

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT COMPANY ACT OF 1940
Release No. 30300 / December 10, 2012

ADMINISTRATIVE PROCEEDING
File No. 3-15127

In the Matter of

**J. Kenneth Alderman, CPA;
Jack R. Blair; Albert C.
Johnson, CPA; James
Stillman R. McFadden; Allen
B. Morgan Jr.; W. Randall
Pittman, CPA; Mary S. Stone,
CPA; and Archie W. Willis
III,**

Respondents.

**ORDER INSTITUTING PUBLIC
ADMINISTRATIVE AND CEASE-AND-DESIST
PROCEEDINGS PURSUANT TO SECTIONS 9(b)
AND 9(f) OF THE INVESTMENT COMPANY
ACT OF 1940**

I.

The Securities and Exchange Commission (“Commission”) deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 9(b) and 9(f) of the Investment Company Act of 1940 (“Investment Company Act”) against the former members of the boards of directors of the five registered investment companies listed in paragraph 10 below (the “Funds”). The former members of the boards of directors of the Funds are: J. Kenneth Alderman (“Alderman”); Jack R. Blair (“Blair”); Albert C. Johnson (“Johnson”); James Stillman R. McFadden (“McFadden”); Allen B. Morgan Jr. (“Morgan”); W. Randall Pittman (“Pittman”); Mary S. Stone (“Stone”); and Archie W. Willis III (“Willis”) (collectively “the Respondents” or “the Directors”).

II.

After an investigation, the Division of Enforcement alleges that:

SUMMARY

1. Between at least January 2007 and August 2007 (the “Relevant Period”), significant portions of the Funds’ portfolios contained below-investment grade debt securities, some of which were backed by subprime mortgages, for which market quotations were not readily available. Under the Investment Company Act, those securities were required to be valued at fair value as determined in good faith by the Directors. In discussing fund directors’ statutory fair valuation obligations, the Commission has stated that directors must “determine the method of arriving at the fair value of each such security. To the extent considered necessary, the board may appoint persons to assist them in the determination of such value, and to make the actual calculations pursuant to the board’s direction. The board must also, consistent with this responsibility, continuously review the appropriateness of the method used in valuing each issue of security in the company’s portfolio.”¹ The Directors did not specify a fair valuation methodology pursuant to which the securities were to be fair valued. Nor did they continuously review the appropriateness of the method to be used in valuing each issue of security in the company’s portfolio. Instead, the Directors delegated their responsibility to determine fair value to a valuation committee without providing any meaningful substantive guidance on how those determinations should be made. In addition, they made no meaningful effort to learn how fair values were actually being determined. They received at best only limited information on the factors considered in making fair value determinations and almost no information explaining why particular fair values were assigned to portfolio securities. These failures were particularly egregious given that fair valued securities made up the majority—and in most cases upwards of 60%—of the Funds’ net asset values (“NAVs”).

A. RESPONDENTS

2. J. Kenneth Alderman, 60 years of age and a resident of Birmingham, Alabama, was an interested director of the Funds beginning in 2003 and during the entire Relevant Period. He is a Certified Public Accountant (“CPA”), licensed in Florida and Alabama, and is a Chartered Financial Analyst.

3. Jack R. Blair, 70 years of age and a resident of Germantown, Tennessee, was an independent director and a member of the Audit Committee of the Funds beginning in 2005 and during the entire Relevant Period. He was also designated as an Audit Committee Financial Expert. Blair has never held any professional licenses.

4. Albert C. Johnson, 68 years of age and a resident of Hoover, Alabama, was an independent director and a member of the Audit Committee of the Funds beginning in 2005 and during the entire Relevant Period. He was also designated as an Audit Committee Financial Expert. Johnson is a CPA currently licensed in Alabama and Texas.

5. James Stillman R. McFadden, 55 years of age and a resident of Germantown, Tennessee, was an independent director and a member of the Audit Committee of the Funds beginning in 2002 and during the entire Relevant Period. He was also designated as an Audit Committee Financial Expert. He has never held any professional licenses.

¹ Accounting Series Release No. 118 (“ASR 118”).

6. Allen B. Morgan Jr., 70 years of age and a resident of Memphis, Tennessee, was an interested director of the Funds beginning in 2002 and during the entire Relevant Period, and was Chairman and CEO of Morgan Keegan until he retired in December 2003.

