SEC PROPOSES NEW FAIR VALUE RULE 2A-5

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U.S. Investment Management Alert

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The Securities and Exchange Commission ("SEC") on April 21, 2020, proposed a new rule to codify fair valuation requirements for funds registered under the Investment Company Act of 1940, as amended ("1940 Act").[1] For fifty years, funds have developed their fair valuation practices, policies, and procedures based on a patchwork of no-action letters, SEC staff statements, and commentary in SEC releases, including most recently with respect to amendments to the rule governing money market funds.[2]

Rule 2a-5 ("Proposed Rule") would be the first rule that establishes a comprehensive regulatory framework for fair valuing investments in good faith for which there are no readily available market quotations. It is the most recent in a series of actions taken by the SEC and its staff to modernize board responsibilities to reflect the board's oversight role.[3] If adopted, the Proposed Rule would:

- permit fund boards to assign fair value decisions to advisers;
- define when a market quotation is "readily available";
- establish a regulatory framework for fair value determinations; and
- require new reports to be provided to fund boards to facilitate oversight.

The provision of the Proposed Rule that would permit a board to "assign" to a fund's investment adviser responsibility for determining the fair value of securities held by the fund is a major departure from prior interpretations. In determining whether to make such an assignment, boards will need to consider the particular types of fund investments that require fair value determinations and an investment adviser's experience in carrying out fair value functions. Boards that oversee funds with thinly traded and complex investments that are fair valued on a periodic basis using complicated methodologies would benefit most from assigning fair value determinations. Advisers of these funds typically have the capacity and expertise to modify methodologies in the event of unusual changes in circumstances. However, even boards of funds that have adopted standard methodologies that seldom change could find it beneficial to assign fair value determinations.

In addition to permitting a board to assign fair value determinations to a fund's investment adviser, the Proposed Rule departs from certain other prior interpretations. A comprehensive table comparing current and proposed new requirements is included at the end of this alert. Please click here to jump to the table.

If the Proposed Rule is adopted, many funds will have to revise their fair value policies and procedures to comply with the fair value determination, performance, and reporting requirements set forth in Rule 2a-5. The release accompanying the Proposed Rule (the "Release") indicates that certain of the Proposed Rule's requirements are based on SEC staff reviews of current fund valuation policies and procedures.

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NEW BOARD AUTHORITY TO "ASSIGN" DETERMINATIONS

The Release recognizes that 1940 Act Section 2(a)(41) assigns boards a "critical role" in determining fair value. The Section 2(a)(41) requirement that fund boards fair value investments for which there is no readily available market quotation is one of only four provisions in the original 1940 Act that require a board determination, including the vote of a majority of independent directors. The other three sections require board approval of a fund's investment advisory agreement, principal underwriting agreement, and independent auditors.

The new approach of the Proposed Rule reflects the SEC's acknowledgement that the allocation of "day-to-day responsibilities to an investment adviser, subject to robust board oversight, is appropriate and consistent with the requirements of [the 1940] Act."[4] Accordingly, the Proposed Rule would permit a board to "assign" to its adviser responsibility for fair value determinations, including the responsibility to establish and apply fair value methodologies. For this purpose, the term "investment adviser" includes any sub-adviser of a fund, including a multi-manager fund. The word "assign" implies that the 1940 Act statutory obligation remains with boards even when decision-making responsibilities are with the adviser. However, the Release makes clear that compliance with the Proposed Rule would satisfy fund boards' statutory obligations in this regard.

