July 21, 2020

Via Electronic Submission (rule-comments@sec.gov)

Ms. Vanessa Countryman, Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Proposed Rule; Good Faith Determinations of Fair Value; SEC Rel. No. IC-33845; File No. S7-07-20

Dear Ms. Countryman:

The Investment Adviser Association ("IAA")[1] appreciates the opportunity to comment on the Securities and Exchange Commission's proposal to adopt new Rule 2a-5 that would specify how a board of directors of an SEC-registered investment company ("fund") must determine the "fair value in good faith" of fund investments for purposes of Section 2(a)(41) of the Investment Company Act of 1940, as amended ("ICA"), and ICA Rule 2a-4.[2] The proposed rule would also permit a fund's board, as an alternative to making the determination itself, to assign the fair value determination relating to any or all fund investments to the primary investment adviser or to a sub-adviser of the fund, in which case, the adviser or sub-adviser would carry out all of the functions required in the rule with certain additional requirements and subject to board oversight. Many of our members are advisers and/or sub-advisers to funds and are therefore significantly affected by the proposal. Fund advisers play an important role and have expertise in the fair value determination process, and boards rely on fund advisers for the day-to-day calculation of fair values.[3]

[1] The IAA is the largest organization dedicated to advancing the interests of investment advisers registered with the Securities and Exchange Commission ("SEC" or "Commission"). For more than 80 years, the IAA has been advocating for advisers before Congress and U.S. and global regulators, promoting best practices and providing education and resources to empower advisers to effectively serve their clients, the capital markets, and the U.S. economy. The IAA's member firms manage more than $25 trillion in assets for a wide variety of individual and institutional clients, including pension plans, trusts, mutual funds, private funds, endowments, foundations, and corporations. For more information, please visit www.investmentadviser.org.

[2] *Good Faith Determinations of Fair Value*, SEC Rel. No. IC-33845 (Apr. 21, 2020), 85. Fed. Reg. 28734 (May 13, 2020) ("Proposal" or "Proposing Release"), available at https://www.govinfo.gov/content/pkg/FR-2020-05-13/pdf/2020-08854.pdf. Section 2(a)(41) of the ICA and Rule 2a-4 thereunder provide that securities for which market quotations are "readily available" are valued at the current market value of such securities, while securities and assets without readily available market quotations are valued at fair value as determined in good faith by a fund's board.

[3] *See* Proposal at 28736, 28756.

We appreciate the Commission's efforts to modernize the regulatory framework for fair valuation of fund securities where market quotations are not readily available. We generally support the proposal to permit all fund boards to allocate the day-to-day responsibilities of determining fair value to an investment adviser, subject to certain requirements and robust board oversight,[4] and agree that this approach is appropriate and consistent with the ICA.[5] We recommend certain modifications that we believe will improve the effectiveness of the proposed rule, reduce unnecessary burdens, more accurately reflect current longstanding and sound fair valuation practices by funds and advisers, and be more consistent with the approach taken by the Commission in the fund compliance program rule and the liquidity risk management rule.[6]

Specifically, we make the following recommendations:

A. The Commission should make the rule's reporting requirements more flexible, including with respect to the frequency of, and triggering events for, reporting to the board. This would better align the resources available to boards and advisers and provide a more efficient process for reporting by the adviser to the board.

B. The Commission should reconsider its approach with respect to the definition of "readily available market quotation" to reflect current valuation practices.

C. The Commission should allow flexibility for a board to assign the fair value determination to either the fund's primary adviser or a fund's sub-adviser(s).

Our comments are discussed below.

[4] These additional requirements include: establishing policies and procedures, including for applying fair value methodologies, evaluating pricing services, and reasonably segregating the process for fair value determinations from the portfolio management of the fund; recordkeeping; periodic and prompt reporting to the board; and other requirements designed to help the board oversee the adviser's fair value determinations.

[5] The proposed rule's requirements would supersede the discussion in the ICA Rule 38a-1 adopting release of specific policies and procedures required under that rule regarding the pricing of portfolio securities and fund shares and fund valuation policies. *See* Proposal at 28741, n. 69 (currently, funds are required to adopt policies and procedures that require the fund to monitor for circumstances that may necessitate the use of fair value prices; establish criteria for determining when market quotations are no longer reliable for a particular portfolio security; provide a methodology or methodologies by which a fund determines the current fair value of the portfolio security; and regularly review the appropriateness and accuracy of the method used in valuing securities and make any necessary adjustments). *See* Compliance Programs of Investment Companies and Investment Advisers, IC Rel. No. 26299 (Dec. 17, 2003) at nn. 39-47 and accompanying text). The Proposal would allow a fund to "adopt the Rule 2a-5 policies and procedures of the adviser in fulfilling its Rule 38a-1 obligation to avoid any duplication." Proposal at 28767-9.

