney explained with respect to the August 2 letter, he reviewed a draft "for clarity," but he accepted on faith its factual statements, because it was "prepared by [SSgA's] most senior level investment people and . . . there was nothing to lead [him] to believe that the facts weren't anything other than as they were set [] forth" in the draft.

For all of these reasons, we find that Flannery was negligent in drafting, editing, and approving the August 2 and 14 letters.

d. Flannery Did Not "Obtain Money or Property by Means of" the Misrepresentations in the August 2 and August 14 Letters.

The Division argues that Flannery "obtain[ed] money or property by means of" the August 2 and August 14 letters because the letters were "used" to mislead investors, and, after the letters were sent, "independent investors made purchases in LDBF." But, as previously explained, we read Section 17(a)(2) to require more than a mere temporal connection between a misrepresentation and the acquisition of money or property. Because the Division has failed to show any *causal* link between the letters and Flannery's (or SSgA's) acquisition of money or property, we find Flannery not liable under Section 17(a)(2).[162]

e. Flannery's Conduct with Respect to the August 2 and August 14 Letters Constitutes a "Course of Business" that Operated as a Fraud on LDBF Investors.

We find that Flannery's conduct with respect to the August 2 and August 14 letters violated Section 17(a)(3). As discussed above, Flannery helped to draft, edit, and approve at

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161 *Cf. Goldfield Deep Mines Co.*, 758 F.2d at 467.

162 As it did with respect to Hopkins, the Division arguably asserts that SSgA and Flannery "obtained money or property" by inducing investors who otherwise would have redeemed their shares in LDBF to remain in the fund. But the Division fails to explain how such a claim would satisfy the requirement that Flannery obtain money or property because of his alleged misrepresentations and did not pursue this theory at oral argument. In addition, as previously noted with respect to Hopkins, at oral argument counsel for the Division suggested that Flannery's receipt of salary and/or bonus payments during the course of his employment might satisfy the "obtained money or property" requirement, on the theory that Flannery successfully "obtained" money for his employer, some of which it passed on to him. But assuming such a standard applies, the Division failed to explain how, if at all, State Street's receipt of money or property was tied to, or dependent upon, Flannery's alleged misconduct.

least two letters that had the cumulative effect of misleading LDBF investors about their investments. His negligent conduct spanned a critical two-week period of market turmoil and encompassed more than one materially misleading communication. We find this sufficient to hold Flannery liable for having engaged in a "course of business" that operated as a fraud on LDBF investors.[163]

V.

A. Fair Notice of Claims Under Rule 10b-5(a) and (c) and Section 17(a)(1) and (a)(3)

Flannery contends that the Division's claims under Rule 10b-5(a) and (c) and Section 17(a)(1) and (a)(3) must be dismissed because he was denied fair notice of those claims. He contends that the OIP did not "describe how [he] allegedly engaged in a scheme to defraud," and the Division also failed to "articulate its theories" in subsequent proceedings. We disagree.

First, we find that the OIP adequately alerted Flannery that the proceedings would consider whether he engaged in a fraudulent course of business. It specifically alleged that he "engaged in a course of business and made material misrepresentations and omissions that misled investors about the extent of subprime mortgage-backed securities held in certain unregistered funds under State Street's management."[164] And it repeatedly invoked the language of the relevant statutory and regulatory provisions, charging Flannery with, among other things, having "engaged in . . . courses of business . . . that operated or would operate as a fraud or deceit upon the purchasers of such securities."[165]

The OIP also made factual allegations in support of those claims. It alleged that Flannery "played an instrumental role in drafting the misrepresentations" made to investors in July and August 2007.[166] And, after describing the July 25 Investment Committee meeting, the OIP stated that "Flannery's involvement in [that] discussion, his awareness of the Fund's holdings, and his expertise concerning the market conditions for the Fund's assets put him in a unique position to understand that the Investment Committee's decision put investors who remained in the Fund at greater risk after the anticipated redemptions were satisfied."[167] The OIP also detailed Flannery's involvement in the August 2 and August 14 letters to investors.[168] We find

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[163] Because we find Flannery negligent, we need not consider whether a violation of Section 17(a)(3) could lie absent a showing of negligence. *See supra* note 30.