The assignment provision is responsive to a request from the Independent Directors Council ("IDC") urging the SEC staff "to take a fresh look at fair valuation, with the view toward proposing a rule that allows fund boards to serve in the capacity in which they add value – i.e. to oversee the fair valuation process, with a focus on those elements of the process that may present conflicts of interest" (emphasis in original).[5] Notably, the IDC specifically requested that a rule "permit a board to delegate to the fund's adviser the responsibility to determine fair values, subject to the board's oversight."[6]

In the past, the SEC staff insisted that only a fund board could adopt and modify the fund's fair value policies and procedures. The Release explains that if a board chooses to assign fair valuation determinations to a fund's investment adviser in reliance on the Proposed Rule, the adviser "would carry out all of the functions required" by the rule, including the adoption and implementation of fair value policies and procedures. The Release recognizes that this is a major change from current industry practice in which advisers and other service providers merely "assist the board in developing the fund's fair value methodologies."[7] According to the Release, this change is an acknowledgment of "the important role that fund investment advisers now play and expertise they now provide in the fair value determination process."[8]

BACKGROUND

The Release acknowledges that adoption of the Proposed Rule will require withdrawal of inconsistent interpretive releases, including Accounting Series Release 113 and Accounting Series Release 118, issued in 1969 and 1970, respectively. In these releases, the SEC expressed the view that, while a board need not perform the fair value calculation, it is the board's responsibility to choose and review the appropriateness of the fair valuation methodology implemented by a fund.[9]

The adoption of the Proposed Rule would also require the withdrawal of a no-action letter in which the SEC staff advised a closed-end fund that its board could authorize a committee to price private placement holdings by following valuation methods adopted by the board in written procedures. The SEC staff stated that the procedures must require the committee "to advise the Board of Directors at any time it believes that the methods established . . . are erroneous so that the Board may determine whether such methods should be modified" (emphasis in

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original).[10] The Release includes a non-exhaustive list of the SEC staff letters and guidance that would be withdrawn or rescinded if the Proposed Rule is adopted.[11]

The SEC's modernization effort of culling outdated guidance while consolidating and updating industry regulation is consistent with the approach it has taken in other recent rule proposals. Recent examples are the proposed rule with respect to the use of derivatives by investment companies and business development companies and amendments to the advertising and cash solicitation rules under the Investment Advisers Act of 1940, as amended ("Advisers Act").

The Investment Company Institute, IDC, and ICI Mutual Insurance Company jointly published a paper in 2005 titled "An Introduction to Fair Valuation" ("ICI Report"). The ICI Report summarized fair valuation regulatory requirements and the key features found in fund valuation policies and procedures. It noted, "Typically, the board and individual board members are not involved in day-to-day valuation decisions." The ICI Report identified reasons for this lack of day-to-day involvement, including that this function is not consistent with the oversight role of a director and board. The Proposed Rule's provision regarding board assignment of fair valuation determinations better reflects the oversight role of boards described in the ICI Report.

The Release describes three important developments that the SEC believes support adoption of Rule 2a-5 and its approach to fair valuation. One was the adoption in 2002 of the Sarbanes-Oxley Act, which established the Public Company Accounting Oversight Board. The second was the SEC's 2003 compliance rules under the 1940 Act and the Advisers Act. The third was adoption by the Financial Accounting Standards Board of ASC Topic 820 in 2006 and 2009, which defined the term "fair value" for purposes of financial report accounting standards.[12] The Release explains that these developments have altered the framework in which funds, boards, and other service providers, including pricing services, perform fair valuation responsibilities.

Under the Proposed Rule, fund boards can adopt their own fair valuation policies and procedures or assign that responsibility to a fund's investment adviser. However, the Release makes clear that Rule 38a-1 under the 1940 Act continues to apply. The adopting release for that rule indicates that a fund's compliance policies and procedures, which must be approved by the fund's board, must include procedures governing fair valuation of securities for which there are no available market prices. Additionally, Rule 38a-1 requires a fund's board to approve the compliance policies and procedures of a fund's investment adviser. Presumably, any fair valuation policies and procedures adopted by an investment adviser under the Proposed Rule will also be subject to approval pursuant to Rule 38a-1 as part of the investment adviser's broader compliance policies and procedures.

