

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

ADMINISTRATIVE PROCEEDINGS RULINGS
Release No. 2893/July 2, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16349

In the Matter of

BARBARA DUKA

ORDER ON RESPONDENT'S
MOTION FOR SUMMARY
DISPOSITION

The Securities and Exchange Commission (Commission) commenced this proceeding on January 21, 2015, with an Order Instituting Administrative and Cease-and-Desist Proceedings (OIP) against Barbara Duka, pursuant to Section 8A of the Securities Act of 1933 (Securities Act), Sections 15E(d) and 21C of the Securities Exchange Act of 1934 (Exchange Act), and Section 9(b) of the Investment Company Act of 1940.

The OIP alleges, in summary, that in late 2010 Standard & Poor's Rating Services (S&P), a nationally recognized statistical rating organization (NRSRO), changed its method for calculating a metric used in determining ratings of commercial mortgage-backed securities (CMBS). OIP at 2-3. The OIP further alleges that this change was made in order to attract more fee-paying customers to S&P because the new methodology resulted in more attractive credit ratings. *Id.* at 2, 5-7. According to the OIP, the change violated S&P's internal policies and procedures and caused reports and data published by S&P to be false and misleading. *Id.* at 2-3. Duka, who oversaw CMBS new issue ratings, is alleged to have aided, abetted, and caused S&P's violations. *Id.* at 10-11; Answer at 5-6, 10.

Duka filed her Answer on February 23, 2015. At a telephonic prehearing conference on February 25, 2015, the parties agreed to a briefing schedule for motions for summary disposition and I scheduled a hearing to begin on September 16, 2015, in New York City. Prehearing Transcript (Tr.) 11, 14; *see Barbara Duka*, Admin. Proc. Rulings Release No. 2354, 2015 SEC LEXIS 732 (Feb. 26, 2015). The Division also confirmed that it had made the investigative file available to Duka. Tr. 4.

On May 8, 2015, Duka filed a Motion for Summary Disposition (Resp. Motion), with attached exhibits 1-62 (Exs. 1-62). Duka seeks the dismissal with prejudice of the charges that she aided, abetted, and caused S&P's violations of Exchange Act Section 15E(c)(3) and Rules 17g-2(a)(2)(iii), 17g-2(a)(6), and 17g-6(a)(2). Resp. Motion at 32. The Division filed an opposition to Duka's Motion on May 22, 2015, and Duka filed a reply on June 1, 2015.

Summary Disposition Standard

After a respondent's answer has been filed and documents have been made available to that respondent for inspection and copying, a party may make a motion for summary disposition of any or all allegations of the OIP with respect to that respondent. *See* 17 C.F.R. § 201.250(a). A motion for summary disposition may be granted if there is no genuine issue with regard to any material fact and the party making the motion is entitled to summary disposition as a matter of law. 17 C.F.R. § 201.250(b). The facts on summary disposition must be viewed in the light most favorable to the non-moving party. *See Jay T. Comeaux*, Exchange Act Release No. 72896, 2014 WL 4160054, at *2 (Aug. 21, 2014). However, once the moving party has carried its burden of establishing that it is entitled to summary disposition on the factual record, the opposing party may not rely on bare allegations or denials, but instead must present specific facts showing a genuine issue of material fact for resolution at a hearing. *See id.*

For the purposes of Duka's Motion, the facts set forth in the OIP have been taken as true. *See* 17 C.F.R. § 201.250(a). The Division has not made any admissions and there are no stipulations, uncontested affidavits, or officially noticed facts. *See id.* Accordingly, Duka's Motion must be denied unless, taking the OIP's allegations as true, Duka is entitled to summary disposition as a matter of law.

Discussion

I assume familiarity with the facts recited in my Order Denying Division of Enforcement's Motion for Partial Summary Disposition. *See Barbara Duka*, Admin. Proc. Rulings Release No. 2889 (July 1, 2015).

A. Exchange Act Rule 17g-2(a)(2)(iii)

Exchange Act Rule 17g-2(a)(2)(iii) requires NRSROs to make and keep accurate books and records relating to each of their current credit ratings, specifically:

If a quantitative model was a substantial component in the process of determining the credit rating of a security or money market instrument issued by an asset pool or as part of any asset-backed securities transaction, a record of the rationale for any material difference between the credit rating implied by the model and the final credit rating issued[.]

17 C.F.R. § 240.17g-2(a)(2)(iii). Duka argues that there was no material difference between the quantitative model used in connection with the eight transactions at issue and the ratings of those transactions; therefore, S&P did not violate Rule 17g-2(a)(2)(iii). Resp. Motion at 28. Duka argues that "[t]o the extent the SEC takes issue with the determination to use the Blended Constant in the model, that issue is not within the scope of and is irrelevant to Rule 17g-2(a)(2)(iii)." *Id.* The Division characterizes Duka's argument as "circular," arguing that Rule 17g-2(a)(2)(iii) prohibits analysts from making "wholesale, material changes to CMBS ratings models – without disclosure or explanation of rationale." Div. Opp. at 24.

