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 Section 8A of the Securities Act of 1933 ("Securities Act"), Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act"), and Section 9(f) of the Investment Company Act of 1940 ("Investment Company Act") against Fifth Street Management, LLC ("FSM" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer 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 him and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Pursuant to Section 8A of the Securities Act of 1933, Section 21C of the Securities Exchange Act of 1934, Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 and Section 9(f) of the Investment Company Act of 1940, 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:

Summary

1. This matter arises from FSM’s improper allocation of expenses to its former business development company (“BDC”) clients, and failures relating to the valuation of two portfolio company investments held by one of the BDCs (“BDC-1”). In 2013 and 2014, FSM improperly allocated to the BDC clients $1,208,510 in rent and other overhead expenses that the adviser should have paid. Further, during 2014, FSM also improperly allocated $118,895 in compensation expenses of two FSM employees to the BDC clients.

2. In addition, FSM was responsible for conducting the quality control review of its BDC clients’ quarterly valuation models (“QC Review”) for illiquid assets whose values could not be determined by reference to market prices or quotes. FSM failed to conduct this work in a reasonable manner resulting in BDC-1 overvaluing two portfolio companies, causing its financial statements that were included in its Forms 10-Q for periods ended March 31 and June 30, 2014, and Form 10-K for period end September 30, 2014, to materially misstate net increase in assets resulting from operations (“Net Income”) and earnings per share (“EPS”). In July 2014 and September 2014, BDC-1 offered and sold additional shares of its stock while these inflated Net Income and EPS figures were outstanding. When these and other valuations were changed to reasonably reflect the portfolio companies’ forecasted performance, BDC-1’s stock price dropped 15% on February 9, 2015, when it filed its Form 10-Q for quarter-end December 31, 2014. FSM did not implement written policies and procedures reasonably designed to prevent violations of the Advisers Act concerning expense allocation until July 2016, did not implement them for the QC Reviews, and did not have adequate policies and procedures concerning the prevention of the use of material, nonpublic information.

3. As a result of the aforementioned conduct, FSM willfully violated Sections 204A, 206(2), 206(4), and 207 of the Advisers Act and Rules 206(4)-7(a) and 206(4)-8(a)(2), thereunder,

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.
and caused BDC-1’s violations of Section 17(a)(2) of the Securities Act and Sections 13(a), 13(b)(2)(A), 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1 and 13a-13, and Section 31(a) of the Investment Company Act and Rule 31a-1 thereunder, and BDC-2’s violations of Exchange Act Sections 13(b)(2)(A) and 13(b)(2)(B) and Section 31(a) of the Investment Company Act and Rule 31a-1, thereunder.

Respondent

4. Fifth Street Management, LLC (“FSM”) is a Delaware limited liability company with its principal office in Greenwich, Connecticut. It was registered with the Commission as an investment adviser from December 2007 until November 2017 when it withdrew its registration. FSM provided investment advisory services to other Fifth Street affiliated companies including BDC-1, BDC-2 (collectively the “BDC clients”), two Collateralized Loan Obligation (“CLO”) funds, and a private hedge fund. As of March 31, 2014, FSM had $2.633 billion under management.

FACTS

A. FSM’s Business Development Company Clients

5. FSM was the investment adviser to two non-diversified, closed-end companies that elected to be treated as BDCs under the Investment Company Act. BDC-1 conducted its initial public offering in 2008 and, according to its Form 10-K as of September 30, 2014, its portfolio totaled $2.5 billion at fair value. BDC-2 conducted an initial public offering in July 2013 and, according to its Form 10-K as of September 30, 2014, its portfolio totaled $300 million at fair value. At all relevant times, the BDCs’ common stock was registered pursuant to Section 12(b) of the Exchange Act and the BDCs were required to file periodic reports with the Commission pursuant to Section 13 of the Exchange Act. FSM stopped being the BDC clients’ adviser in October 2017. FSM charged BDC-1 and BDC-2 quarterly fees based on assets under management and the performance of the funds.

B. FSM’s Misallocation of Rent and Other Overhead Expenses and Employee Compensation

6. The BDC clients entered into Investment Advisory Agreements (“Advisory Agreements”) with FSM. According to these agreements, FSM was responsible for paying “the compensation and routine overhead expenses” of its personnel. Although FSM allocated shared expenses to its clients, it did not adopt and implement written expense allocation policies and procedures until July 2016.