DEFINITION OF "READILY AVAILABLE" MARKET QUOTATIONS

Valuation of a fund's portfolio investments is one of the most important components of a fund's net asset value, the price at which shares of many funds are offered, redeemed, and repurchased. Section 2(a)(41) of the 1940 Act defines "value" as the market value of portfolio securities for which market quotations are "readily available." Neither the 1940 Act nor current rules define when a market quotation is "readily available."

The Proposed Rule would define a market quotation as "readily available" for 1940 Act purposes only when it is a quoted price (unadjusted) in active markets for identical investments that the fund can access at the measurement date. In addition, a quotation must be reliable in order to be considered readily available. The Release states that a quotation would not be considered reliable if U.S. generally accepted accounting principles

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("GAAP") would require the quotation to be adjusted or would require consideration of additional inputs in determining the security's value.

> Considerations for Advisers: The definition of "readily available" stems from ASC Topic 820[13] and is largely consistent with current industry practice. Consistent with current practice, evaluated prices, indications of interest and accommodation quotes would not be "readily available" under the Proposed Rule.

FRAMEWORK FOR FAIR VALUATION DETERMINATIONS

The Proposed Rule would establish a framework for the implementation of fair valuation practices in good faith under the 1940 Act. The Proposed Rule provides that a fund's board or its adviser must perform the following risk-based functions to determine in good faith the value of a fund's investments:

Assessment and Management of Valuation Risks

The Proposed Rule would require the periodic assessment and management of any material risks associated with determining the fair value of fund investments ("valuation risks"), including material conflicts of interest. Material conflicts of interest is the principal valuation risk identified in the Proposed Rule. The Release also includes a non-exhaustive list of various types or sources of valuation risk, including types and proportions of investments held by a fund, potential market or sector shocks or dislocations, observability of inputs, and reliance on service providers.

The Proposed Rule does not specify the frequency with which valuation risks must be assessed. The Release explains that valuation risks and the frequency of assessment would be fund-specific, accounting for and generally taking into account "changes in fund investments, significant changes in a fund's investment strategy or policies, market events, and other relevant factors."

> Considerations for Boards and Advisers: This risk-based approach to the assessment and management of valuation is similar to the recent SEC rule with respect to fund liquidity and the proposed rule with respect fund investments in derivatives, signaling the current SEC approach to rulemaking.

Fair Value Methodologies

The Proposed Rule would require a fair valuation process to include selecting and applying consistently an appropriate methodology or methodologies for the determination and calculation of fair value. This responsibility includes specifying the key inputs and assumptions for each asset class or portfolio holding as well as the methodologies applicable to new types of investments in which a fund intends to invest. The Proposed Rule also would require the periodic review and, if necessary, adjustment of selected methodologies.

The Proposed Rule does not prescribe the particular methodology or methodologies that funds use. The Release states that to "be appropriate under the rule, and in accordance with current accounting standards, a methodology used for purposes of determining fair value must be consistent with ASC Topic 820, and thus derived from one of

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these approaches."[14] In addition, the Proposed Rule would require fund boards or advisers to monitor for circumstances that may necessitate fair valuation and establish criteria for determining when market quotations are no longer reliable and not considered to be "readily available."

Testing Methodologies

The Proposed Rule would require testing the appropriateness and accuracy of the selected fair value methodologies, including identifying the testing methods and minimum frequency of testing. The Proposed Rule does not prescribe a specific test or the frequency of testing, which are left to the discretion of the board or adviser.

Oversight of Pricing Services

The Proposed Rule recognizes that funds may use pricing services to provide information for thinly traded or complex assets. Under the Proposed Rule, the determination of fair value in good faith would require the oversight and evaluation of pricing services. A fund's board or adviser would be required to establish a process for the approval, monitoring, and evaluation of pricing service providers and criteria for initiating price challenges.

Although the Proposed Rule does not mandate a process, the Release suggests that a fund's board or adviser consider certain factors, including a pricing service's: (i) qualifications, experience, and history; (ii) valuation methods, or techniques, and inputs and assumptions for different classes of assets and how they are affected as market conditions change; (iii) conflicts of interest and the steps the pricing service takes to mitigate such conflicts; (iv) testing processes; and (v) challenge procedures, including how the pricing service incorporates information from challenges into its pricing information.

