

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

**SECURITIES EXCHANGE ACT OF 1934**  
**Release No. 63818 / February 2, 2011**

**ACCOUNTING AND AUDITING ENFORCEMENT**  
**Release No. 3237 / February 2, 2011**

**ADMINISTRATIVE PROCEEDING**  
**File No. 3-14216**

**In the Matter of**

**Deerfield Capital Corp. and**  
**Danielle Valkner, CPA,**

**Respondents.**

**ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 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 that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 (“Exchange Act”), against Deerfield Capital Corp. (“Deerfield Capital”) and Danielle Valkner (collectively “Respondents”).

**II.**

In anticipation of the institution of these proceedings, Respondents have submitted Offers of Settlement (the “Offer”) which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission’s jurisdiction over them and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant to Section 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 finds<sup>1</sup> that:

#### Summary

1. Deerfield Capital Corp. ("Deerfield Capital") violated the books and records and internal control provisions of the Exchange Act in connection with three transactions involving securities issued by a Real Estate Mortgage Investment Conduit ("REMIC")—an investment vehicle used for the pooling of mortgage loans and the issuance of mortgage-backed securities. In each of the transactions, one of which occurred in December 2005 and two in March 2006, Deerfield Capital improperly recognized a gain from the purported sales of the REMIC while simultaneously purporting to purchase a "new" security (or "re-REMIC") representing nearly the same rights to nearly the same stream of payments. Deerfield Capital's recognition of a gain on the sale of the REMIC was contrary to Generally Accepted Accounting Principles ("GAAP").

2. For the December 2005 transaction, Deerfield Capital recognized \$3.9 million of gain on the sale of the REMIC, which constituted 15 percent of Deerfield Capital's reported net income for the fourth quarter of 2005 and 6 percent of its net income for the year ended December 31, 2005. For the March 2006 transactions, Deerfield Capital recognized gains of \$3.6 million, which constituted 14 percent of its net income for the quarter ended March 31, 2006 and 4 percent of its net income for the year ended December 31, 2006.

3. The misstatement related to the December 2005 transaction caused an excess payment of \$977,000 in performance fees to Deerfield Capital Management LLC ("Deerfield Management"), which by virtue of its provision of investment management and administrative services to Deerfield Capital, made the decision to account for the December 2005 transaction as a sale.

#### Respondents

4. Deerfield Capital Corp. is a Maryland corporation with its principal place of business located in Rosemont, Illinois. At all relevant times, Deerfield Capital traded on the New York Stock Exchange ("NYSE") and was a specialty finance company that invested in real-estate securities and various other asset classes and elected to be taxed as a real estate investment trust ("REIT"), which meant that it was required to distribute to investors at least 90 percent of its taxable income. The company's stated objective was to provide attractive returns to its investors through a combination of dividends and capital appreciation. At all times relevant to this Order, Deerfield Capital was externally managed by Deerfield Management. As an externally-managed

---

<sup>1</sup> The findings herein are made pursuant to Respondents' Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

company, Deerfield Capital had its own CEO and CFO, but it had no employees and relied on Deerfield Management to conduct its business and operations. On December 21, 2007, Deerfield Management became a wholly-owned subsidiary of Deerfield Capital. On October 1, 2008, Deerfield Capital terminated its REIT status retroactive to January 1, 2008. Deerfield Capital is now a Nasdaq-listed company.

5. Danielle Valkner (“Valkner”), age 41, is a CPA and was the CFO of Deerfield Management during the relevant time period. During the relevant time period, Valkner worked closely with Deerfield Capital’s CFO and the staff responsible for Deerfield Capital’s accounting. Valkner did not sign any of Deerfield Capital’s public filings, but signed management representation letters in connection with the 2005 and 2006 audits and quarterly reviews of Deerfield Capital by its outside auditor.

### **Background**

6. The three REMIC securities at issue in this matter were “digital” interest-only (“IO”) securities, which paid an annualized return of 8.375 percent when the one-month LIBOR exceeded 4.0 percent, but nothing when LIBOR was at or below 4.0 percent. During 2005, as the one-month LIBOR rose, these digital IOs increased in value.