7. W. Randall Pittman, 59 years of age and a resident of Birmingham, Alabama, was an independent director and a member of the Audit Committee of the Funds beginning in 2003 and during the entire Relevant Period. He was also designated as an Audit Committee Financial Expert. Pittman is a CPA licensed in Alabama.

8. Mary S. Stone, 62 years of age and a resident of Birmingham, Alabama, was an independent director and Chairman of the Audit Committee of the Funds beginning in 2003 and during the entire Relevant Period. She was also designated as an Audit Committee Financial Expert. Stone is a CPA licensed in Florida.

9. Archie W. Willis III, 54 years of age and a resident of Memphis, Tennessee, was an independent director and a member of the Audit Committee of the Funds beginning in 2002 and during the entire Relevant Period. He was also designated as an Audit Committee Financial Expert. Willis has never held any professional licenses.

B. OTHER RELEVANT ENTITIES

10. The Funds consisted of five registered investment companies: (i) RMK High Income Fund, Inc.; (ii) RMK Multi-Sector High Income Fund, Inc.; (iii) RMK Strategic Income Fund, Inc.; (iv) RMK Advantage Income Fund, Inc.; and (v) Morgan Keegan Select Fund, Inc. (“Select Fund”). The Select Fund was an open-end company with a fiscal year end of June 30 that contained three open-end series—the Select High Income portfolio, the Select Intermediate Bond portfolio, and the Select Short Term Bond portfolio. The other funds were closed-end funds with a fiscal year end of March 31. During the Relevant Period, each Fund had a board of directors that consisted of two interested directors and six independent directors. All of the independent directors sat on each Fund’s Audit Committee. The closed-end funds calculated and published daily NAVs, although these were not the basis of transactions in their shares.

11. Morgan Asset Management, Inc. (“Morgan Asset”) is an investment adviser registered with the Commission, and Morgan Keegan & Company, Inc. (“Morgan Keegan”) is a broker-dealer and an investment adviser registered with the Commission. Both were headquartered in Memphis, Tennessee. During the Relevant Period, Morgan Asset served as the investment adviser for the Funds and Morgan Keegan provided accounting services to the Funds through its Fund Accounting group (“Fund Accounting”).

C. OVERVIEW OF THE FUNDS

12. As of March 31, 2007, the Funds held securities with a combined net asset value of approximately \$3.85 billion. The Funds owned many of the same securities and almost all of the Funds invested the majority of their total assets in complex securities known as structured products that included collateralized debt obligations, collateralized mortgage obligations, collateralized loan obligations, home-equity loan-backed securities, various types of asset-backed securities, and certificate-backed obligations.

13. The Funds' filings with the Commission disclosed that their assets would be concentrated in below-investment grade debt securities, which carried inherent risks such as more frequent and pronounced changes in the perceived creditworthiness of issuers, greater price volatility, reduced liquidity, and the presence of fewer dealers in the market for such securities. Another, particularly relevant characteristic of the Funds' holdings was their significant concentrations in mortgage-backed securities.

14. A significant number of the structured products held by the Funds were subordinated tranches of various securitizations, for which market quotations were not readily available during the Relevant Period. As a result, a large percentage of the Funds' portfolios had to be fair valued as determined in good faith by the Funds' boards, in accordance with the requirements of Section 2(a)(41)(B) of the Investment Company Act. As of March 31, 2007, more than 60% of the NAV of each of the four closed-end funds was required to be fair valued. As of June 30, 2007, more than 50% of the NAV of each of the two largest open-end series was fair valued.

D. RESPONDENTS DELEGATE THEIR VALUATION RESPONSIBILITIES WITH MINIMAL GUIDANCE

15. In the Funds' Policy and Procedure Manual (the "Manual"), the Directors delegated to Morgan Asset "the responsibility for carrying out certain functions relating to the valuation of portfolio securities . . . in connection with calculating the NAV per share of the Funds." The Manual also stated that "portfolio securities for which market quotations are readily available are valued at current market value [while] . . . [a]ll other portfolio securities will be valued at 'fair value' as determined in good faith by [Morgan Asset] in accordance with the Funds' Valuation Procedures.