[6] *See* ICA Rules 38a-1 and 22e-4(b).

A. The Proposed Board Reporting Provisions Should be More Flexible and Better Reflect Current Practice

If the board assigns the fair value determinations to an adviser of the fund, the proposed rule would require that the adviser provide to the fund's board in writing: (i) a quarterly report of an assessment of the adequacy and effectiveness of the adviser's process for determining the fair value of the assigned portfolio of investments; and (ii) promptly (but no later than three business days) a notification of any matters related to the adviser's process that materially affect, or could have materially affected, the fair value of the assigned portfolio of investments. This notification must include any significant deficiency or material weakness in the design or implementation of the adviser's fair value determination or process or material changes in the fund's valuation risks.[7] The Commission seeks comment on the board reporting provisions.[8]

We make several recommendations on periodic reporting that we believe would reduce burdens on fund boards while allowing for appropriate board oversight of the fair valuation process.

Routine reporting should be annual, not quarterly. Most of the items proposed to be reported would be more appropriately reported on an annual basis since advisers' valuation processes and methodologies and their assessment of valuation risks, conflicts, and resources do not typically change much quarter to quarter. We believe that this would strike a more appropriate balance between requiring robust board oversight and burdening fund boards with frequent reporting of items that likely will not have materially changed from the preceding quarter. Requiring annual rather than quarterly reporting would also be consistent with the current reporting framework under Rule 38a-1 and the requirements in the liquidity risk management rule.[9]

Certain material changes could be reported quarterly. To the extent that there are material changes to the annual report, it would be sufficient, in our view, for the adviser to inform the board of these changes at the next quarterly board meeting. In addition, we believe that reporting on material valuation risks would be more appropriate on a quarterly rather than on

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[7] Proposed Rule 2a-5(b)(1)(i) and (ii). Although the Proposal states that the rule would not mandate a "detailed level of reporting," the proposed quarterly report requirement includes a detailed list of items that must be included, such as a summary of material valuation risks, material changes to methodologies, testing results, information about valuation resources, material changes to oversight of pricing services, and material events such as price overrides. *See* proposed Rule 2a-5(b)(1)(i)(A)-(E).

[8] Proposal at 28746 (Question 29) and 28747 (Question 39).

[9] *See* ICA Rule 38a-1(a)(4)(iii) (fund's CCO must meet with and provide a report to the board at least annually to address the operation of the policies and procedures – including material changes – of the fund and of each investment adviser and other service providers to the fund), and ICA Rule 22e-4(b)(2)(iii) (board must review, no less frequently than annually, a written report prepared by the liquidity risk management program administrator that addresses the operation of the program and assesses its adequacy and effectiveness of implementation, including any material changes to the program (and the operation of the highly liquid investment minimum, if applicable)).

a "prompt" basis because prompt reporting should be reserved for urgent matters that did materially affect or could have materially affected fair valuation.

With respect to what would constitute a material effect on valuation risk, we do not agree with the Commission that "a significant increase in price challenges or overrides likely would reflect a material change to the fund's valuation risks."[10] Advisers frequently use independent pricing vendors and conduct regular assessments of such vendors in determining an accurate price. Overrides of or challenges to a vendor's price are often a fairly routine result of the adviser's independent analysis and do not necessarily reflect a material change to the fund's valuation risks.

Prompt reporting should be reserved for items that require urgent board attention. We agree with the Commission that "it is important for the adviser to notify the board of certain issues as they arise that may require their immediate attention,"[11] but it is also important not to overload boards with off-schedule matters that are not urgent. In order to ensure effective board oversight and use of a board's resources, advisers should need to report promptly only those items that warrant immediate board consideration. As noted above, we do not believe that changes to a fund's valuation risks fall into this category. Rather, the prompt reporting requirement should be limited to "matters associated with the adviser's process that materially affect or could have materially affected the fair value of the assigned portfolio of investments, including a significant deficiency or material weakness in the design or implementation of the adviser's fair value determination process."[12]

The three-day reporting period should be extended. Three business days for the prompt reporting requirement is unworkably short and prescriptive. We believe that advisers would need more than three days to analyze the facts and circumstances, attempt to remediate any potential issues, and make necessary adjustments to reduce any potential material effect of any matter. Boards would also have difficulty meeting quorum requirements within that time. We recommend instead that the Commission extend the time for advisers to make their prompt reports to up to ten days from the date the adviser becomes aware of the matter that triggers the reporting requirement. A ten-day period should allow an adviser sufficient time to assess the issue while still allowing for appropriate board oversight.

