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## Two State Street executives cleared of SEC charges of misleading investors

**Sheri Qualters**

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Mintz Levin's Jack Sylvia



McDermott Will's Mark Pearlstein

The U.S. Securities and Exchange Commission has lost an administrative case against two former State Street Global Advisors executives accused of misleading investors through disclosures about the underperformance of a State Street fund holding subprime mortgage-backed securities.

In an Oct. 28 [58-page ruling](#), SEC Chief Administrative Law Judge Brenda Murray dismissed the case against the two executives, John Flannery and James Hopkins, finding that they were unaware of the vulnerability of the subprime securities in August 2007, when they made the disclosures.

Murray's ruling is technically an initial decision, which allows either party to file a motion to correct a manifest error of fact within 10 days of the ruling or a petition for review within 21 days of service. Any appeal would first go to the full commission, then the U.S. Court of Appeals for the 1st Circuit or the D.C. Circuit.

State Street Global Advisors is the asset-management business of State Street Corp., a publicly traded company. Flannery was previously the company's chief investment officer, and Hopkins was previously a vice president and head of North American product engineering.

The SEC launched the case in September 2010 with what is known as an order instituting proceedings. The agency charged Flannery and Hopkins with misleading investors about the extent of subprime mortgage-backed securities that State Street held in an unregistered fund in 2006-07. The agency accused the two former executives of violating the Securities Act of 1933 and the Securities Exchange Act of 1934.

Murray's findings stated that Flannery and Hopkins were credible witnesses: "Both Respondents answered without hesitation or equivocation and they evidenced candor, conviction, and, at times, frustration."

Murray also wrote that "unrefuted expert testimony" has established that it was reasonable to believe in August 2007, when the communications at issue took place, that securities in State Street's Limited Duration Bond Fund portfolio "could eventually recover in value and become more liquid. It is with the benefit of hindsight that the Division believes it was incumbent on Flannery and Hopkins to warn investors of something that the evidence shows they were unaware of at the time — the vulnerability of AA and AAA-rated subprime bonds."

Murray found that "neither Flannery nor Hopkins was responsible for, or had ultimate authority over, the allegedly false and materially misleading documents at issue in this proceeding." She referenced the June U.S. Supreme Court ruling in *Janus Capital Group v. First Derivative Traders*, which determined that mutual fund investment adviser Janus Capital was **not liable for violating SEC Rule 10b-5**, which prohibits "making any untrue statement of a material fact," if it lacked full control over the statements, such as in a mutual fund prospectus. Janus Capital is the investment adviser and administrator of Janus Investment Fund, a separate legal entity owned by mutual fund investors. The fund filed the prospectus with the SEC.

Murray found that Flannery and Hopkins lacked full control over certain documents, including Limited Duration Bond Fund fact sheets, slides in PowerPoint presentations about the fund and several 2007 letters sent to fund investors.

Murray also found that those documents as well as statements Hopkins made to a prospective investor in April 2007 and Flannery's August 2007 letter "did not contain materially false or misleading statements or material omissions."

Despite massive publicity about the subprime market meltdown and the resulting investor losses, this case demonstrates that "enforcement cases are determined by the actual evidence of how individuals behaved," said **Mark Pearlstein**, the partner in charge of **McDermott Will & Emery's Boston** office and Flannery's lead lawyer in the SEC case.

Pearlstein said he's not aware of another SEC case involving disclosures about subprime investments that has gone to trial, but there have been settlements in several cases against companies including State Street.

"These guys lived under a cloud during the pendency of this case and setting the public record straight is so important," Pearlstein said. "[It's] telling the world they didn't do anything wrong and it's a very, very gratifying feeling."

"We're pleased, but not surprised," said Hopkins' lead lawyer on the case Jack Sylvia, who co-chairs the securities litigation practice group at Boston's Mintz, Levin, Cohn, Ferris, Glovsky and Popeo.

Sylvia also said, "I would think it may cause some reflection at the SEC about what cases to bring with respect to disclosure claims in the future because this case, in particular, is one that never should have been brought."

SEC spokesman Kevin Callahan said the agency is "reviewing the decision."

*Sheri Qualters can be contacted at [squalters@alm.com](mailto:squalters@alm.com).*