16. The Funds' Valuation Procedures within the Manual stated more specifically that "[w]hen price quotations for certain securities are not readily available from the sources noted above [i.e., sources of market prices] or if the available quotations are not believed to be reflective of market value, those securities shall be valued at "fair value" *as determined in good faith by [Morgan Asset's] Valuation Committee.*" [Emphasis added] The Valuation Procedures then listed various general and specific factors, which the Valuation Committee was supposed to consider when making fair value determinations. The "General Factors" listed were (i) the fundamental analytical data relating to the investment; (ii) the nature and duration of restrictions on disposition of the securities; and (iii) an evaluation of the forces which influence the market in which these securities are purchased and sold." The "Specific Factors" listed were: (i) type of security; (ii)

financial statements of the issuer; (iii) cost at date of purchase (generally used for initial valuation); (iv) size of the Fund's holding; for restricted securities, (v) any discount from market value of restricted securities of the same class at the time of purchase; (vi) the existence of a shelf registration for restricted securities; (vii) information as to any transactions or offers with respect to the security; (viii) special reports prepared by analysts; (ix) the existence of merger proposals, tender offers or similar events affecting the security; and (x) the price and extent of public trading in similar securities of the issuer or comparable companies.”

17. Other than listing these factors, which were copied nearly verbatim from ASR 118, the Valuation Procedures provided no meaningful methodology or other specific direction on *how* to make fair value determinations for specific portfolio assets or classes of assets. For example, there was no guidance in the Valuation Procedures on how the listed factors should be interpreted, on whether some of the factors should be weighed more heavily or less heavily than others, or on what specific information qualified as “fundamental analytical data relating to the investments” or “forces that influence the market in which these securities are bought and sold” for particular types of securities held by the Funds. Additionally, the Valuation Procedures did not specify what valuation methodology should be employed for each type of security or, in the absence of a specified methodology, how to evaluate whether a particular methodology was appropriate or inappropriate. Also, the Valuation Procedures did not include any mechanism for identifying and reviewing fair-valued securities whose prices remained unchanged for weeks, months and even entire quarters.

18. The Directors did not provide any other guidance—either written or oral—on how to determine fair value beyond what was stated in the Valuation Procedures.

19. The “Written Reports of Fair Value Determinations” subsection of the Valuation Procedures contained the only procedures regarding information required to be provided to the Directors. It stated that “[u]pon making a determination as to the fair value of a security, the Valuation Committee shall maintain a written report documenting the manner in which the fair value of a security was determined and the accuracy of the valuation made based on the next reliable public price quotation for that security,” and further required that the Valuation Committee create and provide to the Directors for review “[q]uarterly reports listing all securities held by the Fund that were fair valued during the quarter under review, along with explanatory notes for the fair values assigned to the securities.”

E. THE FUNDS’ ACTUAL FAIR VALUATION PRACTICES

20. In practice, the task of assigning fair values on a daily basis was performed by Fund Accounting, which consisted of Morgan Keegan employees.

21. In determining fair value, Fund Accounting did not use any reasonable analytical method to arrive at fair value. For example, neither Fund Accounting nor the Valuation Committee used a pricing model or made any real effort to analyze future cash flows that a particular bond in the portfolio would likely generate.

22. Under the actual fair valuation process, Fund Accounting typically set a security's initial fair value as its purchase price (its cost) and, thereafter, left that fair value unchanged unless a sale or a price confirmation indicated a more than 5% variance from the previously assigned fair value. In addition, Kelsoe occasionally contacted Fund Accounting, by email or other means, and specified prices for particular securities. Without any explanation of his basis for such prices, Fund Accounting routinely accepted the prices provided by Kelsoe.

23. Shortly after each month end, Fund Accounting randomly selected and sought price confirmations for as few as 10% of the Funds' securities that were required to be fair valued, except for March and June when, in connection with annual audits, confirmations were sought for 100% of the fair valued securities. The price confirmations were essentially opinions on price from broker-dealers, rather than bids or firm quotes. The price confirmations virtually always contained disclaimers explicitly making clear that the dealer providing the price confirmation was not offering to buy the security at the stated price. In addition, the price confirmations were generally sought for month-end prices, but were obtained several weeks after the respective month-ends. Accordingly, they could not have sufficed as the primary valuation method, given the open-end Fund series' obligation to timely price the securities.

24. Although these monthly price confirmations could not suffice as the primary valuation method, Fund Accounting regularly relied on them when making daily fair value determinations. For example, if a month end price confirmation showed a price more than 5% different than the Funds' current price for that security, Fund Accounting would typically consult the portfolio manager on how to price that security.