B. The Commission Should Reconsider its Approach with Respect to the Definition of "Readily Available Market Quotation" to Reflect Current Valuation Practices

Fund boards generally consider both Level 1 and many Level 2 investments under U.S. generally accepted accounting principles ("GAAP"), ASC 820, Fair Value Measurement to have

[10] Proposal at 28746, n. 113.

[11] Proposal at 28746.

[12] Proposed Rule 2a-5(b)(1)(ii).

a readily available market quotation, and consider Level 3 investments to be subject to a fair value determination.[13] The Proposal would substantially change current practice.[14] Specifically, the proposed rule would define when market quotations are or are not readily available based on the definition of a Level 1 input under ASC 820, and, under the Proposal, only Level 1 securities would be considered to have readily available market quotations.[15] While the Commission states that it "treat[s] investments that are valued using Level 1 inputs as investments for which market quotations would be available, and investments valued using Level 2 and 3 inputs as investments that would be fair valued in good faith by the fund's board of directors,"[16] it does not explain the basis for this treatment.

Treating Level 2 securities as *per se* not readily available is a significant and unwarranted departure from the fair value methodology and approach currently taken by funds.[17] Funds follow a considerably different valuation process when valuing Level 2 securities and when valuing Level 3 securities. They do not consider the process of getting an evaluated bid for a Level 2 security from a third party to be fair valuation under the ICA, and generally do not view Level 2 securities as presenting the risks of a "true" fair value where the adviser is using its own judgment to determine the price. For instance, a fund adviser may price a Level 2 fixed income security with the assistance of an independent pricing vendor, including receiving an evaluated bid from that vendor, where the adviser has assessed and the fund board has approved the

[13] As noted in the Proposal, "[a]ccording to ASC 820, assets and liabilities are classified using Level 1, Level 2, or Level 3 inputs. Level 1 inputs are 'quoted prices (unadjusted) in active markets for identical assets or liabilities that the reporting entity can access at the measurement date.' Level 2 inputs are 'inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.' Level 3 inputs are 'unobservable inputs for the asset and liability.'" (citing Financial Accounting Standards Board, Fair Value Measurement (Topic 820)). Proposal at 28755, n. 209.

[14] Proposal at 28739.

[15] Proposal at 28748. Under ICA Section 2(a)(41), if market quotations are "not readily available," the holding's value must be fair valued as determined in good faith by the board. Under proposed Rule 2a-5(c), a market quotation is "readily available only when that quotation is a quoted price (unadjusted) in active markets for identical investments that the fund can access at the measurement date, provided that a quotation will not be readily available if it is not reliable."

[16] Proposal at 28755.

[17] It is also a departure from the Commission's earlier approach to the definition of "readily available market quotation." *See* Proposal at 28748, n. 129. The Commission notes that: "ASC Topic 820 defines level 1 inputs as '[q]uoted prices (unadjusted) in active markets for *identical* assets . . . that the reporting entity can access at the measurement date.' ASC Topic 820-10-20 (emphasis added). In ASR [Accounting Series Release] 113, the Commission interpreted 'readily available market quotations' to refer to 'reports of current public quotations for securities *similar* in all respects to the securities in question.' [emphasis added]. Despite the respective references to 'securities similar in all respects' in the Commission's prior guidance and 'identical assets' in ASC Topic 820, we view these respective definitions as *substantively the same."* (emphasis added). We disagree with the Commission's conclusion that these definitions are substantively the same and believe that the Commission should recognize that "similar in all respects" should not be viewed as "identical" as it pertains to what is a readily available market quotation.

vendor's methodology. Independent pricing services following approved methodologies provide evaluated prices that are akin to a readily available market price. Furthermore, there are instances when an adviser may use multiple pricing vendors. When it does so, the adviser independently analyzes and determines the price that it believes is most accurate. This does not mean that one pricing vendor's price is necessarily wrong or that the adviser's process is fair valuation.

