

**UNITED STATES OF AMERICA**  
**Before the**  
**SECURITIES AND EXCHANGE COMMISSION**

**SECURITIES EXCHANGE ACT OF 1934**  
**Release No. 62835 / September 2, 2010**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-14029**

**In the Matter of**  
  
**DAMYON MOUZON,**  
  
**Respondent.**

**ORDER INSTITUTING CEASE-AND-  
DESIST PROCEEDINGS PURSUANT TO  
SECTION 21C OF THE SECURITIES  
EXCHANGE ACT OF 1934**

**I.**

The Securities and Exchange Commission (“Commission”) deems it appropriate that public cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 (“Exchange Act”) against Damyon Mouzon (“Respondent”).

**II.**

After an investigation, the Division of Enforcement alleges that:

**A. Respondent**

1. From April 2007 until January 2009, Mouzon was the President of LACE Financial Corp. (“LACE”), a credit rating agency that has been registered with the Commission as a Nationally Recognized Statistical Rating Organization (“NRSRO”) since February 2008. As the President, Mouzon was responsible for managing the operations of LACE, including overseeing LACE’s staff of analysts and the ratings process, maintaining client relationships, and managing sales and marketing. In his capacity as President of LACE, he communicated frequently with the Commission staff regarding LACE’s application to register with the Commission as an NRSRO. Mouzon was notified in October 2008 that he would be terminated by LACE due to his job performance, and his final day at LACE was January 16, 2009.

**B. Other Relevant Entity**

2. LACE is a credit rating agency located in Frederick, Maryland. During 2008, LACE had total revenues of \$918,714 and net income of \$98,837. LACE was formed in 1984, and derives most of its revenue from subscription fees. On February 11, 2008, the Commission granted LACE’s application to register as an NRSRO for all five classes of credit ratings described in clauses (i) through (v) of Section 3(a)(62)(B) of the Exchange Act. On the same day, the

Commission also granted LACE's request for an exemption from Exchange Act Rule 17g-5(c)(1) until January 1, 2009. Exchange Act Rule 17g-5(c)(1) (the "Ten Percent Rule") prohibits an NRSRO from issuing or maintaining a credit rating solicited by a person that, in the most recently ended fiscal year, provided the NRSRO with net revenue equaling or exceeding ten percent of the total net revenue of the NRSRO for the fiscal year. The Commission's order required that LACE disclose that the firm received more than ten percent of its net revenue in fiscal year 2007 from a client that paid it to rate asset-backed securities. Since its founding, LACE has specialized in issuing credit ratings for financial institutions. At the time that LACE became registered as an NRSRO, LACE provided quarterly credit ratings on approximately 7,900 commercial and savings banks, 1,000 bank holding companies, 850 savings and loans, 1,500 to 8,700 credit unions (depending on the quarter), 250 foreign banks, and 95 title insurance companies.

### **C. Summary**

3. These proceedings arise out of misrepresentations made by LACE in its application to the Commission to become registered as an NRSRO and in connection with its accompanying request for an exemption from the Ten Percent Rule. In its application and request for an exemption from this rule, LACE materially misstated the amount of revenue it received from its largest customer during 2007.

4. LACE also violated certain other Commission rules governing NRSROs. LACE violated Section 15E(a)(1) of the Exchange Act and Exchange Act Rule 17g-1(a) by making the misstatements described above and by failing to disclose in its registration application that it performed an extra layer of review for the credit ratings of issuers whose securities made up the pools for asset-backed securities managed by LACE's largest customer. LACE violated Section 17(a) of the Exchange Act and Exchange Act Rule 17g-2(a)(6) by failing to document the process of this extra layer of review in its written policies and procedures. LACE also violated Section 17(a) of the Exchange Act and Exchange Act Rule 17g-2(b)(7) by failing to maintain all emails relating to its credit ratings. Mouzon, as President of LACE beginning in April 2007 and the person responsible for the day-to-day operations of the company until his departure in January 2009, was a cause of LACE's violations.