25. The Valuation Procedures contained a section entitled "Price Override Procedures," which provided that the Adviser could "override prices provided by a pricing service or broker-dealer only when it had a reasonable basis to believe that the price . . . does not accurately reflect the fair value of the portfolio security." The section further provided that "the basis for overriding the price shall be documented and provided to the Valuation Committee for its review." Because the Valuation Committee and Fund Accounting interpreted this provision as applying only to broker-dealer quotes (i.e., actual offers to buy or sell), the Valuation Committee did not receive notice or explanation when Fund Accounting chose to ignore the price confirmations. The Respondents knew or should have known that Fund Accounting relied heavily on price confirmations when making fair valuation decisions, but that there was nothing requiring Fund Accounting to identify or explain those instances where the price confirmations differed materially from the Funds' price.

26. In the event a price confirmation indicated a more than 5% variance from the previously assigned fair value, Fund Accounting effectively allowed the portfolio manager to select the fair value. The portfolio manager took advantage of the fact that Fund Accounting allowed him to arbitrarily set values without a reasonable basis and did so in a way that postponed the degree of decline in the NAVs of the Funds which should have occurred during the Relevant Period.

27. The Valuation Committee, which consisted of Fund officers and Fund Accounting employees, was responsible according to the Funds' procedures for overseeing the fair valuation

process. During most of the Relevant Period, the Valuation Committee met monthly, but received insufficient information as to the basis of the fair values assigned to various securities. Specifically, the Valuation Committee received Security Sales reports for the Funds (described in greater detail below), brief explanations for greater-than-5% variances therein, and price confirmations obtained from broker-dealers.

28. The Valuation Committee reviewed pricing information provided by Fund Accounting. The pricing test typically employed by the Valuation Committee was a comparison included in the Security Sales reports of sales prices to previously assigned fair values. And while the Valuation Committee did receive the price confirmations that Fund Accounting solicited from independent broker-dealers, the Valuation Committee did not perform any additional tests to validate the fair values of portfolio securities that had not been sold or confirmed from a broker-dealer. Less than 25% of the approximately 350 securities held by the Funds that were required to be fair valued were actually sold in the first six months of 2007 and price confirmations were sought for as few as 10% of the fair valued securities through broker-dealers on a monthly basis.

F. THE DIRECTORS FAILED TO SATISFY THEIR FAIR VALUATION OBLIGATIONS

29. Throughout the Relevant Period, the Directors did not know and did not inquire what methodology was used by Fund Accounting and the Valuation Committee to fair value particular securities or types of securities. The information and reports provided to Directors at their board meetings did not provide sufficient information for the Directors to understand whatever methodology was being used by Fund Accounting to fair value securities. For example, at each quarterly board meeting the Directors received a list of the Funds' portfolio securities that were required to be fair valued and the fair values assigned to each security. However, there was no way a Director could determine from the list the type of security, the basis for a particular assigned fair value, or whether that price had changed from prior quarters. Furthermore, while the Directors did meet more frequently to discuss the Funds' holdings and did inquire about liquidity and valuation after being contacted by the SEC staff with valuation-related concerns in July 2007, the Directors still never asked specific questions about how the Funds' assets were being valued and how those values were being tested.

30. The Directors received at each quarterly board meeting three other documents relating to fair value determinations. The three documents were: (i) a "Report from the Joint Valuation Committee [of the Funds];" (ii) a "Fair Valuation Form" for each of the Funds; and (iii) "Security Sales" reports for each of the Funds.

31. The *Report from the Joint Valuation Committee* was a one-page, two-paragraph, narrative that was largely uninformative. Typical language contained in this report for the quarterly board meetings in November 2006, January 2007 and May 2007, said: "The Valuation Committee met three times during the [preceding] calendar quarter[.] . . . The values of internally-priced securities were randomly confirmed with third parties and no material exceptions were noted. The Valuation Committee feels that all securities are being fairly priced and there are no material misstatements." The report did not, however, state how fair values were determined, and gave no details on how fair valued securities, which it referred to as "internally-priced securities," were "randomly confirmed with third parties."

32. Although price confirmations played a significant role in the Funds' fair valuation process, the Directors never established any guidelines regarding the use of price confirmations, such as how frequently they should be requested for any particular type of security, or the selection of broker-dealers used to provide such price confirmations. Nor did the Directors require any review to identify those securities for which no price confirmation had been obtained for a particular length of time.