The Division seeks to extend the reach of Rule 17g-2(a)(2)(iii) beyond its terms. The text of the rule describes recordkeeping requirements that exist only if there is a material difference between (1) the rating implied by the model used by the NRSRO to determine a rating, and (2) the credit rating actually issued. There is no allegation in the OIP that this was the case. Instead, the Division argues that there was material difference between the rating implied by the blended constant model and the rating that would have been implied by the model previously used by CMBS NI. See OIP ¶¶ 28-29; Div. Opp. at 23-24. This may be so, but this is not addressed by Rule 17g-2(a)(2)(iii), which imposes recordkeeping requirements for changes made to the *initial credit rating* implied by the quantitative model, not for changes made to the *model itself*, and which was designed to ameliorate concerns that analysts might adjust the credit ratings implied by the models for inappropriate reasons. See Amendments to Rules for Nationally Recognized Statistical Rating Organizations, Exchange Act Release No. 59342, 2009 WL 233865, at *12 (Feb. 2, 2009) (noting that in the absence of the rule’s record keeping requirement, there may be no way to determine whether adjustments to the result implied by the model were made by applying appropriate qualitative factors permitted under the NRSRO’s documented procedures or because of undue influence or other inappropriate reasons).

In order to find that Duka aided and abetted a violation by S&P, I must first find that S&P committed a primary violation. *Clarke T. Blizzard*, Investment Advisers Act of 1940 Release No. 2253, 2004 WL 1416184, at *5 (June 23, 2004). Accordingly, because the facts in the OIP, even if taken as true, cannot support a finding that S&P committed a primary violation of Exchange Act Rule 17g-2(a)(2)(iii), Duka is entitled to summary disposition on the claim that she aided and abetted and caused a violation of that rule.

B. Exchange Act Rule 17g-2(a)(6)

Exchange Act Rule 17g-2(a)(6) requires NRSROs to make and retain “[a] record documenting the established procedures and methodologies used by the nationally recognized statistical rating organization to determine credit ratings.” 17 C.F.R. § 240.17g-2(a)(6). Duka argues that S&P complied with this rule because it published and retained the Criteria Article. Resp. Motion at 29. She further argues that to the extent the Division believes the switch to blended constants was an unauthorized amendment to the Criteria Article rather than an interpretation of it, the change was done at Parisi’s direction and she was not negligent in relying on his advice. *Id.* at 29-30. The Division disputes that S&P followed its internal guidelines when deciding to use blended constants and insists that the switch was a change to S&P’s established procedures and methodologies which S&P failed to accurately document. Div. Opp. at 25. In response, Duka argues that because the Criteria Article did not “clearly state” how, if at all, the criteria constants would be used, the change to using blended constants could not have been a change to S&P’s established procedures and methodologies. Resp. Reply at 22.

The OIP adequately alleges that the Criteria Article was, in effect, improperly amended without a record being made of the change. See, e.g., OIP ¶ 30 (“A reasonable person in Duka’s position would have documented her actions concerning the change in methodology and would have made a reasonable effort to follow S&P’s policies and procedures concerning criteria changes.”); see also *id.* ¶¶ 27-28. The OIP also alleges that Duka was at least negligent in causing S&P’s violation. See OIP ¶¶ 14, 30, 41-44, 48. Accordingly, the charge that she aided

and abetted and caused S&P's violation of Exchange Act Rule 17g-2(a)(6) cannot be dismissed on summary disposition.

C. Exchange Act Rule 17g-6(a)(2)

Exchange Act Rule 17g-6(a)(2) prohibits NRSROs from:

[i]ssuing, or offering or threatening to issue, a credit rating that is not determined in accordance with the nationally recognized statistical rating organization's established procedures and methodologies for determining credit ratings, based on whether the rated person, or an affiliate of the rated person, purchases or will purchase the credit rating or any other service or product of the nationally recognized statistical rating organization or any person associated with the nationally recognized statistical rating organization.

17 C.F.R. § 240.17g-6(a)(2). Duka first argues that the application of blended constants was properly approved by Parisi as a criteria interpretation and thus, the credit rating was determined using S&P's established procedures and methodologies. Resp. Motion at 30-31. She further argues that even if Parisi's interpretation was not within his authority, there is no evidence that Duka or others at S&P knew or were negligent in not knowing that Parisi's determination fell outside S&P's established procedures and methodologies. *Id.* at 31. In response, the Division asserts that the decision to use blended constants deviated from S&P's procedures, was not a proper interpretation, and was not understood by S&P employees to be within Parisi's authority. Div. Opp. at 26-27.