> Considerations for Boards and Advisers: The information currently provided to fund boards regarding fair valuation methodologies would no longer be required if fair valuation responsibility is assigned to the adviser. However, fund boards would continue to receive information regarding the fair valuation process, testing, and the pricing services used. It is not clear whether the Proposed Rule would require board or adviser approval of methodologies if assigned to pricing services.

Policies and Procedures

The Proposed Rule would require fair value determinations to be made pursuant to written policies and procedures. If a fund's board retains responsibility for determining the fair value of the fund's investments, the board would be required to adopt and implement a fund's written valuation procedures. However, if the fund's board assigns fair value determinations to the fund's adviser, the Proposed Rule would require the adviser to adopt and implement valuation procedures for the fund, subject to board oversight.[15]

> Considerations for Boards. Boards likely will need to revisit their funds' Rule 38a-1 valuation procedures and compliance program, as it is expected most boards will continue to rely on advisers to implement the valuation process. The SEC noted in the Release that it continues to believe that allocating day-to-day responsibilities to a fund's investment adviser, subject to robust board oversight, is appropriate and

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> consistent with the 1940 Act.

Recordkeeping

The Proposed Rule would require that a fund maintain documentation to support fair value determinations for five years and a copy of the fund's or its adviser's policies and procedures currently in effect or that were in effect at any time within the past five years. The reporting requirements are discussed below.

OVERSIGHT OF ADVISERS

In fulfilling their oversight responsibility, the SEC emphasized that boards have a duty to identify, monitor, and manage potential conflicts of interest with respect to the adviser and other service providers involved in a fair value determination. Additionally, the Release directs boards to "probe the appropriateness of the adviser's fair value processes," which would include the periodic review of the financial resources, technology, staff, and expertise of the adviser, the reasonableness of the adviser's reliance on other service providers, and the compliance capabilities that support the fund's fair valuation processes.[16]

The adviser must specify the titles of the persons responsible for fair valuing the assigned investments, including the functions for which they are responsible. The Release states that fair valuation policies and procedures generally should describe the composition and role of an adviser's valuation committee and identify specific personnel with duties associated with price challenges, including those with the authority to override prices (and their roles and responsibilities), and establish a process for the review of price overrides. The adviser also must reasonably segregate the fair value determination process from the portfolio management of the Fund.

The Release acknowledges that portfolio managers often are most knowledgeable regarding a fund's investments and that it may be appropriate for them to provide input into the process. Nevertheless, the Release cautions funds that, "because portfolio management personnel are often compensated in part based on the returns of the fund, a portfolio manager's incentives may not be fully aligned with the fund's with respect to the determination of fair value, and a portfolio manager therefore should not be making the fair value determinations."[17] The Release cautions boards and advisers to consider the extent of influence that portfolio managers may exercise in connection with the administration of the fair valuation process and provide an appropriate independent check on that process.

> Considerations for Advisers. Advisers should evaluate the role of portfolio management in their fair valuation processes to determine whether portfolio management could exert undue influence on valuations and whether there is sufficient independent oversight of portfolio management's participation in the valuation process. This separation of responsibilities may be particularly difficult for smaller organizations that do not have dedicated valuation personnel.

REPORTING

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To facilitate oversight, the Proposed Rule would establish new board reporting requirements. The Release directs Boards to evaluate the type, content, and frequency of the reports they receive from the adviser. The Release states in this regard that, while a board can rely on the information provided to it by the adviser, "it is incumbent on the board to request and review such information as may be necessary to be fully informed of the adviser's process for determining the fair value of fund investments."[18] Additionally, the Release cautioned that, if a board becomes aware of material matters, the board should make the necessary inquires and take reasonable steps to address the matters.

