

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 100905 / September 3, 2024

ADMINISTRATIVE PROCEEDING
File No. 3-22053

In the Matter of

Demotech, Inc.

Respondent.

**ORDER INSTITUTING ADMINISTRATIVE
AND CEASE-AND-DESIST PROCEEDINGS,
PURSUANT TO SECTIONS 15E(d) AND 21C
OF THE SECURITIES EXCHANGE ACT OF
1934, MAKING FINDINGS, AND IMPOSING
REMEDIAL SANCTIONS AND A CEASE-
AND-DESIST ORDER**

I.

The Securities and Exchange Commission (“Commission”) deems it appropriate, in the public interest and for the protection of investors that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 15E(d) and 21C of the Securities Exchange Act of 1934 (“Exchange Act”) against Demotech, Inc. (“Demotech” or “Respondent”).

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (“Offer”) that the Commission has determined to accept. Respondent admits the facts set forth in Section III below, acknowledges that its conduct violated the federal securities laws, admits the Commission’s jurisdiction over it and the subject matter of these proceedings, and consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Pursuant to Sections 15E(d) and 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order (“Order”), as set forth below.

III.

On the basis of this Order and Respondent’s Offer, the Commission finds¹ that:

¹ The findings herein are made pursuant to Respondent’s Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

Summary

1. Nationally recognized statistical rating organizations (“NRSROs”) and the credit ratings they issue play a unique and important role in our financial markets. The federal securities laws impose recordkeeping requirements on NRSROs to establish a framework of oversight to ensure that NRSROs responsibly discharge their role. The Commission has long said that recordkeeping requirements have proven integral to the Commission’s investor protection function because preserved records are the primary means of monitoring compliance with applicable federal securities laws.

2. These proceedings arise out of failures by Demotech, an NRSRO, to adhere to certain NRSRO recordkeeping requirements. Demotech employees, including those at senior levels, have communicated by text messages using personal mobile devices since at least July 2022, both internally and externally (“off-channel communications”). The messages included discussions of initiating, determining, maintaining, monitoring, changing, or withdrawing a credit rating (“Credit Rating Activities”).

3. Demotech failed to maintain or preserve messages concerning Credit Rating Activities as required by NRSRO recordkeeping rules. Respondent’s failure was firm-wide and involved employees at various levels of seniority. As a result, Demotech violated Section 17(a) of the Exchange Act and Rule 17g-2(b)(7) thereunder.

4. After becoming an NRSRO in July 2022, Demotech initiated a training program to educate employees about the regulatory requirements of its new status as an NRSRO, including recordkeeping of communications. In July 2023, Demotech implemented a new policy concerning approved and unapproved methods of communicating about Demotech business and specifically addressing the preservation of business-related communications that employees sent or received by text message or platforms other than Demotech’s official email system. Demotech also implemented additional controls regarding the new policy, including trainings, periodic reminders, quarterly certifications, and surveillance.

Respondent

5. Demotech is a privately owned corporation formed in Ohio, with its principal office in Dublin, Ohio. Demotech became registered with the Commission as an NRSRO on July 11, 2022.

NRSRO Recordkeeping Requirements

6. Section 17(a)(1) of the Exchange Act authorizes the Commission to issue rules requiring NRSROs to make and keep for prescribed periods, and furnish copies of, such records as necessary or appropriate in the public interest, for the protection of investors or otherwise in furtherance of the purposes of the Exchange Act.

7. Pursuant to this provision, the Commission adopted recordkeeping requirements specific to NRSROs. Those requirements include, among other provisions, Exchange Act Rule 17g-2(b)(7), which requires an NRSRO to retain internal and external communications, including

electronic communications, received and sent by the NRSRO and its employees that relate to Credit Rating Activities. Rule 17g-2(c) specifies that this recordkeeping requirement applies for a period of three years.

8. In adopting Rule 17g-2 in 2007, the Commission emphasized the importance of analogous recordkeeping requirements, stating, “the retention of written communications has played an important role in assisting the Commission in identifying legal violations and compliance issues with respect to other regulated entities.” *Final Rule, Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organizations*, 72 Fed. Reg. 33563, 33588 (June 18, 2007). The Commission also specifically emphasized the evidentiary relevance of internal NRSRO records, stating that “internal communications will play an important role in assisting the Commission in identifying legal violations and compliance issues in its oversight of NRSROs.” *Id.*

Demotech’s Electronic Communications Policies and Procedures

9. Since it became registered as an NRSRO, Demotech has maintained certain policies and procedures designed to ensure the retention of business-related records, including electronic communications, pursuant to the relevant recordkeeping provisions.

10. Demotech’s policies and procedures required employees to use only their Demotech email addresses for communications with rated entities or their representatives. Demotech’s policies and procedures also required employees to maintain their own internal and external communications, including electronic communications, which related to Credit Rating Activities for a period of at least three years.

11. However, prior to July 2023, Demotech had no policy or procedure in place that prescribed the approved and unapproved methods of communicating between and amongst Demotech employees about Credit Rating Activities. Nor did Demotech have policies and procedures for automatically and consistently maintaining or preserving business-related communications that employees sent or received by text message or platforms other than Demotech’s official email system.

12. Messages sent through Demotech’s email system were monitored, subject to review, and, when appropriate, archived. Other than messages that employees maintained on their own, messages sent through other communication methods, such as on personal devices, were not monitored, subject to review, or archived.