[164] OIP, 2010 WL 3826277, at *1. The OIP also put Flannery on notice that the proceedings would consider whether he employed "devices," "schemes," and "artifices" to defraud, though that issue is rendered moot by our determination that he is liable only under Section 17(a)(3). We also do not address Flannery's contention that the OIP was deficient in its failure to mention the July 26 letter, since we find him not liable with respect to that letter.

[165] *Id.* at *13.

[166] *Id.* at *2, *8.

[167] *Id.* at *11.

[168] *Id.* at *12.

these allegations sufficient to inform Flannery "of the charges in enough detail to allow [him] to prepare a defense."[169]

Moreover, we note that even if the OIP were ambiguous in the manner Flannery suggests, that would not justify dismissal of the Section 17(a)(3) claim for which we find him liable. In administrative proceedings, the standard for determining whether notice is adequate is whether "the respondent understood the issue and was afforded full opportunity to justify [his] conduct during the course of the litigation."[170] "Thus, the question on review is not the adequacy of the [OIP] but is the fairness of the whole procedure."[171] Here, the record shows that Flannery (and his counsel, who represented him throughout the proceeding) adequately understood the nature of the Division's claims and had ample opportunity to defend against them. It is especially telling that both Flannery and the Division filed multiple letters with the law judge addressing the scope of "scheme" and "course of business" claims following the Supreme Court's decision in *Janus* and a subsequent district court decision.[172] Those letters demonstrate that Flannery was aware that the Division intended to argue that he was liable under Section 17(a)(3).[173]

B. Preservation of Issues Raised on Appeal

Hopkins and Flannery assert that many of the Division's arguments on appeal go beyond the issues raised in its petition for review and therefore are not properly before us. According to Hopkins, the Division ignores Commission Rules of Practice 410(b) and 411(d), which require that the petition "set forth specific findings . . . as to which exception is taken" and limit Commission review to issues specified in the petition.[174] Flannery also suggests that we should defer to the law judge's factual findings.

While it is true that the Division's petition does not articulate extensive specific challenges to the Initial Decision, the petition *does* state that the Division seeks review of the law

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[169] *McConville*, 2005 WL 1560276, at *14 (noting also that the OIP "need not disclose to the respondent the evidence upon which the Division intends to rely").

[170] *Aloha Airlines, Inc. v. Civil Aeronautics Bd.*, 598 F.2d 250, 262 (D.C. Cir. 1979) (internal quotation marks omitted); *accord Flying Food Grp., Inc. v. NLRB*, 471 F.3d 178, 183-84 (D.C. Cir. 2006); *Clawson v. SEC*, No. 03-73199, 2005 WL 2174637, at *1 (9th Cir. Sept. 8, 2005).

[171] *Aloha Airlines*, 598 F.2d at 262 (internal quotation marks omitted); *James L. Owsley*, Exchange Act Release No. 32491, 51 SEC 524, 1993 WL 226056, at *4 (June 18, 1993) (recognizing that a defect in an administrative pleading can be remedied if the record shows that the respondent understood the issue and was afforded a sufficient opportunity to justify his conduct).

[172] *See Flannery*, 2011 WL 5130058, at *34-35.

[173] We note as well that Flannery has not asserted that he suffered prejudice as a result of the supposed lack of notice. He has not identified any additional evidence or defenses he would have proffered had he better understood the charges against him. *See Aloha Airlines*, 598 F.2d at 262; *Clawson*, 2005 WL 2174637, at *1.

[174] 17 C.F.R. §§ 201.410(b), 201.411(d).

judge's findings that: (i) Hopkins did not violate Section 17(a), Section 10(b), and Rule 10b-5, and (ii) Flannery did not violate Section 17(a), Section 10(b), and Rules 10b-5(a) and (c).[175] The Petition also broadly disputes the Initial Decision's findings of fact, stating, the "Division takes exception to many of the findings in the Initial Decision, including the misapplication of *Janus*."[176] We find these challenges sufficient to render the issues raised in the Division's briefs properly before us. Moreover, our *de novo* review of the decision below affords us broad authority to consider all aspects of this case on appeal.[177] Finally, we note that neither Flannery nor Hopkins suggests that he was denied an adequate opportunity to prepare a response to the Division's appeal, nor is there any other apparent basis for such a finding. Thus, due process concerns do not limit the scope of our review.[178]

VI.