The Release states that the reporting requirements are "intended to help ensure that boards receive the amount and type of information that they find most valuable in overseeing the adviser."[19] The SEC's view is that "these reports should familiarize directors with the salient features of the adviser's process and provide them with an understanding of how that process addresses the requirements of [the Proposed Rule]."[20] The Release explains that, to provide the board with the context for the matters covered in the adviser's reports, the reports should include the information reasonably necessary for the board to evaluate the matters covered in the reports.

Periodic Reporting

At least quarterly, the fund board must assess the adequacy and effectiveness of the adviser's fair valuation process. At a minimum, this assessment must summarize the following:

- The assessment and management of material valuation risks, including conflicts of interest attendant to the adviser and any other service provider;
- Material changes to, or deviations from, established fair valuation methodologies;
- Results of testing of fair value methodologies;
- The adequacy of resources allocated to the adviser's fair valuation process, including material changes to the roles or functions of personnel responsible for determining fair value;
- Material changes to the adviser's process for overseeing pricing services and material events, such as changes to service providers or price overrides; and
- Any other materials requested by the board.

The Release states that these requirements are intended to supplement, rather than replace, board oversight. It also states that to the Proposed Rule would not mandate the level of detailed information that advisers provide to boards, recognizing that board oversight may be better facilitated through more targeted reports. However, the Release notes that boards may seek additional relevant information, such as summaries of price challenges, specific calibration and back-testing data, stale price and pricing error reports, pricing service due diligence information, and auditor testing results.

Prompt Reporting

The Proposed Rule would require the adviser to report to the board in writing regarding matters associated with the adviser's fair valuation process that materially affect, or could have materially affected, the fair value of the assigned portfolio of investments. These include a significant deficiency or material weakness in the design or implementation of the adviser's fair value determination process or material changes in the fund's valuation risks.

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The Proposed Rule would require that the adviser provide this report to the board in writing within three business days after the adviser becomes aware of the matter. The SEC explained in the Release that this requirement is intended to apply where a matter was detected which affected one security, which may not be material, but had it not been detected, could have materially affected a larger number of portfolio investments.

Additional Recordkeeping

The fund must maintain a list of the investments or investment types for which the adviser has been assigned fair value determination responsibility. Reports and other information the adviser provides to a board must be maintained for five years.

Boards currently receive a variety of detailed reports from advisers regarding fair value determinations. The Proposing Release acknowledges that while some of the reports currently provided may be useful for boards, the volume and detailed nature of such reports may not be effective in facilitating board oversight. As such, the proposed reporting requirements focus on providing boards an overview of the fair valuation process in order to position boards to identify trends, exceptions, or outliers.

> Considerations for Boards: Boards should consider the usefulness of the reports prescribed by the Proposed Rule to facilitate their oversight of the fair value process. Additionally, boards should consider the type and content of reports they receive to determine what additional reporting is most helpful to their oversight, for instance, price challenge reports, back-testing reports, stale price reports, information on pricing errors, reports on pricing service due diligence, etc. Considerations for Advisers. Advisers should pay close attention to the proposed reporting requirements in considering whether to comment on the Proposed Rule. For instance, advisers should assess whether the reporting provisions and mandated timing for reporting are appropriate or whether a more principles-based approach would provide more flexibility. Advisers should also review the reporting they currently provide to fund boards and determine what additional resources, if any, would be required to provide the quarterly assessment of the adequacy and effectiveness of the adviser's fair valuation process. In particular, advisers and funds not part of a large fund complex may not have a reporting process that is equipped to address all elements required under the Proposed Rule.

NEXT STEPS

The Proposed Rule is a long awaited and welcome development in the modernization of fund valuation practices. As proposed, it would clarify the process for funds and streamline valuation guidance, rather than dramatically change market practices with respect to valuation. The Release includes many questions that advisers, boards, and other industry groups should consider in order to determine whether the Proposed Rule sufficiently addresses the myriad of valuation issues that funds and advisers face. The deadline for submitting comments on the Proposed Rule is July 21, 2020.