7. Due to differences in tax accounting for the original issue discount on the digital IO, Deerfield Capital’s reported taxable income was greater than its reported GAAP income. Deerfield Capital’s REIT status required it to distribute substantially all of its taxable income to its shareholders, and the difference in taxable income and GAAP income would have led to Deerfield Capital showing negative retained earnings on its GAAP balance sheet. Deerfield Capital’s board was concerned about the tax/GAAP disparity and the possibility of shareholder confusion, as shareholders might have interpreted dividend payments in excess of GAAP earnings as a premature return of capital. In October 2005, Deerfield Capital’s board of directors requested that Deerfield Management attempt to resolve the difference between Deerfield Capital’s GAAP and taxable income, and Deerfield Management then began exploring the possible sale of the digital IOs. Thus, in late 2005, Deerfield Management personnel explored the option of selling one of the digital IOs in order to eliminate a difference between the income reported for tax purposes and the income reported for GAAP purposes and to capture the gain on the increasing value of the digital IO.

8. The trader responsible for Deerfield Capital’s mortgage-backed securities portfolio did not want to sell the digital IO because he felt that the security provided an effective hedge against increased funding costs of Deerfield Capital’s portfolio. The trader wanted either to retain the digital IO or to acquire an identical or similar security to provide that hedge. In order to accommodate the divergent goals of realizing a gain with respect to the digital IO, preserving its perceived hedge value, and more closely aligning Deerfield Capital’s GAAP and tax income, Deerfield Capital explored a number of options during the last quarter of 2005.

9. The efforts to consummate a transaction or series of transactions, which had begun in October, intensified as the year end approached. During December, Deerfield Management personnel continued their attempts to sell the digital IO but were unable to obtain what they felt was a fair price.

10. Finally, on December 28, a sales person for a third-party broker-dealer proposed the following transaction:

- The third-party broker-dealer would purchase the digital IO by the end of 2005, with settlement on January 24, 2006.
- The third-party broker-dealer would re-secureitize the digital IO cash flows by combining the cash flows with those from an unrelated stream of principal-only (“PO”) payments representing approximately 10 percent of the total value of the “new” security.
- Deerfield Capital would purchase the “new” security for settlement on January 30, 2006.
- The price of the digital IO component would be the same in both the sale and purchase transactions. Deerfield Capital and the third-party broker-dealer agreed upon a price halfway between the bid and ask price of the security on the date of the transaction. Since the third-party broker-dealer’s “purchase” and “sale” of the IO component would be at the same price, the third-party broker-dealer’s salesman told Deerfield Management’s trader that he was “indifferent” to the pricing of the security.

11. On December 29, the parties agreed to the transaction described above. In its financial statements for the year ended December 31, 2005, Deerfield Capital recognized a gain of \$3.9 million as a result of the transaction.

### **Application of GAAP**

12. These transactions do not qualify for sale treatment under SFAS 140, *Accounting for the Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, the applicable generally accepted accounting principle. Under SFAS 140(9)(a)-(c), a transaction may be accounted for as a sale, and a gain or loss recognized, only if all of certain conditions are met. Otherwise, the sale must be treated as a financing, upon which a gain or loss cannot be recognized.

13. Deerfield Capital’s three REMIC transactions in late 2005 and early 2006 did not meet the requirements of SFAS 140(9)(b) and therefore should not have been treated as sales under GAAP. SFAS 140(9)(b) requires that the transferee have the right to pledge or exchange the transferred assets it received and that no conditions both constrain the transferee from taking advantage of its right to pledge or exchange and provide more than a trivial benefit to the transferor. Deerfield Capital agreed to purchase a re-REMIC security that included the same cash flows represented by the IOs sold through a forward purchase contract concurrent with the third-

party broker-dealer's purchase, effectively constraining the third-party broker-dealer from pledging or exchanging the assets. Further, the IOs Deerfield Capital purportedly sold represented all payments from the underlying REMIC trust, constraining the third-party broker-dealer's ability to obtain a similar security. SFAS 140(32) states that, "A free standing forward purchase-sale contract between the transferor and the transferee on transferred assets not readily obtainable in the marketplace would benefit the transferor and is likely to constrain a transferee in much the same manner" as a free standing call option.