As to both Flannery and Hopkins, the Division seeks (i) a suspension or bar from association with investment advisers and investment companies under Section 9(b) of the Investment Company Act of 1940 ("Investment Company Act") and/or Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act"); (ii) a cease-and-desist order under Section 8A of the Securities Act and/or Section 21C of the Exchange Act; and (iii) civil penalties under Section 8A of the Securities Act, Section 21B(a) of the Exchange Act, Section 203(i) of the Advisers Act, and/or Section 9(d) of the Investment Company Act.[179]

A. Suspensions or Bars

To impose a suspension or bar from association with investment advisers or investment companies under Section 9(b) of the Investment Company Act as a remedy for their Securities Act and/or Exchange Act violations, we must find that (i) Hopkins and Flannery willfully

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175 Petition at 2.

176 *Id.* at 3.

177 *Gary M. Kornman*, Investment Advisers Act Release No. 2840, 2009 WL 367635, at *9 n.44 (Feb. 13, 2009) (noting that the Commission's review of a law judge's opinion is *de novo*); *see also Gregory M. Dearlove, CPA*, Exchange Act Release No. 57244, 2008 WL 281105, at *10 n.42 (Jan. 31, 2008) ("The law judge's opinion ceased to have any force or effect once [petitioner] filed his petition for review."); *Fundamental Portfolio Advisors*, 2003 WL 21658248, at *13 n.44 (same); *see generally Rules of Practice*, 1995 WL 368865, at *83 ("On appeal from or review of the initial decision, the agency has all the powers which it would have in making the initial decision except as it may limit the issues on notice or by rule." (quoting 5 U.S.C. § 557(b)).

178 *Cf. Aloha Airlines*, 598 F.2d at 262 (stating that the standard for whether notice is adequate is whether "the respondent understood the issue and was afforded full opportunity to justify [his] conduct during the course of the litigation" (internal quotation marks omitted; alteration in original)).

179 OIP, 2010 WL 3826277, at *13-14.

violated the Securities Act or the Exchange Act, and (ii) the sanction is in the public interest.[180] To impose a suspension or bar from association with investment advisers under Section 203(f) of the Advisers Act as a remedy for their respective violations, we must find that the two above criteria are satisfied and, in addition, that Hopkins and Flannery were "person[s] . . . associated with an investment adviser" during the relevant period.[181] As discussed below, we find that all of these criteria are satisfied and, accordingly, impose one-year suspensions on both Hopkins and Flannery under the Investment Company Act and the Advisers Act.

1. Respondents Willfully Violated the Securities Laws.

In the context of securities laws violations, the term "willfully" means merely "that the person charged with the duty knows what he is doing."[182] It is sufficient that the actor "intentionally" or "voluntarily" committed the act that constitutes the violation; he need not also be aware that he is violating one of the securities laws or rules promulgated thereunder.[183] Here, we find that Hopkins "willfully" violated the Securities Act and the Exchange Act, and Flannery "willfully" violated the Securities Act. Although they contest their violations, neither respondent seriously contests a finding of willfulness, and the record gives no indication they did not intentionally and voluntarily engage in the conduct for which we hold them liable.

2. Suspensions Are in the Public Interest.

When determining whether remedial action is in the public interest, we consider: the egregiousness of the respondent's actions, the isolated or recurrent nature of the infraction, the degree of scienter involved, 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 likelihood that the respondent's occupation will present opportunities for future violations.[184] Our inquiry is flexible, and no one factor is dispositive.[185] Also, we note that the remedy is intended to "protect[] the trading public from further harm," not to punish the respondent.[186]

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[180] *See* 15 U.S.C. § 80a-9(b).

[181] *See id.* § 80b-3(e)(5), (f).

[182] *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (internal quotation marks omitted); *Jason A. Craig*, Exchange Act Release No. 59137, 2008 WL 5328784, at *4 (Dec. 22, 2008).

[183] *Wonsover*, 205 F.3d at 414; *accord Mathis v. SEC*, 671 F.3d 210, 217 (2d Cir. 2012); *Decker v. SEC*, 631 F.2d 1380, 1386 (10th Cir. 1980); *Jason A. Craig*, 2008 WL 5328784, at *4.

[184] *See Steadman v. SEC*, 603 F.2d 1126, 1140 (5th Cir. 1979), *aff'd on other grounds*, 450 U.S. 91 (1981).