### **D. The Credit Rating Agency Reform Act and Commission Rules Governing NRSROs**

5. The Credit Rating Agency Reform Act of 2006 ("Rating Agency Act"),<sup>1</sup> enacted on September 29, 2006, defined the term "nationally recognized statistical rating organization" and provided authority for the Commission to implement registration, recordkeeping, financial reporting, and oversight rules with respect to registered credit rating agencies. The final Commission implementing rule (Exchange Act Rule 17g-1) and form (Form NRSRO) prescribing the process for a credit rating agency to apply for registration became effective on June 18, 2007. Exchange Act Rule 17g-1 requires a credit rating agency applying for registration as an NRSRO to use Form NRSRO to furnish the Commission with the initial application. The Rule requires a firm, after becoming registered as an NRSRO, to update its registration application if any of the information becomes materially inaccurate and to provide an annual certification on Form NRSRO. Exchange Act Rules 17g-2 through 17g-6 became effective on June 26, 2007. Among other things, these rules (a) require an NRSRO to make and retain certain records (Rule 17g-2); and (b) prohibit NRSROs from having certain conflicts of interest and require NRSROs to

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<sup>1</sup> Pub. L. No. 109-291 (2006).

establish, maintain, and enforce written policies and procedures reasonably designed to address and manage certain other conflicts of interest related to the issuance of credit ratings by the NRSRO (Rule 17g-5).

6. To register with the Commission as an NRSRO, a credit rating agency must have been in business as a credit rating agency for at least three consecutive years immediately preceding the date of its application, and it must issue credit ratings with respect to one or more of the following categories of obligors: (a) financial institutions, (b) insurance companies, (c) corporate issuers, (d) issuers of asset-backed securities, and (e) issuers of government securities, municipal securities, or securities issued by a foreign government. The credit rating agency also must submit an application that contains certain information including, among other things, the procedures and methodologies that the applicant uses to determine credit ratings, policies and procedures to prevent the misuse of material, nonpublic information, any conflict of interest relating to the issuance of credit ratings, whether it has a code of ethics in effect, and certain financial information.

7. The Commission's rules were designed to further the goals of the Rating Agency Act to "improve ratings quality for the protection of investors and in the public interest by fostering accountability, transparency, and competition in the credit rating agency industry."<sup>2</sup> To meet these goals, it is critical that firms provide accurate information to the Commission and the public in their Form NRSROs and financial reports, that they do not have prohibited conflicts, and that they establish, maintain, and enforce policies and procedures to address conflicts of interest. Compliance with the recordkeeping requirements is critical to the Commission's NRSRO examination and oversight programs.

#### **E. LACE's Misstatements in its NRSRO Application**

8. The Commission received a completed application from LACE to register as an NRSRO on October 31, 2007.

9. In a letter dated October 30, 2007, LACE requested that the Commission issue an order exempting LACE from the Ten Percent Rule, Rule 17g-5(c)(1).

10. LACE requested an exemption from the Ten Percent Rule because, for the fiscal year ending December 31, 2007, LACE maintained credit ratings on asset-backed securities solicited by LACE's largest client ("Firm A"), which had provided LACE with more than ten percent of LACE's total revenue during fiscal year 2007. Firm A, among other things, manages Collateralized Debt Obligation ("CDO") investment vehicles constructed from pools of assets comprised largely of trust-preferred securities issued by banks and thrifts, and hired LACE to prepare initial and semi-annual reports regarding the issuing entities that Firm A distributed to investors in these CDOs.

11. LACE prepared the investor reports for Firm A twice a year for each of Firm A's five (and beginning in 2007, six) CDO pools. The reports included, among other things, a report on the financial condition of the particular CDO pool, summaries of all issuers whose LACE ratings had been upgraded or downgraded from the previous quarter, a description of any issuers that had undergone a merger or acquisition in the past quarter, and a banking industry analysis. The reports also included charts showing selected financial ratios and other financial data.

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<sup>2</sup> Preamble to the Rating Agency Act.

12. The reports also contained LACE's credit rating for each issuer whose securities were in the CDO pools, as well as a rating of the overall credit worthiness of each CDO pool, based on the par weighted average of LACE's ratings on each issuer of securities in the pool. LACE did not rate the various tranches of securities issued by the CDOs.