Should the Proposed Rule be adopted, the SEC is proposing a one-year transition period to allow for funds and advisers to come into compliance. A fund board would first be able to make an assignment determination — and either a fund board or an investment adviser would be required to adopt fair valuation policies and procedures

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that comply with the provisions of the final rule — one year after publication of the final rule in the Federal Register. For more information about regulation of the mutual fund industry, please go to the K&L Gates HUB.

COMPARISON OF EXISTING REGULATORY FRAMEWORK TO PROPOSED RULE

The table below compares the requirements regarding fair valuation under the current regulatory framework to requirements that would be imposed by the Proposed Rule.

TYPE OF PROVISION	EXISTING REGULATORY FRAMEWORK	PROPOSED RULE
Performance of Fair Value Determinations	The SEC has taken the position that Section 2(a)(41) prohibits a fund's board from delegating its statutory duty to determine the fair value of fund portfolio securities. Fund boards appoint others, such as the fund's investment adviser or a valuation committee, to assist the board in determining fair value.[21]	A fund board may assign fair value determinations relating to any or all fund investments to an investment adviser of the fund, including authority to revise methodologies, subject to board oversight and certain reporting requirements.
Adoption of Policies and Procedures	Rule 38a-1 under the 1940 Act requires a fund to adopt and implement written policies and procedures reasonably designed to prevent violation of the federal securities laws by the fund. The adopting release for Rule 38a-1 provides that such policies and procedures must require a fund to: (1) monitor for circumstances that may necessitate the use of fair value prices; (2) establish criteria for determining when market quotations are no	Rule 38a-1 continues to apply. In addition, the Proposed Rule would require the party making fair value determinations to adopt and implement written policies and procedures addressing the determination of the fair value of fund investments that are reasonably designed to comply with requirements that the party: (1) periodically assess any material risks associated with the determination of the fair value of fund investments, including material conflicts of interest, and manage those identified valuation risks; (2) establish and apply fair value methodologies;[22] (3) test the appropriateness and accuracy of the fair value methodologies that have been selected, including identifying the testing methods to be used and the minimum frequency with which such testing methods are used; and (4) oversee pricing service providers, if used, including establishing (i) the

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	longer reliable for a particular portfolio security; (3) provide a methodology or methodologies by which the fund determines the current fair value of the portfolio security; and (4) regularly review the appropriateness and accuracy of the method used in valuing securities, and make any necessary adjustments.	process for the approval, monitoring, and evaluation of each pricing service provider, and (ii) criteria for initiating price challenges.
Board Oversight and Reporting	There are no express board oversight and reporting requirements under the current regulatory framework. The SEC staff have stated that a board must "periodically review the appropriateness of the methods used to fair value price portfolio securities and the quality of the prices obtained through these procedures, and . . . make changes when appropriate."[23]	The Proposed Rule would impose specific reporting requirements. If a board assigns fair value determinations to an investment adviser, the investment adviser must provide the board with a written report no less frequently than quarterly that assesses the adequacy and effectiveness of the investment adviser's process for determining the fair value of the assigned portfolio of investments.[24] Additionally, the adviser must report promptly (but in no event later than three business days after the adviser becomes aware of the matter) on matters 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 or material changes in the fund's valuation risks.
Specification of Responsibilities	There are no requirements for funds or advisers to specify responsibilities regarding fair value determinations. Many Rule 38a-1 compliance policies and procedures establish a valuation committee to implement fair value methodologies in a manner that is designed to mitigate	If a board assigns fair value determinations to an investment adviser, the investment adviser must specify the titles of the persons responsible for determining the fair value of the assigned investments and the functions for which they are responsible. Advisers also must reasonably segregate the process of making fair value determinations from the portfolio management of the fund. If an adviser assigns responsibility to a valuation committee or