7. FSM and the BDC clients used the same office space and numerous employees performed work for both FSM and the BDC clients. From quarter-end June 30, 2013 through year-end September 30, 2014, FSM had between 52 and 75 employees. While FSM allocated compensation expenses for only eight or nine employees to the BDC clients, it allocated essentially all the rent and other overhead expenses associated with its employees to the BDC clients. This over allocation of rent and other overhead expenses to FSM’s BDC clients was $1,208,510.
8. In addition, from April 2014 until November 2014, FSM improperly allocated $118,895 to the BDC clients for the compensation of two FSM employees who assisted in preparing the Form S-1 for an FSM affiliate’s 2014 initial public offering. That initial public offering was unrelated to FSM’s advisory work for the BDC clients.

9. FSM’s misallocation of rent and other overhead and employee compensation expenses to its BDC clients caused the BDCs’ books and records to be inaccurate for the periods during which the misallocations occurred because their expenses were overstated.

10. These expense allocations were also contrary to FSM’s Forms ADV. In 2014, Item 5.E of Part 1 of Form ADV required that an investment adviser identify or describe the ways it is compensated for providing advisory services. FSM’s Form ADV filed on March 31 and August 15, 2014 identified that it received a percentage of assets under management and performance-based fees, but did not disclose that, in addition to such amounts, its BDC clients were paying FSM’s rent, other overhead expenses, and a portion of the compensation of two employees, which constituted “other” compensation under Item 5.E.

C. FSM’s Role in BDC-1’s Portfolio Company Quarterly Valuation Process

11. BDC-1 loaned funds to, and invested in, small and mid-sized companies. Its portfolio was composed of mostly first and second liens and subordinated debt investments that were valued using Level 3 inputs under Financial Accounting Standards Board Accounting Standards Codification Topic 820, Fair Value Measurements and Disclosures.

12. In its public filings, BDC-1 described a board-approved methodology and nine-step process that it used to value its portfolio on a quarterly basis, with BDC-1’s board ultimately determining in good faith the fair value of the portfolio. FSM’s portfolio company analysts (“Analysts”) were integrally involved in BDC-1’s valuation process and FSM conducted the QC Review of BDC-1’s quarterly valuation models that used Level 3 inputs for its debt investments.

13. FSM’s Analysts were responsible for uploading to FSM’s shared network drive each portfolio companies’ most recently available financial reporting packages, budget projections, lender updates, and board presentations. All of BDC-1’s non-advisory functions and corporate officers were outsourced to an FSM affiliate that was not an investment adviser. The affiliate’s employees who performed the non-advisory functions are hereafter referred to as “BDC-1 personnel.” BDC-1’s quarterly valuation process began with BDC-1’s personnel preparing the valuation models using objective and subjective inputs gathered from the portfolio company information uploaded to the shared drive.

14. FSM’s QC Review of the inputs to the valuation models was a critical part of BDC-1’s quarterly valuation process and its internal accounting controls. Unlike BDC-1’s personnel, FSM’s Analysts worked closely with the portfolio companies and were thus very familiar with the portfolio companies’ financial performance and outlook and, thus, were better suited to assess the reasonableness of the valuation model inputs.
15. BDC-1 provided FSM’s Analysts with a checklist to confirm the use of the most recent company specific information and the reasonableness of subjective inputs as part of the QC Review process. Some FSM employees, including the two analysts discussed herein, however, did not understand the level of review required, and failed to flag incorrect or unreasonable valuation model inputs for at least two of BDC-1’s portfolio company investments that resulted in materially inaccurate financial statements of BDC-1 that were included in its Forms 10-Q for the periods ended March 31 and June 30, 2014, and Form 10-K for period ended September 30, 2014. FSM failed to adopt and implement written policies and procedures concerning the QC Review process, and failed to train its Analysts who conducted the QC Reviews.

QC Review of Portfolio Company A for Periods Ended March 31, June 30, and September 30, 2014

16. In March 2013, BDC-1 restructured a loan to Portfolio Company A, resulting in BDC-1 becoming the controlling equity owner of the company. FSM’s head of portfolio management, and the junior analyst covering Portfolio Company A (“Company A Analyst”) became company board members. Thus, they were familiar with the operational and financial performance of Portfolio Company A and its future prospects.