33. The second document received quarterly by the Directors for each of the Funds was called a "*Fair Valuation Form*," which also contained boilerplate phraseology. Specifically, next to the words "Basis/Source/Method For Determining Price Used" was the same reoccurring phrase: "[i]nternal matrix based on actual dealer prices and/or Treasury spread relationships provided by dealers." There was no explanation of the "internal matrix" and no indication of what was meant by the terms "actual dealer prices" or "Treasury spread relationships provided by dealers." The Directors did not understand how the matrix operated.

34. Meaningful "explanatory notes for the fair values assigned to the securities" were not presented, quarterly or otherwise, to the Directors, despite the fact that the Valuation Procedures required that the Directors receive them on a quarterly basis. Furthermore, the Directors never followed up to request that such explanatory notes or any other specific information regarding the basis for the values assigned be provided to them.

35. Contrary to the statements in the Fair Valuation Form, the internal matrix was only used to price approximately 12% of the securities held by the four closed-end Funds' that were required to be fair valued as of March 31, 2007.

36. The "*Security Sales*" report for the Funds listed information about the securities sold in each Fund in the preceding quarter, including: (1) par value sold; (2) sales price; (3) the previous day's assigned price; (4) whether it was priced externally or internally, *i.e.*, fair valued; (5) the resulting variance; and (6) the impact on the Fund.

37. The utility of the Security Sales reports in the review of valuations was limited, because the reports included no information about securities that *had not been sold*—a very important category given the fact that securities that were required to be fair valued constituted a majority of Fund assets and less than 25% of the securities held by the Funds that were required to be fair valued were sold in the first six months of calendar 2007.

38. As a result of the Directors' causing the Funds to fail to adopt and implement reasonable procedures, the NAVs of the Funds were materially misstated at least from March 31, 2007 through August 9, 2007. Consequently, the prices at which the open-end Fund sold, redeemed, and repurchased its shares were also inaccurate. Additionally, at least one registration statement and other reports filed with the Commission by the Funds contained NAVs as of dates within the Relevant Period that were materially misstated. Included among these was a Form N-1A, filed by the Select Fund on October 29, 2007 that contained NAVs as of June 30, 2007 that were materially misstated.

G. VIOLATIONS

39. As a result of the conduct described above, Respondents caused the open-end Fund series' violations of Rule 22c-1 under the Investment Company Act, which makes it unlawful for registered investment companies issuing redeemable securities, persons designated in such issuer's prospectus as authorized to consummate transactions in such securities, and principal underwriters of, or dealers in such securities, to sell, redeem, or repurchase such securities except at a price based on the current net asset value of such security.

40. As a result of the conduct described above, Respondents caused the Funds' violations of Rule 30a-3(a) under the Investment Company Act. That rule requires that registered management investment companies maintain internal control over financial reporting. The term "internal control over financial reporting" is defined in paragraph (d) of the rule as a process designed by or under the supervision of the registered management investment company that provides reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

41. As a result of the conduct described above, Respondents caused the Funds' violations of Rule 38a-1 under the Investment Company Act. That rule requires that registered investment companies adopt and implement written policies and procedures reasonably designed to prevent violation of the federal securities laws by the fund, including policies and procedures that provide for the oversight of compliance by the fund's investment adviser. The Funds failed to adopt and implement meaningful fair-valuation methodologies and related procedures.

42. As a result of the conduct described above, Respondents willfully caused to be made in a registration statement filed with the Commission under the Investment Company Act a statement which was at the time and in the light of the circumstances under which it was made false or misleading with respect to a material fact, or omitted to state in such registration statement a material fact which was required to be stated therein.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate in the public interest that public administrative and 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 Respondents an opportunity to establish any defenses to such allegations;
- B. What, if any, remedial action is appropriate in the public interest against Respondents pursuant to Section 9(b) of the Investment Company Act including, but not limited to, civil penalties pursuant to Section 9(d) of the Investment Company Act; and
- C. Whether, pursuant to Section 9(f) of the Investment Company Act, Respondents should be ordered to cease and desist from committing or causing violations of and any future violations of Rules 22c-1, 30a-3(a) and 38a-1, promulgated under the Investment Company 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 Respondents 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 a 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 Respondents 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