The OIP adequately alleges that (1) the process used by S&P when rating the CMBS transactions at issue violated S&P's established procedures and methodologies for determining credit ratings; (2) the use of blended constants was motivated by the desire to make S&P's feedback less conservative and thus more attractive to issuers; and (3) Duka was at least negligent in substantially assisting S&P's violation. *See, e.g.*, OIP ¶¶ 5, 8, 23-30, 42-44, 48. Accordingly, the charge that she aided and abetted and caused S&P's violation of Exchange Act Rule 17g-6(a)(2) cannot be dismissed on summary disposition.

D. Exchange Act Section 15E(c)(3)

Exchange Act Section 15E(c)(3) requires each NRSRO to:

establish, maintain, enforce, and document an effective internal control structure governing the implementation of and adherence to policies, procedures, and methodologies for determining credit ratings, taking into consideration such factors as the Commission may prescribe, by rule.

15 U.S.C. § 78o-7(c)(3) (the IC Statute).

First, Duka argues that the IC Statute violates due process because it fails to provide meaningful notice of the conduct it prohibits. Resp. Motion at 18. She also argues that even

under the rules eventually promulgated by the Commission, the alleged violation would not be cognizable because none of the relevant allegations suggest that S&P's internal control structure was ineffective. *Id.* at 21-23. She also contends that because the decision to use blended constants was a criteria interpretation rather than an amendment, S&P's policies and procedures were followed and she was not negligent in relying on Parisi's direction. *Id.* at 24-26. Finally, she disputes that the record shows that she aided and abetted or caused any violation of the IC Statute based on her interactions with S&P's Model Quality Review (MQR) group. *Id.* at 27.

Due process requires only that laws "give the person of ordinary intelligence a reasonable opportunity to know what is prohibited, so that he may act accordingly." *Grayned v. City of Rockford*, 408 U.S. 104, 108 (1972). The degree of required notice varies according to the circumstances, and securities laws in general are subject to a "less strict vagueness test because 'the subject matter is [] more narrow, and because businesses, which face economic demands to plan behavior carefully, can be expected to consult relevant legislation in advance of action.'" *SEC v. Brown*, 740 F. Supp. 2d 148, 161 (D.D.C. 2010) (quoting *Village of Hoffman Estates v. Flipside, Hoffman Estates, Inc.*, 455 U.S. 489, 498 (1982)). I assume that I have the authority to adjudicate Duka's due process claim. *But see Charles L. Hill, Jr.*, Admin. Proc. Rulings Release No. 2675, 2015 SEC LEXIS 1899, at *25-26 (May 14, 2015), and authorities cited therein.

The IC Statute provides sufficient notice of the conduct it prohibits, because it provides notice similar to at least one other internal control statute that has withstood a constitutional vagueness challenge. *See Div. Opp.* at 13 (citing 15 U.S.C. § 78m(b)(2)). Duka's argument that the IC Statute could "apparently reach[] every policy, procedure and methodology at S&P" stretches the text of the statute beyond both its terms and its context. *Resp. Reply* at 4. It is also entirely unsupported by the record; for instance, S&P's personnel policies, whatever they may be, would seem to have no relevance to the IC Statute.

As for the merits, the allegations in the OIP are sufficient to support a finding that S&P violated the IC Statute, and that Duka aided and abetted or caused S&P's violation. The OIP alleges that: (1) S&P's CMBS criteria committee determined at least some aspects of S&P's CMBS model, suggesting that it played a role in "implementation of . . . policies, procedures, and methodologies for determining credit ratings"; (2) Duka served on the CMBS criteria committee, suggesting that Duka influenced S&P's internal controls over "implementation of . . . policies, procedures, and methodologies for determining credit ratings," particularly with respect to the CMBS model; and (3) S&P's MQR group reviewed the CMBS model "to determine whether the model was an appropriate computer implementation of the S&P criteria," based on methodology "determined by the CMBS criteria committee." OIP ¶¶ 19-22, 25. It is a reasonable inference that MQR was a component of S&P's internal control structure, and Duka herself contends that "MQR did not require a spreadsheet that used the Blended Constant." *See id.* ¶ 25; *Resp. Motion* at 27; *Ex. 59* at 77, 84-86.

Taken as a whole, the record suggests that: (1) by placing Duka in a position to influence the determination of the same criteria she was tasked with implementing, S&P undermined its own internal control structure; and (2) that MQR's procedures were ineffective at monitoring S&P's policies, procedures, and methodologies for determining credit ratings. This is sufficient to establish a genuine issue of material fact regarding S&P's alleged violation of the IC Statute,

and Duka's involvement in that violation. Duka is thus not entitled to summary disposition as a matter of law on the claim that she aided and abetted and caused a violation of Exchange Act Section 15E(c)(3).

Order

It is therefore ORDERED that Duka's Motion for Summary Disposition is GRANTED IN PART and DENIED IN PART as outlined above.

Cameron Elliot
Administrative Law Judge