17. After Portfolio Company A’s restructuring and into 2014, the company’s financial performance significantly deteriorated. In February 2014, Portfolio Company A revised its budget and reduced its 2014 projected net revenue. However, Company A Analyst did not upload that budget to the shared drive, and BDC-1 personnel did not incorporate the updated projections into Portfolio Company A’s valuation model for the quarter-ended March 31, 2014. As a result, BDC-1’s valuation model did not reasonably reflect Portfolio Company A’s deteriorating condition and outlook.

18. Company A Analyst conducted the QC review of the valuation model for Portfolio Company A for March 31, 2014, and failed to identify that financial projections used as valuation model inputs were based on stale data from August 2013. Company A Analyst also failed to note that year-over-year sales growth estimates were unreasonable, particularly given the fact that Portfolio Company A had recently lost a major customer. Although the analyst noted on the QC review checklist that the 2014 net revenue projection used in the valuation model was incorrect and listed the correct number, the analyst failed to make the correction in the electronic version of the model, and the preliminary valuation presented to and approved by BDC-1’s audit committee and board did not incorporate the updated projection.

19. During the quarter-ended June 30, 2014, Portfolio Company A’s performance continued to decline and BDC-1 injected additional equity into the company and that equity investment was written down at quarter end. Portfolio Company A management also revised downward its 2014 financial projections.

20. Company A Analyst also conducted the QC Reviews for the June 30 and September 30, 2014, Portfolio Company A valuation models. The analyst again failed to identify that financial projections used as valuation model inputs were based on stale data from August 2013 or note that the year-over-year sales growth estimates were unreasonable in light of Portfolio Company A’s continued deteriorating performance and outlook.
21. As a result of the failures in the QC review process for the March 31, June 30, and September 30, 2014, Portfolio Company A valuation models, the valuations presented to and approved by BDC-1’s audit committee and board were overvalued by about $3 million for each quarter. These incorrect valuations were ultimately incorporated into BDC-1’s financial statements that were included in Forms 10-Q for the periods ended March 31 and June 30, 2014, and Form 10-K for the period ended September 30, 2014.

**QC Review of Portfolio Company B for Periods Ended June 30 and September 30, 2014**

22. As of quarter-end June 30, 2014, BDC-1 had maintained its loan position in Portfolio Company B for a number of years. In 2013, Portfolio Company B experienced significant issues with legacy contracts, deteriorating financial performance, and problems with its internal accounting. Those problems continued in 2014 and in May of that year FSM’s team covering Portfolio Company B requested an operational and financial performance update from the company.

23. On June 10, 2014, Portfolio Company B presented a written lender update to FSM’s head of portfolio management and the junior analyst covering Portfolio Company B (“Company B Analyst”), showing that Portfolio Company B’s management expected 2014 adjusted earnings before interest, taxes, depreciation and amortization (“EBITDA”) to decline from about $10 million to just under $3 million.

24. Company B Analyst failed to upload the June 10, 2014, lender update to FSM’s shared drive and BDC-1 personnel were therefore unaware of Portfolio Company B’s significantly lower revision of its projected 2014 EBITDA when preparing Portfolio Company B’s valuation model for the quarter ended June 30, 2014.

25. On July 10, 2014, Company B Analyst conducted the QC review of BDC-1’s valuation model for the company. However, the analyst failed to identify the reduction of Portfolio Company B’s expected 2014 EBITDA to approximately $3 million, instead of the $10 million used in the valuation model.

26. At the July 21, 2014, BDC-1 audit committee meeting where the June 30, 2014, preliminary quarterly valuations were reviewed and discussed, FSM failed to identify that Portfolio Company B expected a significant decline in expected 2014 EBITDA. The failure to incorporate the $3 million expected EBITDA assumption into the valuation model resulted in Portfolio Company B being overvalued in the range of $7.2 million to $19 million, depending on whether other model assumptions were adjusted. BDC-1’s audit committee and board reviewed and approved the preliminary Portfolio Company B valuation that did not account for the reduction in projected EBITDA.