[185] *David Henry Disraeli*, Exchange Act Release No. 57027, 2007 WL 4481515, at *15 (Dec. 21, 2007), *aff'd*, 334 F. App'x 334 (D.C. Cir. 2009) (per curiam).

[186] *McCarthy v. SEC*, 406 F.3d 179, 188 (2d Cir. 2005); *see also Paz Sec., Inc. v. SEC*, 566 F.3d 1172, 1175-76 (D.C. Cir. 2009).

We find that it is in the public interest to suspend Hopkins and Flannery from associating with investment advisers or investment companies for one year. As to Hopkins, his conduct in violation of Section 17(a)(1) and Rule 10b-5 was an abuse of his responsibilities as a securities professional. He has refused to acknowledge the wrongful nature of that conduct; indeed, he has consistently insisted that he acted in the best interests of LDBF investors. He also has made no assurances against future violations. Thus, we are concerned that Hopkins will commit future violations of the securities laws and present a danger to investors if not subjected to a suspension.

As to Flannery, although he did not act with scienter, his misconduct spanned more than one communication and thus cannot be seen as a single lapse in judgment. He was a senior SSgA official responsible for client investments who, like Hopkins, abused his professional responsibilities. Moreover, Flannery too has never acknowledged the wrongful nature of his conduct or made assurances against future violations. Thus, we are similarly concerned about protecting investors from future violations and impose a one-year suspension.[187]

In reaching this determination, we have considered factors that Respondents contend are mitigating. They argue, for instance, that the Division failed to show how many, or to what extent, investors were harmed by their actions.[188] But the Division is not required to establish reliance or loss by any investor,[189] and our decision that suspensions are warranted is not premised on investors having suffered financial losses. Respondents also note that they were not shown to have benefited personally from the fraud. But that is not a requirement for imposing a suspension and, in any event, we find that their misconduct was (at the very least) in furtherance of their lucrative careers as securities professionals. Finally, Respondents emphasize that they have had long careers as securities professionals without any prior disciplinary history. We have considered that fact in finding that it is in the public interest to impose the relatively lenient sanction of a one-year suspension as to both Hopkins and Flannery.

3. Respondents Were Associated with an Investment Adviser.

Under the Advisers Act, the term "person associated with an investment adviser" means: "[A]ny partner, officer, or director of such investment adviser (or any person performing similar functions), or any person directly or indirectly controlling or controlled by such investment adviser, including any employee of such investment adviser."[190] For purposes of determining

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187 *Cf. IMS/CPAs & Assoc.*, Advisers Act Release No. 8031, 2001 WL 1359521, at *12 (Nov. 5, 2001) (imposing suspensions on persons associated with an investment adviser who committed antifraud violations by failing to disclose to their clients their receipt of compensation in return for making investment recommendations), *petition denied sub nom. Vernazza v. SEC*, 327 F.3d 851 (9th Cir. 2003).

188 At oral argument, counsel for Flannery and Hopkins noted that the Division presented only a single witness, Hammerstein, to testify about the effect of the alleged fraud on investors.

189 *See, e.g.*, *Morgan Keegan & Co.*, 678 F.3d at 1244; *Graham v. SEC*, 222 F.3d 994, 1001 n.15 (D.C. Cir. 2000).

190 15 U.S.C. § 80b-2(a)(17).

whether a suspension or bar may be imposed under Section 203(f), the definition of "associated" persons is quite broad; it includes even those "whose functions are clerical or ministerial."[191] We find that both Hopkins and Flannery were persons associated with a registered investment adviser.

As a bank, State Street is excluded from the definition of investment adviser in the Advisers Act.[192] And, as previously noted, SSgA is not itself a legal entity; it is merely an operating division of State Street Corporation. But State Street Corporation has (and had in 2006 and 2007) a separate registered investment subsidiary, SSgA Global Funds Management Inc. ("SSgA FM"), that is (and was in 2006 and 2007) the registered investment adviser for mutual funds registered under the Investment Company Act.[193]

Flannery testified that, when he served as CIO of the Americas at SSgA, he directly supervised portfolio managers for some of the registered funds managed by SSgA FM. In addition, Flannery was a member of SSgA's Investment Committee; according to the SSgA Funds' prospectus, that committee was responsible for overseeing all of the portfolio management teams at SSgA FM, including the teams responsible for the registered funds. That evidence is sufficient to establish that Flannery was "associated with" SSgA FM: By supervising SSgA FM portfolio managers responsible for registered funds, he was, at minimum, performing functions similar to those of a partner, officer, or director of an investment adviser and was "directly or indirectly controlling" SSgA FM and its employees.