13. Mouzon was involved in the editing and production of these reports. He supervised the analysts who created the initial drafts, edited their drafts, and oversaw the production process.

14. In its October 30, 2007 letter requesting an exemption from the Ten Percent Rule, LACE stated that its estimated annual revenues from Firm A for 2007 would be \$119,000 when calculated on a cash basis and \$179,000 when calculated on an accrual basis. The letter further stated that the account represented 18.6 percent of LACE's revenues and that LACE expected this percentage to decrease by the end of 2007 and further decrease in 2008.

15. Subsequently, in an attempt to keep its 2007 revenue from Firm A as close as possible to ten percent of its total revenues for the year, LACE postponed until January 2008 billing Firm A for reports completed during December 2007. The deferred billings totaled \$115,450, which LACE recognized as 2008 revenue. However, because the reports had been completed in December 2007, under generally accepted accounting principles ("GAAP"), LACE should have recorded the \$115,450 as 2007 revenue.<sup>3</sup>

16. In a letter dated January 10, 2008 to the staff of the Commission's Division of Trading and Markets, LACE stated that its 2007 revenues from Firm A were \$119,393, which accounted for 14.2 percent of LACE's 2007 revenue. The letter, signed by Mouzon and copied to LACE's majority owner, stated that although the numbers provided in the letter were unaudited, LACE did not anticipate that there would be any material changes. The amount of revenue attributed to Firm A in the letter was the amount that LACE actually had been paid by Firm A during 2007, but did not include the \$115,450 that LACE had deferred billing for until January 2008. The letter signed by Mouzon did not describe the basis for the stated revenue amount or disclose that, inconsistent with GAAP, LACE had deferred its recognition of revenue from Firm A into 2008. The total value of work performed for Firm A by LACE during 2007 was in fact \$233,268.28, comprising approximately 28 percent of LACE's revenues for the year when properly calculated on an accrual basis as required by GAAP.<sup>4</sup>

17. On February 11, 2008, the Commission granted LACE's application to be registered as an NRSRO in all five classes of credit ratings. On the same day, the Commission issued an order exempting LACE from the Ten Percent Rule until January 1, 2009, provided that LACE disclosed in its Form NRSRO that it received more than ten percent of its net revenue from a client that paid it to rate asset-backed securities. In granting the exemption, the Commission recognized the "unique circumstances of a small credit rating agency while balancing this against the goal of Rule 17g-5(c)(1) - to prohibit a conflict that has the potential to influence a credit rating

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<sup>3</sup> GAAP provides that revenue should generally be recognized when it is earned, as opposed to when it is billed or received. See SEC Staff Accounting Bulletin No. 104, Revenue Recognition (December 17, 2003) (Corrected Copy).

<sup>4</sup> There is a discrepancy of \$1,574.72 between the revenue LACE reported from Firm A in the January 10, 2008 letter (\$119,393) and the amounts reflected on the invoices sent by LACE to Firm A and paid during 2007 (\$117,819.28).

agency's impartiality." The Commission's order also specifically noted that LACE had "stated that it expects the percentage of total revenue provided by the client will decrease."

18. On February 27, 2008, LACE's auditor sent an email to Mouzon stating, "I did notice that there was a billing to [Firm A] early in January 2008 . . . that appeared to be for services provided in December 2007. We'll have to talk about this when I come out, as I need to make sure that revenues are recorded in the correct accounting period." In response, Mouzon represented to the auditor that the work in question for Firm A had not been completed until January 2008, thus making them 2008 revenues, even though he knew or should have known that the work in question had been completed during December 2007.

19. Mouzon directed the auditor to entries on the Firm A invoices indicating that "rework" had been performed, and told the auditor that this work had carried over into 2008, when in fact LACE had completed its work on the Firm A reports before the end of 2007. The "rework" noted in the invoices referred to Firm A adding additional issuers to the CDO pools during November 2007. Mouzon knew or should have known that this work had been completed in 2007, because he was heavily involved in editing the reports for Firm A and overseeing their completion. Furthermore, Mouzon sent and received emails indicating that the reports were to be amended and delivered in November or December of 2007.