27. Portfolio Company B provided FSM with another lender update on September 22, 2014, which showed that company management expected 2014 adjusted EBITDA to be negative $3.7 million. Company B Analyst also performed the QC review for the preliminary Portfolio Company B valuation model and again failed to identify that the model was using the stale $10 million EBITDA figure instead of the September revision. These incorrect valuations were
presented to and approved by BDC-1’s audit committee and board and were ultimately incorporated into BDC-1’s financial statements that were included in its Form 10-Q for the period ended June 30, 2014, and Form 10-K for the period ended September 30, 2014.

Effect of Portfolio Company A & B Overstated Valuations on BDC-1’s SEC Periodic Filings, 2014 Stock Offerings, and Books and Records

28. The overstated Portfolio Company A valuation had a material effect on BDC-1’s net increase in assets resulting from operations (“Net Income”) and earnings per share (“EPS”) for the period ended March 31, 2014, while the overstated Portfolio Company A and B valuations had a material effect on BDC-1’s Net Income and EPS for the periods ended June 30 and September 30, 2014. In addition, BDC-1 offered and sold additional shares while the materially misstated valuations for periods ended March 31 and June 30, 2014, were outstanding.

29. In particular, for quarter-end March 31, 2014, BDC-1’s reported Net Income was $30.1 million. That figure was overstated by approximately $3 million and BDC-1’s EPS was overstated at $0.22 instead of $0.20. On July 15, 2014, BDC-1 conducted a secondary offering of 13.25 million shares of common stock that raised net proceeds of $129.7 million. This offering was overvalued due to the material misstatements in BDC-1’s Form 10-Q for quarter-end March 31, 2014.

30. Likewise, for quarter-ended June 30, 2014, BDC-1’s Net Income of approximately $20.287 million was also materially overstated by at least $10 million and as much as $22 million, which would have reduced its EPS from $0.15 to between $0.00 and $0.05. In September 2014, BDC-1 conducted an at-the-market offering that raised net proceeds of $8.3 million. This offering was also overvalued due to the material misstatements in BDC-1’s Form 10-Q for quarter-end June 30, 2014.

31. The amount of advisory fees BDC-1 paid to FSM was based on the value of the BDC-1’s assets and its performance. Thus, as a result of the overvaluation of Portfolio Company A and B for the periods ended March 31, June 30, and September 30, 2014, BDC-1 paid excess advisory fees to FSM which further caused BDC-1’s books and records to be inaccurate.

D. Prevention of Misuse of Nonpublic Information

32. In addition to its BDC clients, FSM was the investment adviser to the Fifth Street group’s hedge fund. Some of FSM’s investment professionals simultaneously performed work for FSM’s BDC clients and the hedge fund. Thus, FSM learned material, non-public information about the BDCs’ portfolio companies.

33. In addition, FSM’s marketing materials for the hedge fund stated that FSM sought to leverage private company information flow generated through the FSM’s work for its other clients. That is, FSM, as the adviser for the BDCs, had information about the BDC’s portfolio companies, which information FSM could then use to make investment decisions for the hedge fund. Although FSM maintained a written insider trading policy, it did not address the situation of using one client’s material, nonpublic information for the benefit of another client. Thus, FSM failed to establish,
maintain, and enforce written policies and procedures reasonably designed to prevent the misuse of material, non-public information gained from working for one client and using it for the benefit of another.

**Violations**

34. As a result of the conduct described above, FSM willfully violated Section 206(2) of the Advisers Act which makes it unlawful for any investment adviser, directly or indirectly to “engage in any transaction, practice or course of business which operates as a fraud or deceit upon any client or prospective client.” Scienter is not required to establish a violation of Section 206(2), but rather may rest upon a finding of negligence. SEC v. Steadman, 967 F.2d 636, 643 n.5 (D.C. Cir. 1992)(citing SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 194-195 (1963)).

35. As a result of the conduct described above, FSM willfully violated Section 206(4) of the Advisers Act and Rule 204(4)-8(a)(2) promulgated thereunder, which makes it unlawful for any investment adviser to a pooled investment vehicle to “engage in any act, practice, or course of business that is fraudulent, deceptive, or manipulative with respect to any investor or prospective investor in the pooled investment vehicle.” A violation of Section 206(4) and the rules thereunder does not require scienter. Steadman, 967 F.2d at 647.