According to Hopkins's testimony, he served as a product engineer for certain of SSgA FM's registered funds (in addition to serving as a product engineer for certain unregistered funds, such as LDBF). And when the responsibility for working with the registered funds passed to another individual, he served as that person's supervisor. That is sufficient to establish that Hopkins was "associated with" SSgA FM. As he himself explained, his responsibilities as a product engineer included advising clients directly about how funds were managed and assisting portfolio managers by explaining their strategies to client-facing personnel. These activities, when performed on behalf of SSgA FM's registered funds, were central to the funds' operations and made him an integral member of the investment and client management teams. They place him well within the definition of "associated" persons under the Advisers Act.[194]

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191 *Id.*

192 *See id.* § 80b-2(a)(11).

193 *See generally id.* § 80a-8.

194 *See, e.g.*, *Michael Batterman*, Investment Advisers Act Release No. 2334, 57 SEC 1031, 2004 WL 2785527, at *3-4 (Dec. 3, 2004) (noting that the Commission may "discipline a person associated with an investment adviser even if that person is associated only in a clerical or ministerial capacity" and finding that respondent's associated activities exceeded that standard, as he was "part of the team" responsible for client investments and his role was "important to the fund's operations"); *see also SEC v. Householder*, No. 02-4128, 2002 WL 31207292, at *5 (N.D. Ill. Oct. 1, 2002) (individual with an "integral" role in "running" investment company was "associated with an investment adviser").

B. Cease-and-Desist Orders

Section 8A of the Securities Act and Section 21C of the Exchange Act authorize us to issue a cease-and-desist order against any person who "has violated" those statutes or rules thereunder.[195] When determining whether such an order is appropriate, we consider public interest factors that are substantially the same as those we consider when imposing a suspension or bar.[196] "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."[197] Again, this inquiry is flexible, and no single factor is dispositive.[198] Evidence of a past violation ordinarily suffices to establish a risk of future violations, absent evidence to the contrary.[199]

Here, we find that Respondents' respective past violations of the securities laws demonstrate a risk of future violations. We note, as well, the seriousness of their misconduct and each Respondent's failure to appreciate his responsibilities as a securities professional. Accordingly, we find sufficient risk that Hopkins and Flannery will commit future violations to warrant our imposition of a cease-and-desist order as to each.

C. Civil Penalties

1. Authority to Impose Civil Penalties

Both Hopkins and Flannery contend that imposing civil penalties in this case would entail improper retroactive application of Section 929P(a) of the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") because the conduct for which they are

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195 15 U.S.C. § 77h-1(a) (Securities Act); *id.* § 78u-3(a) (Exchange Act).

196 *See Joseph J. Barbato*, Exchange Act Release No. 41034, 53 SEC 1259, 1999 WL 58922, at *14 n.31 (Feb. 10, 1999). For instance, we consider the seriousness of the violation, the isolated or recurrent nature of the violation, the respondent's state of mind in committing the violation, the sincerity of assurances against future violations, the respondent's recognition of the wrongful nature of the conduct, and the respondent's opportunity to commit future violations. *KPMG Peat Marwick LLP*, Exchange Act Release No. 43862, 54 SEC 1135, 2001 WL 47245, at *26 (Jan. 19, 2001), *pet. denied*, 289 F.3d 109 (D.C. Cir. 2002).

197 *KPMG Peat Marwick*, 2001 WL 47245, at *26.

198 *Id.* at *24, *26.

199 *See Schoemann v. SEC*, 398 F. App'x 603, 604 (D.C. Cir. 2010) (per curiam) (affirming the imposition of a cease-and-desist order because petitioner's conduct "constituted a violation of the [Securities] Act") *aff'g* Securities Act Release No. 9076, 2009 WL 3413043, at *12-13 (Oct. 23, 2009) (noting that "absent evidence to the contrary, a single past violation ordinarily suffices to raise a sufficient risk of future violations"); *cf. KPMG Peat Marwick*, 2001 WL 47245, at *24, *26 (finding that a cease-and-desist order may be imposed only where there is some risk of future violations, but that the risk "need not be very great").