14. In addition, neither Deerfield Capital nor Deerfield Management performed a sufficient analysis or obtained the legal advice necessary to determine if the transactions satisfied SFAS 140(9)(a), which requires that the assets be "presumptively beyond the reach of the transferor and its creditors." The third-party broker-dealer had a contractual obligation to deliver a security for which 90 percent of the price represented the same stream of payments from the same pool of specifically identified assets. Deerfield Capital and Deerfield Management did not fully analyze the available evidence or obtain a legal opinion and therefore did not have reasonable assurance that the transactions would be deemed a true sale at law.

#### **Deerfield Capital's Accounting for the Transactions**

15. In late December 2005, Valkner played a significant role in the operations of Deerfield Capital. Although others participated in the structuring of the December 2005 transaction, Deerfield Capital's management relied primarily upon Valkner, the CFO of Deerfield Management, to determine whether the transaction qualified for sales treatment under GAAP. Valkner was aware of the difficulties that Deerfield Capital faced in executing a transaction that met all the previously stated objectives. Additionally, Deerfield Management's head of trading told Valkner in a December 21 email that "an outright sale" of the IO security was "very challenging as no one wanted to provide a firm bid at a reasonable level in an acceptable time frame.

16. In a series of December 29 communications between Valkner and other members of Deerfield Management personnel, including the mortgage trader who had negotiated the transaction, and after consultation with other Deerfield Capital accounting personnel, Valkner stated she believed that the December 29 transaction qualified for sale treatment. Deerfield Capital had not previously engaged in a transaction similar to the December 29 transaction, and Valkner did not correctly analyze the application of SFAS 140. When analyzing the transaction, Valkner did not ask the trader how the terms of the sale of the digital IO and the purchase of the re-REMIC were negotiated; never reviewed the Bloomberg message reflecting the terms of the transaction; and did not determine whether the digital IO represented an entire tranche of a pool of collateral, thereby making it unique.

17. Deerfield Capital's accounting staff failed to document its analysis of the complex accounting issues raised by the transaction. Although Deerfield Capital's outside auditors had been consulted concerning previous efforts to conduct a transaction concerning the IO, Deerfield

Capital did not consult its outside auditor in connection with the December 2005 transaction and did not bring the transaction to the auditor's attention in connection with the audit of Deerfield Capital's accounts for the year ended December 31, 2005.

18. Valkner did not review the transaction after December 29. Although she did not sign the filings containing Deerfield Capital's financial statements, she signed management representation letters addressed to Deerfield Capital's outside auditors, in which she stated to the best of her knowledge, that Deerfield Capital's financial statements were presented in accordance with GAAP, for the audit of the year ended December 31, 2005, the year ended December 31, 2006 and the quarter ended March 31, 2006.

19. At the close of the quarter ended March 31, 2006, Deerfield Capital sold two additional digital IO securities in similar transactions. Deerfield Capital's new CFO did not undertake any independent review of the transactions, purportedly relying instead upon the work done by Valkner and others to ensure compliance with GAAP in connection with the December 29 transaction. Deerfield Capital did not inform its outside auditor of the transaction. In connection with the March 2006 transactions, Deerfield Capital recognized \$3.6 million in gains on the sales.

#### **Impact on Deerfield Capital's Financial Statements**

20. In connection with the December 2005 transactions, Deerfield Capital recognized a gain on sale of \$3.9 million and recorded a related expense of \$977,000 for an incentive fee paid to Deerfield Management. In connection with the March 2006 transactions, Deerfield Capital recognized a gain on sale of \$3.6 million and recorded an incentive fee expense of \$915 thousand; however, Deerfield Management did not ultimately collect that fee at the time of its year-end calculation, due to losses arising from the impairment of the re-REMICs later in 2006.

21. In its audited Statement of Operations included in its Form 10-K for the year ended December 31, 2005, Deerfield Capital represented that it had realized a net gain of \$5.372 million on the sale of available-for-sale securities, which was a component of \$5.435 million in other income and gain. Deerfield Capital failed to disclose that \$3.9 million of that gain represented the "sale" of the IO security and there was an agreement to purchase a newly created re-REMIC security that included the cash flows of the IO sold combined with cash flows from a PO security. Similarly, in the Form 10-Q for the three months ended March 31, 2006, Deerfield Capital represented that it had realized a gain of \$2.092 million on the sale of available-for-sale securities. Again, Deerfield Capital failed to disclose that \$3.6 million of that gain related to the sale of the digital IOs and that there was an agreement to purchase a newly created re-REMIC security that included the cash flows of those IOs.