20. LACE thus continued to improperly record as 2008 revenue the \$115,450 for which it had deferred billing to Firm A. Because LACE did not properly record the revenues that it earned from Firm A, LACE's audited financial statements for 2007, which were provided to the Commission and purportedly prepared in accordance with GAAP, were inaccurate.

21. As president of LACE, Mouzon, together with LACE's founder and majority owner, was responsible for ensuring the accuracy of the information provided to the Commission in connection with LACE's NRSRO application and its request for an exemption from the Ten Percent Rule.

22. Mouzon knew or should have known that LACE was required to recognize all of the revenue it earned from Firm A for work completed during 2007 as 2007 revenue, and that as a result, the financial information that LACE provided to the Commission in connection with its NRSRO application and its request for an exemption from the Ten Percent Rule was inaccurate. Furthermore, despite LACE's frequent communications with the Division of Trading and Markets staff regarding LACE's NRSRO application and exemption request, Mouzon failed to ensure that the Commission was informed about LACE's deferral of revenue from Firm A at the time the application and exemption request were pending. In January 2009, three months after he had been notified that he would be terminated and shortly before his departure from LACE, Mouzon contacted the Commission staff and informed them of LACE's deferral of revenue from Firm A.

#### **F. LACE's Undisclosed, Additional Internal Review for Credit Ratings on Certain Entities**

23. During 2007 and 2008, LACE's process for rating banks, thrifts, and credit unions began with the retrieval of publicly-available financial data on the rated institutions. After the data was loaded into LACE's computer system, LACE's proprietary computer ratings model was applied to the data.

24. Using ratings guidelines established by LACE, analysts then reviewed the ratings generated by the computer model. Initially, the ratings were reviewed by a junior analyst, who

marked any computer-generated ratings that he or she thought should be changed. Those changes were then reviewed by a senior analyst, and the two analysts discussed any discrepancies. If the analysts could not reach agreement, they consulted a third analyst or a supervisor, including Mouzon or LACE's majority owner.

25. After the ratings were finalized, they were entered into the LACE computer system and issued on the LACE Monitoring System, which allowed subscribers to view LACE's credit ratings online.

26. LACE, however, performed an extra review of its credit ratings for the banks whose securities were part of the CDO pools managed by Firm A. After completing its normal ratings procedures, but before the ratings were entered into LACE's system and published online, the ratings for these banks were reviewed a third time. During 2007 and 2008, Mouzon was primarily responsible for performing this extra review.

27. Mouzon made a significant number of changes to the ratings produced by the firm's normal ratings procedures when performing this extra layer of review on the issuers whose securities were in the CDO pools managed by Firm A. In December 2007, March 2008, and June 2008, for example, there were over 50 changes in each quarter, out of a total of approximately 220 institutions whose securities were in Firm A's CDO pools. Approximately 85 percent of these changes were upgrades from the ratings that had resulted from LACE's normal quarterly credit ratings process. These revised ratings were then published online and incorporated into the investor reports that LACE prepared regarding Firm A's CDO pools.

28. LACE was required to disclose in its NRSRO application the procedures and methodologies that it used to determine credit ratings. LACE failed to disclose its practice of conducting an extra review for the issuers whose securities were in the CDO pools managed by Firm A. Furthermore, LACE had no written policies and procedures in place governing this extra layer of review. Mouzon knew or should have known that LACE was required to disclose this extra review, and have written policies and procedures in place that described and governed the extra review, yet he failed to ensure that LACE did so.

#### **G. LACE's Failure to Retain Emails**

29. During 2008 to mid-2009, after LACE became registered as an NRSRO, LACE had no systems in place to ensure that email messages relating to initiating, determining, maintaining, changing, or withdrawing a credit rating were retained, and, as a result, LACE failed to retain all relevant email messages for that period. As LACE's President from April 2007 to January 2009, Mouzon knew or should have known that, as an NRSRO, LACE was required to retain such email messages. Mouzon failed to ensure that the required emails were retained.

#### **H. Violations**

30. Pursuant to Section 15E(a)(1) of the Exchange Act, a credit rating agency that elects to be treated as an NRSRO:

shall furnish to the Commission an application for registration . . . containing . . . the procedures and methodologies that the applicant uses in determining credit ratings . . . and . . . any other information and documents concerning the applicant . . . as the Commission, by rule, may prescribe as necessary or appropriate in the public interest or for the protection of investors.