36. As a result of the conduct described above, FSM willfully violated Section 206(4) of the Advisers Act and Rule 206(4)-7(a) promulgated thereunder, which require investment advisers registered or required to be registered with the Commission to adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act and its rules by the adviser or its supervised persons.

37. As a result of the conduct described above, FSM willfully violated Section 207 of the Advisers Act, which makes it “unlawful for any person willfully to make any untrue statement of a material fact in any registration application or report filed with the Commission . . . or willfully to omit to state in any such application or report any material fact which is required to be stated therein.”

38. As a result of the conduct described above, FSM willfully violated Section 204A of the Advisers Act, which requires investment advisers subject to Section 204 of the Advisers Act to establish, maintain, and enforce written policies and procedures reasonably designed to prevent the misuse of material, nonpublic information by the investment adviser or any person associated with such investment adviser.

39. As a result of the conduct described above, FSM caused BDC-1’s violation of Section 17(a)(2) of the Securities Act, which prohibits any person from obtaining money or property in the offer or sale of securities by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading.

40. As a result of the conduct described above, FSM caused BDC-1’s violations of Exchange Act Section 13(a) and Rules 13a-1, and 13a-13 thereunder, which require that every
issuer of a security registered pursuant to Exchange Act Section 12 file with the Commission, among other things, annual and quarterly reports as the Commission may require.

41. As a result of the conduct described above, FSM caused BDC-1’s violation of Rule 12b-20 under the Exchange Act, which requires that, in addition to the information expressly required to be included in a statement or report filed with the Commission, there shall be added such further material information, if any, as may be necessary to make the required statements, in light of the circumstances under which they are made, not misleading.

42. As a result of the conduct described above, FSM caused BDC-1’s and BDC-2’s violations of Section 13(b)(2)(A) of the Exchange Act which require issuers with a security registered pursuant to Section 12 to make and keep books, records and accounts which, in reasonable detail, accurately and fairly reflect transactions and dispositions of their assets.

43. As a result of the conduct described above, FSM caused BDC-1’s and BDC-2’s violations of Section 13(b)(2)(B) of the Exchange Act, which requires issuers with a security registered pursuant to Section 12 to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that transactions are recorded as necessary to, among other things, permit preparation of financial statements in accordance with GAAP.

44. As a result of the conduct described above, FSM caused BDC-1’s and BDC-2’s violations of Section 31(a) of the Investment Company Act, made applicable to the BDCs by Section 64 of the Investment Company Act, and Rule 31a-1 thereunder, which requires registered investment companies, among other entities, to maintain and keep current books and records, including, among other things, ledgers reflecting all assets, liabilities, reserve, capital, income and expense accounts.

IV.

In view of the foregoing, the Commission deems it appropriate, in the public interest to impose the sanctions agreed to in Respondent’s Offer.

Accordingly, pursuant to Section 8A of the Securities Act, 21C of the Exchange Act, Sections 203(e) and 203(k) of the Advisers Act, and Section 9(f) and of the Investment Company Act it is hereby ORDERED that:

A. FSM cease and desist from committing or causing any violations and any future violations of Section 17(a)(2) of the Securities Act, 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 promulgated thereunder, Sections 206(2), 206(4), 207, and 204A of the Advisers Act and Rules 206(4)-8 and 206(4)-7 promulgated thereunder, and Section 31(a) of the Investment Company Act and Rule 31a-1 promulgated thereunder.

B. FSM is censured.
C. FSM shall, within 30 days of the entry of this Order, pay disgorgement of $1,999,115.86, prejudgment interest of $334,545.65, and a civil money penalty in the amount of $1,650,000.00 to the Securities and Exchange Commission. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600 and 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;

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 Fifth Street Management, LLC 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 C. Dabney O’Riordan, the Associate Director, Division of Enforcement, Securities and Exchange Commission, 444 South Flower Street, Suite 900, Los Angeles, CA 90071.

D. Pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, as amended, a Fair Fund is created for the disgorgement, prejudgment interest AND penalties referenced in paragraph C above. 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 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.

Brent J. Fields
Secretary