We thus recommend that the Commission distinguish between Level 2 and Level 3 securities and that it not categorize Level 2 securities as *per se* securities required to be fair valued under the rule. Specifically, we ask that the Commission revise the definition of "readily available market quotation" to include evaluated prices by independent pricing vendors of Level 2 securities where the adviser or board has approved the vendor's methodology. The Commission should further confirm that data from an independent third-party pricing vendor may be used in a determination of the value of a security without the security being deemed to be fair valued.[18] Finally, we suggest that the Commission clarify that even though an adviser is relying on a third party when it uses a pricing vendor, the adviser remains responsible for pricing under the proposed rule.

C. The Commission Should Allow Flexibility for a Board to Assign the Fair Value Determination to Either the Fund's Primary Adviser or a Sub-Adviser(s)

The proposed rule provides that the board may choose to assign the fair value determination to "an investment adviser of the fund."[19] The Proposing Release states that a fund's board would be permitted to assign the determination relating to any or all fund investments to a fund's primary adviser or one or more sub-advisers.[20] The Commission seeks comment on whether it should allow boards to assign the fair value determination process to sub-advisers, or only allow assignment to the fund's primary investment adviser.[21]

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[18] This approach is similar to the approach taken by the Commission in the liquidity risk management rule. *See* Investment Company Liquidity Risk Management Programs, SEC Rel. No. IC-32315, 81 Fed. Reg. 82142, 82171 (Nov. 18, 2016) ("We believe that a fund could appropriately use [third-party service provider] data [and analyses assessing the relative liquidity of a fund's portfolio investments] to inform or supplement its own consideration of the liquidity of an asset class or investment. However, a fund would not be required to do so.[footnote omitted] Also, we generally believe that a fund should consider having the person(s) at the fund or investment adviser designated to administer the fund's liquidity risk management program review the quality of any data received from third parties, as well as the particular methodologies used and metrics analyzed by third parties, to determine whether this data would effectively inform or supplement the fund's consideration of its portfolio holdings' liquidity characteristics. This review could include an assessment of whether modifications to an 'off-the-shelf' product are necessary to accurately reflect the liquidity characteristics of the fund's portfolio holdings.")

[19] Proposed Rule 2a-5(b).

[20] Proposal at 28742.

[21] Proposal at 28744 (Question 22).

We support the Commission's intention to provide fund boards flexibility to assign the fair value determination to sub-advisers, as long as the board, the primary adviser, and the sub-adviser all agree. We note, however, that while sub-advisers currently may provide input and support to the primary adviser on pricing and the fair value process, ultimately fund boards rely on the primary adviser, not the sub-adviser, to conduct the day-to-day valuation work.[22] In order to be able to agree to a board's assignment to them of the fair value determination, sub-advisers may need to amend their investment advisory agreements and implement new policies and procedures to allow them to make fair value determinations. They may also need to add resources and change their fee structures to account for the new responsibilities.

The Commission seeks comment as to whether it should impose any obligations for the adviser to oversee any assigned sub-adviser, by for example, requiring in the rule that a fund must establish reconciliation procedures to address situations where sub-advisers have differing views on the fair value of a fund investment.[23] We do not believe the Commission should require or prescribe specific policies, procedures, or approaches. We believe that the Commission should instead provide principles-based guidance to assist sub-advisers in carrying out any assigned fund valuation duties. For instance, the Commission could provide guidance on factors to consider in reaching an agreement regarding various duties and responsibilities, such as with respect to reconciliation.

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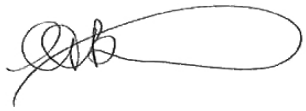
[22] As the Commission recognizes, "for practical reasons, few boards today are directly involved in the performance of the day-to-day valuation tasks required to determine fair value. Instead they enlist the fund's investment adviser to perform certain of these functions, subject to their supervision and oversight." Proposal at 28742.

[23] Proposal at 28744 (Question 22).

We appreciate the Commission's consideration of our comments on this important proposal and would be happy to provide any additional information that may be helpful. Please contact the undersigned or Associate General Counsel Monique Botkin at (202) 293-4222 if we can be of further assistance.

Respectfully Submitted,



Gail C. Bernstein
General Counsel

cc: The Honorable Jay Clayton, Chairman
The Honorable Hester M. Peirce, Commissioner
The Honorable Elad L. Roisman, Commissioner
The Honorable Allison Herren Lee, Commissioner
Dalia Blass, Director, Division of Investment Management