22. Correcting the improper accounting requires that the gain on sale be excluded from, and that the incentive fee be added back to, the income statement. As a result of the accounting errors, Deerfield Capital overstated its net income for the fourth quarter of 2005 by \$2.9 million, or 15 percent, and for the first quarter of 2006 by \$2.7 million, or 14 percent. As a result of the

errors, Deerfield Capital also overstated its net income for the year ended December 31, 2005 by 6 percent.

### Violations

23. As a result of the conduct described above, Deerfield Capital violated Section 13(a) of the Exchange Act and Rules 12b-20, 13a-1, and 13a-13 thereunder, and Valkner was a cause of Deerfield's violations of Section 13(a) of the Exchange Act and Rules 12b-20, and 13a-1 thereunder, which require every issuer of a security registered pursuant to Section 12 of the Exchange Act to file with the Commission information, documents, and annual and quarterly reports as the Commission may require, and mandate that periodic reports contain such further material information as may be necessary to make the required statements not misleading. Deerfield Capital violated those provisions by filing quarterly and annual reports that misstated its net income and gain on sale of available-for-sale securities and by failing to disclose that it was obligated to reacquire certain assets for which it had recognized revenue on a purported sale that should have been accounted for as a financing.

24. As a result of the conduct described above, Deerfield Capital violated Section 13(b)(2)(A) of the Exchange Act, and Valkner was a cause of Deerfield Capital's violations of Section 13(b)(2)(A) of the Exchange Act, which requires reporting companies to make and keep books, records, and accounts which, in reasonable detail, accurately and fairly reflect their transactions and dispositions of their assets. Because Deerfield Capital incorrectly recorded the transactions described above as sales, rather than financings, its books, records and accounts did not, in reasonable detail, accurately and fairly reflect its transactions and dispositions of assets.

25. Lastly, as a result of the conduct described above, Deerfield Capital violated Section 13(b)(2)(B) of the Exchange Act, which requires all reporting companies to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles. Deerfield Capital failed to implement internal accounting controls relating to its transactions in sales and purchases of re-securitizations sufficient to provide reasonable assurances that these accounts were accurately stated in accordance with generally accepted accounting principles.

### IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondents' Offers.

Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 21C of the Exchange Act, Respondent Deerfield Capital cease and desist from committing or causing any violations and any future violations of Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1, and 13a-13 thereunder.

B. Pursuant to Section 21C of the Exchange Act, Respondent Valkner cease and desist from causing any violations and any future violations of Sections 13(a) and 13(b)(2)(A) of the Exchange Act and Rules 12b-20 and 13a-1 thereunder.

C. Respondent Deerfield Capital shall, within 15 days of the entry of this Order, pay disgorgement of \$977,000 and prejudgment interest of \$300,070.36 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600. Payment shall be: (A) made by wire transfer, United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the Securities and Exchange Commission; (C) hand-delivered or mailed to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, VA 22312; and (D) submitted under cover letter that identifies Respondent Deerfield Capital as a Respondent in these proceedings, the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Gerald Hodgkins, Associate Director, Division of Enforcement, Securities and Exchange Commission, 100 F St., N.E., Washington, DC 20549-6010.

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, Making Findings, Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), on the Respondents and their 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  
100 F Street, N.E.  
Washington, DC 20549-2557

Douglas McAllister, Esq.  
Enforcement Division  
Securities and Exchange Commission  
100 F Street, N.E.  
Washington, DC 20549-6561

Ms. Danielle Valkner  
c/o Kevin J. McCall, Esq.  
Jenner & Block LLP  
353 N. Clark Street  
Chicago, IL 60654-3456

Kevin J. McCall, Esq.  
Jenner & Block LLP  
353 N. Clark Street  
Chicago, IL 60654-3456  
(Counsel for Danielle Valkner)

Deerfield Capital Corp.  
c/o William R. Baker III  
Latham & Watkins LLP  
555 Eleventh Street, N.W.  
Suite 1000  
Washington, DC 20004

William R. Baker III  
Latham & Watkins LLP  
555 Eleventh Street, N.W.  
Suite 1000  
Washington, DC 20004  
(Counsel for Deerfield Capital Corp.)