

MEMO# 5608

February 23, 1994

SEC SANCTIONS BDC DIRECTOR FOR FAILURE TO EVALUATE PORTFOLIO SECURITIES

February 23, 1994 TO: SEC RULES COMMITTEE NO. 18-94 RE: SEC SANCTIONS BDC DIRECTOR FOR FAILURE TO EVALUATE PORTFOLIO SECURITIES

The Securities and Exchange Commission recently sanctioned a director of a business development company ("BDC") for violations related to the valuation of the BDC's portfolio securities. A copy of the Commission's order is attached. Section 13(g) of the Securities Exchange Act required the BDC to file periodic reports on Forms 10-K and 10-Q, and in those reports the BDC was required to list and value its portfolio securities according to Section 2(a)(41)(B) of the Investment Company Act and Rule 2a-4 thereunder. Since market quotations of the BDC's portfolio securities were not readily available, Section 2(a)(41)(B)(ii) required that the BDC's board of directors determine the "fair value" of its portfolio securities in "good faith". The Commission found that the director had a statutory obligation (along with the BDC's two other directors) to determine the fair value of the securities in good faith. The Commission found that the director failed to meet those responsibilities during fiscal year 1989 and the first three quarters of fiscal year 1990 by not having any involvement in the valuation process. The BDC's board of directors allegedly did not meet during those two fiscal years and the director did not review any materials relating to the portfolio securities. The Commission found that during this period, the director's participation was essentially limited to signing the BDC's annual report and certificates of corporate resolution. The Commission found that as a result of the director's failure to fulfill her statutory obligation, the periodic reports filed by the BDC for those periods were materially deficient and false and misleading, since they represented that the board of directors was responsible for determining the fair value of the BDC's portfolio securities, and since they materially overstated the value of the BDC's portfolio securities, net income, assets, and shareholders equity. The Commission found that the director willfully aided and abetted and caused the BDC's violation of Section 13(a) of the Securities Exchange Act and Rules 12b-20, 13a-1, and 13a-13 thereunder. Without admitting or denying the Commission's findings, the director consented to a permanent bar from association with any broker, dealer, investment adviser, or investment company, and to an order to cease and desist from committing or causing any violation of those provisions. Thomas M. Selman Assistant Counsel Attachment

should not be considered a substitute for, legal advice.