31. Rule 17g-1(a) requires a credit rating agency applying for registration as an NRSRO to furnish the Commission with an initial application on Form NRSRO that follows the Form's instructions. By willfully making misstatements concerning the amount of revenue it received from Firm A in its NRSRO application and its request for an exemption from the Ten Percent Rule, LACE violated Section 15E(a)(1) of the Exchange Act and Rule 17g-1(a). Additionally, the instructions to Exhibit 2 of Form NRSRO require that an applicant or NRSRO provide "a general description of the procedures and methodologies used by the Applicant/NRSRO to determine credit ratings . . . within the classes of credit ratings for which the Applicant/NRSRO is seeking registration . . . . The description must be sufficiently detailed to provide users of credit ratings with an understanding of the processes employed by the Applicant/NRSRO in determining credit ratings . . ." LACE violated Section 15E(a)(1) and Rule 17g-1(a) and the instructions to Exhibit 2 of Form NRSRO by failing to disclose in its application that it performed an extra layer of review when determining credit ratings for banks whose securities were part of Firm A's CDO pools, after those entities already had been rated through LACE's standard ratings process, which LACE had described in its initial application.

32. The Rating Agency Act amended Section 17(a)(1) of the Exchange Act to add NRSROs to the list of entities required to make and keep such records, and make and disseminate such reports, as the Commission prescribes by rule as necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the Exchange Act. The Commission implemented Rule 17g-2 under this authority. Rule 17g-2(a)(6) requires an NRSRO to make and retain a current and complete record documenting the established procedures and methodologies it uses to determine credit ratings. LACE violated Section 17(a) of the Exchange Act and Rule 17g-2(a)(6) by failing to maintain records regarding the policies and procedures that governed the extra layer of review performed on the credit ratings issued on the banks whose securities were part of Firm A's CDO pools.

33. Rule 17g-2(b)(7) requires an NRSRO to retain internal and external communications, including electronic communications, received and sent by the NRSRO and its employees that relate to initiating, determining, maintaining, changing, or withdrawing a credit rating. LACE violated Section 17(a) of the Exchange Act and Rule 17g-2(b)(7) because it did not retain all emails sent or received by the firm and its employees relating to initiating, determining, maintaining, changing, or withdrawing credit ratings.

34. As a result of the conduct described above, LACE willfully violated Sections 15E(a)(1) and 17(a) of the Exchange Act and Rules 17g-1(a), 17g-2(a)(6), and 17g-2(b)(7) thereunder.

35. Mouzon, as the President of LACE and a person responsible for LACE's policies and procedures, the disclosures in LACE's NRSRO application, and the statements made to the Commission staff in connection with LACE's request for an exemption from the Ten Percent Rule, was a cause of LACE's violations.

### III.

In view of the allegations made by the Division of Enforcement, the Commission deems it appropriate that cease-and-desist proceedings be instituted to determine:

A. Whether the allegations set forth in Section II are true and, in connection therewith, to afford Respondent an opportunity to establish any defenses to such allegations; and

B. What, if any, remedial action is appropriate in the public interest against Respondent pursuant to Section 21C of the Exchange Act.

#### IV.

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened not earlier than 30 days and not later than 60 days from service of this Order at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

IT IS FURTHER ORDERED that Respondent shall file an Answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220.

If Respondent fails to file the directed answer, or fails to appear at a hearing after being duly notified, the Respondent may be deemed in default and the proceedings may be determined against him upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f) and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f) and 201.310.

This Order shall be served forthwith upon Respondent personally or by certified mail.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 300 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice.



In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not “rule making” within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Elizabeth M. Murphy  
Secretary

Service List

Rule 141 of the Commission's Rules of Practice provides that the Secretary, or another duly authorized officer of the Commission, shall serve a copy of the Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934 (Order) on the Respondent and his legal agents.

The attached Order has been sent to the following parties and other persons entitled to notice:

Honorable Brenda P. Murray  
Chief Administrative Law Judge  
Securities and Exchange Commission  
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