charged occurred before the statute was enacted.[200] They are mistaken. As discussed below, although the Dodd-Frank Act did grant us new authority to impose penalties in some cases, this is not such a case. Rather, our authority to impose penalties here derives from provisions of the Advisers Act and the Investment Company Act that were in effect when the violative conduct occurred.[201]

Section 929P(a) amended the Securities Act, Exchange Act, Advisers Act, and Investment Company Act, in part, by authorizing the Commission to impose monetary penalties in administrative cease-and-desist proceedings brought under those statutes. As Respondents note, before the provision was enacted, the Division could not have obtained penalties against Hopkins or Flannery in administrative proceedings brought under the Securities Act or the Exchange Act. The Securities Act did not authorize the imposition of civil penalties in any administrative proceedings. And the Exchange Act authorized penalties only in actions against those registered under its provisions; as to others, such as Hopkins and Flannery, the Division could obtain monetary relief only in actions brought in federal court.

But the Advisers Act and the Investment Company Act were not so limited. Even before Dodd-Frank was enacted, both statutes authorized us to impose penalties in administrative suspension proceedings, even though we could not do so in administrative cease-and-desist

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[200] *See* Pub. L. No. 111-203, 124 Stat. 1376, 1862-65 (July 21, 2010).

[201] We therefore need not address Respondents' claim that it would be improper to impose penalties here under Section 929P(a)'s amendments to the Securities Act or the Exchange Act. Nonetheless, we note that we are not persuaded by their argument that reliance on Section 929P(a) here to impose penalties would violate the presumption against retroactive legislation. We read the Supreme Court's decisions in *Landgraf v. USI Film* Products, 511 U.S. 244, 273-74 (1994), and *Hallowell v. Commons*, 239 U.S. 506, 508 (1916), to indicate that Section 929P(a) is precisely the sort of forum-shifting legislation that *may* be applied to pre-enactment conduct notwithstanding the presumption against retroactive legislation. Section 929P(a)'s amendments to the Securities Act and the Exchange Act merely establish a new forum in which the Division may bring certain claims for monetary relief—but such relief was already available to the Division in actions brought in federal court. Moreover, we find the authority Respondents cite on this issue inapposite. Both *Molosky v. Washington Mutual, Inc.* and *SEC v. Daifotis* address entirely separate provisions of the Dodd-Frank Act; whether *those* provisions may be applied retroactively has no bearing on the scope of Section 929P(a). *See Molosky*, 664 F.3d 109, 113 n.1 (6th Cir. 2011) (stating that provisions regarding federal preemption of state banking laws had "no retroactive effect"); *Daifotis*, 2011 WL 2183314, at *12-14 (holding that provision authorizing the Commission to bring new aiding and abetting claims under the Investment Company Act, could not be applied retroactively because it "created jurisdiction where none previously existed[,] . . . increased the extent of liability," and "eliminated defenses" available to defendants); *see also Landgraf*, 511 U.S. at 280 (rejecting notion that "diverse provisions of [a statute] must be treated uniformly for [retroactivity] purposes"). And in *Gupta v. SEC*, the court speculated about the possible retroactive application of Section 929P(a), but it did not give serious consideration to the question, let alone hold that it would be improper to apply the provision in a case like this one. 796 F. Supp. 2d 503, 507 (S.D.N.Y. 2011).

proceedings.[202] Because this is, in part, a suspension proceeding brought under the applicable provisions of the Advisers Act and the Investment Company Act, we are well within our authority to impose penalties against Hopkins and Flannery here, even without invoking the additional authority granted to us by Section 929P(a) of the Dodd-Frank Act.

2. Appropriate Penalties

In proceedings under Section 203(f) of the Advisers Act and Section 9(b) of the Investment Company Act, penalties are warranted only if we find that Hopkins and Flannery willfully violated the securities laws and that imposing penalties would be in the public interest.[203] As discussed above, we find that both Hopkins and Flannery acted willfully when committing their respective violations. To determine whether imposing penalties would be in the public interest, we consider (i) whether the act or omission involved fraud, (ii) whether the act or omission resulted in harm to others, (iii) the extent to which any person was unjustly enriched, (iv) whether the individual has committed previous violations, (v) the need to deter such person and others from committing violations, and (vi) such other matters as justice may require.[204] We may assess separate penalties "for each act or omission" in violation of the federal securities laws; those penalties fall into three tiers, depending on the nature of the violation.[205] As relevant here, we may impose first-tier penalties of up to $6,500 for violations of the securities laws and second-tier penalties of up to $65,000 for violations that "involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement."[206]