13. In July 2023, Demotech implemented a new policy stating that employees are prohibited from using unapproved email or messaging systems, including personal email accounts and text messages, for business-related communications without approval from the Board of Directors.

Demotech’s Recordkeeping Failures

14. Since at least July 2022—when Demotech became registered as an NRSRO—Demotech employees involved in determining credit ratings, including those at senior levels, have

communicated internally and externally using text messages that were not retained or monitored by Demotech, for purposes relating to Credit Rating Activities.

15. In March 2023, Commission staff commenced an investigation to determine whether Demotech was properly retaining messages relating to Credit Rating Activities that were sent and received on personal or work-issued devices. Demotech cooperated with the investigation by voluntarily gathering communications from the devices of a sampling of employees, including senior executives and all employees involved in Credit Rating Activities.

16. The Commission staff's investigation uncovered off-channel communications relating to Credit Rating Activities at various seniority levels of Demotech's credit rating business. The staff requested off-channel communications data from various Demotech personnel and found that all of these individuals had engaged in off-channel communications relating to Credit Rating Activities. Overall, these personnel sent and received numerous off-channel communications relating to Credit Rating Activities, involving other Demotech employees, credit rating clients, and other external parties.

17. For example, in the weeks immediately after Demotech registered as an NRSRO, a senior executive exchanged numerous off-channel communications with the Chief Executive Officer of a credit rating client relating to Credit Rating Activities. That same senior executive also exchanged multiple off-channel communications with Demotech ratings analysts, including a credit analyst supervisor, relating to Credit Rating Activities with respect to the same client.

18. As another example, in the months following Demotech's registration as an NRSRO, a ratings analyst and a credit analyst supervisor exchanged multiple off-channel communications regarding Credit Rating Activities involving various clients, including a screenshot of an internal Demotech rating template.

19. As an additional example, on September 9, 2022, a credit analyst supervisor sent a text message to a ratings analyst forwarding a voicemail from the Chief Executive Officer of a credit rating client inquiring about the effect a planned dividend might have on its rating. The credit analyst supervisor and the ratings analyst proceeded to discuss the voicemail and the potential impact on Demotech's rating of the client through text message.

Demotech's Violation

20. As a result of the conduct described above, Demotech willfully² violated Section 17(a)(1) of the Exchange Act and Rule 17g-2(b)(7) thereunder, which requires each NRSRO, for a

² "Willfully," for purposes of imposing relief under Section 15E(d) of the Exchange Act, "means no more than that the person charged with the duty knows what he is doing." See *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting *Hughes v. SEC*, 174 F.2d 969, 977 (D.C. Cir. 1949)). There is no requirement that the actor "also be aware that he is violating one of the Rules or Acts." *Tager v. SEC*, 344 F.2d 5, 8 (2d Cir. 1965). The decision in *The Robare Group, Ltd. v. SEC*, which construed the term "willfully" for purposes of a differently structured statutory

period of three years, to retain internal and external communications, including electronic communications, received and sent by the NRSRO and its employees that relate to initiating, determining, maintaining, monitoring, changing, or withdrawing a credit rating.

Demotech's Efforts to Comply

21. In determining to accept the Offer, the Commission considered steps undertaken by Demotech before and after being approached by Commission staff, as well as cooperation afforded the Commission staff. Prior to being approached by Commission staff, in July 2022, Demotech initiated a training program to educate employees about the regulatory requirements of its new status as an NRSRO, including recordkeeping of communications. In July 2023, Demotech implemented a new policy delineating approved and unapproved methods of communicating about Demotech business and setting forth a procedure for preserving any unsolicited messages on unapproved messaging platforms. Demotech also implemented controls regarding the new policy, including trainings, periodic reminders, quarterly certifications, and surveillance. Demotech also disciplined two employees who failed to comply with record retention requirements.

IV.

In view of the foregoing, the Commission deems it appropriate, in the public interest, and for the protection of investors to impose the sanctions agreed to in Respondent Demotech's Offer.

Accordingly, pursuant to Sections 15E(d) and 21C of the Exchange Act, it is hereby ORDERED that:

- A. Respondent Demotech cease and desist from committing or causing any violations and any future violations of Section 17(a)(1) of the Exchange Act and Rule 17g-2(b)(7) thereunder.
- B. Respondent Demotech is censured.
- C. Respondent Demotech shall, within thirty (30) days of the entry of this Order, pay a civil money penalty in the amount of \$100,000.00 to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury, subject to Exchange Act Section 21F(g)(3). If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. § 3717.

Payment must be made in one of the following ways:

- (1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

provision, does not alter that standard. 922 F.3d 468, 478-79 (D.C. Cir. 2019) (setting forth the showing required to establish that a person has “willfully omit[ted]” material information from a required disclosure in violation of Section 207 of the Investment Advisers Act of 1940).

- (2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at <http://www.sec.gov/about/offices/ofm.htm>; or
- (3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Demotech as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Sheldon L. Pollock, Associate Regional Director, Division of Enforcement, Securities and Exchange Commission, 100 Pearl Street, Suite 20-100, New York, New York 10004-2626.

D. Amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that in any Related Investor Action, it shall not argue that it is entitled to, nor shall it benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that it shall, within thirty (30) days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Securities and Exchange Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

By the Commission.

Vanessa A. Countryman
Secretary