We find that Hopkins committed at least one violation of the securities laws based on the misrepresentation he made during his May 10, 2007 presentation to National Jewish using the Typical Portfolio Slide. Because he acted with scienter in violating Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act, and Rule 10b-5, we find that, at minimum, he demonstrated "reckless disregard of a regulatory requirement." Moreover, Hopkins's conduct created a substantial risk of harm to investors who remained invested in LDBF without a full understanding of the extent to which the fund was exposed to ABS. Indeed, when, following the meeting, Yanni Partners advised its clients to remain invested in SSgA's Commodities Fund (which was invested in LDBF), many of those clients saw the value of their LDBF investments plummet with the onset of the subprime crisis in 2007. We find that one second-tier penalty of $65,000 is warranted to deter him and others in similar positions from future violations.

We find that Flannery also committed at least one violation of the securities laws based on his course of conduct relating to the August 2 and August 14 letters. Flannery's violation, like Hopkins's, created a significant risk of harm to investors who remained in LDBF during the

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202 *See* 15 U.S.C. § 80a-9(b), (d); *id.* § 80b-3(f),(i).

203 *See id.* § 80a-9(d)(1); *id.* § 80b-3(i)(1)(A).

204 *See id.* § 80a-9(d)(3); *id.* § 80b-3(i)(3).

205 *See id.* § 80a-9(d)(2); *id.* § 80b-3(i)(2).

206 *See id.* § 80a-9(d)(2); *id.* § 80b-3(i)(2); 17 C.F.R. § 201.1003 & Pt. 201, Subpt. E, Tbl. III.

subprime crisis while better informed SSgA clients were fleeing the fund. Indeed, just as Flannery himself warned during the Investment Committee meeting on July 25, 2007, the investors who remained in the fund through late July and August 2007 were "stuck with a lower quality portfolio" after proceeds from the sale of LDBF's highest-rated assets were used for redemptions. Flannery's conduct, we find, warrants one first-tier penalty of $6,500, which will help to deter Flannery and others in similar positions from engaging in future violations.

An appropriate order will issue.[207]

By the Commission (Chair WHITE and Commissioners AGUILAR and STEIN); Commissioners GALLAGHER and PIWOWAR, dissenting.

Brent J. Fields
Secretary

[207] We have considered all of the parties' contentions. We have rejected or sustained them to the extent that they are inconsistent or in accord with the views expressed in this opinion.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9689 / December 15, 2014

SECURITIES EXCHANGE ACT OF 1934
Release No. 73840 / December 15, 2014

INVESTMENT ADVISERS ACT OF 1940
Release No. 3981 / December 15, 2014

INVESTMENT COMPANY ACT OF 1940
Release No. 31374 / December 15, 2014

Admin. Proc. File No. 3-14081

In the Matter of

JOHN P. FLANNERY and
JAMES D. HOPKINS

ORDER IMPOSING REMEDIAL SANCTIONS

On the basis of the Commission's opinion issued this day, it is

ORDERED that John P. Flannery be suspended for one year from association with any investment adviser or investment company; and it is further

ORDERED that James D. Hopkins be suspended for one year from association with any investment adviser or investment company; and it is further

ORDERED that John P. Flannery cease and desist from committing or causing any violations or future violations of Section 17(a)(3) of the Securities Act of 1933; and it is further

ORDERED that James D. Hopkins cease and desist from committing or causing any violations or future violations of Section 17(a)(1) of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934 and Exchange Act Rule 10b-5 thereunder; and it is further

ORDERED that John P. Flannery pay a civil money penalty of $6,500; and it is further

ORDERED that James D. Hopkins pay a civil money penalty of $65,000.

Payment of the civil money penalty shall be (i) made by United States postal money order, certified check, bank cashier's check, or bank money order; (ii) made payable to the Securities and Exchange Commission; (iii) mailed to Enterprises Services Center, Accounts Receivable Branch, HQ Bldg., Room 181, 6500 South MacArthur Blvd., Oklahoma City, OK 73169; and (iv) submitted under cover letter that identifies the respondent and the file number of this proceeding.

By the Commission.

Brent J. Fields
Secretary