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	any potential conflicts of interest.	similar body to assist in the process of determining fair value, the fair value policies and procedures generally should describe the composition and role of the committee, or reference any related committee governance documents as appropriate.
Recordkeeping	There are no recordkeeping rules that specifically address fair value determinations. Rule 38a-1(d) requires the maintenance of certain records, including copies of: all compliance policies and procedures; materials provided to the board in connection with their approval of fund and service provider policies and procedures under the rule; the CCO's annual report to the board; and any records documenting the board's annual review of fund and service provider compliance policies and procedures under the rule. Rule 204-2 under the Investment Advisers Act of 1940 requires an adviser to maintain copies of the adviser's compliance policies and procedures and any records documenting its annual review of such policies and procedures.[25] Other provisions of the federal securities laws require that registered investment companies maintain appropriate books	The Proposed Rule would impose specific recordkeeping requirements with respect to fair value determinations. In addition to existing recordkeeping requirements, a fund must maintain: (1) appropriate documentation to support fair value determinations, including information regarding the specific methodologies applied and the assumptions and inputs considered, as well as any necessary or appropriate adjustments in methodologies, and (2) a copy of policies and procedures. When a board assigns fair value determinations to an investment adviser, the fund must maintain copies of: (1) the reports and other information provided to the board; and (2) a list of the investments or investment types whose fair value determination has been assigned to the adviser.

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	and records in support of the fund's financial statements and preserve for a specified period (generally six years) all schedules evidencing and supporting each computation of net asset value.[26] In addition, funds reporting under the Securities Exchange Act of 1934 must make and keep books, records, and accounts that accurately and fairly reflect their transactions and dispositions of their assets in reasonable detail.[27]	
Definition of "Readily Available" Market Quotations	Neither the 1940 Act nor the rules thereunder currently define "readily available." In the Proposing Release, the SEC states that it understands that "industry practice has developed to incorporate many of the concepts of ASC Topic 820 when evaluating whether market quotations are readily available."	The Proposed Rule would define "readily available" to align with concepts in U.S. GAAP. A market quotation would qualify as 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.

FOOTNOTES

[1] Good Faith Determinations of Fair Value, SEC Release No. IC-33845 (Apr. 21, 2020), available here ("Release").

[2] *See, e.g.*, Money Market Fund Reform; Amendments to Form PF, SEC Release Nos. 33-9616, IA-3879, IC-31166 (July 23, 2014) at n.896, available here ("Money Market Fund Reform").

[3] *See, e.g.*, 1940 Act Rule 22e-4, 17 CFR 270.22e-4, Investment Company Liquidity Risk Management Programs, SEC Release Nos. 33-10233, IC-32315 (Oct. 13, 2016), available here; Independent Directors Council (pub. avail. Feb. 28, 2019), available here; Use of Derivatives by Registered Investment Companies and

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Business Development Companies; Required Due Diligence by Broker-Dealers and Registered Investment Advisers Regarding Retail Customers' Transactions in Certain Leveraged/Inverse Investment Vehicles, SEC Release Nos. 34-87607, IA-5413, IC-33704 (Nov. 25, 2019), available here.

[4] Release, *supra* note 1, at 33.

[5] Letter from Amy B.R. Lancellotta, Managing Director, Independent Directors Council, to Dalia Blass, Director, Division of Investment Management (Oct. 16, 2017), available here.

[6] *Id.*

[7] Release, *supra* note 1, at 73.

[8] *Id.* at 14.

[9] Statement Regarding "Restricted Securities," Accounting Series Release No. 113 (Oct. 21, 1969); Accounting for Investment Securities by Registered Investment Companies, Accounting Series Release No. 118 (Dec. 23, 1970).

[10] Paul Revere Investors Inc. (pub. avail. Feb. 21, 1973), available here.

[11] Release, *supra* note 1, at 66–67.

[12] *See* Release, *supra* note 1, at 11–13.

[13] FASB ASC Topic 820, *Fair Value Measurement*. ASC stands for Accounting Standards Codification established by the Financial Accounting Standards Board. ASC is the source of authoritative U.S. GAAP recognized by the FASB to be applied by nongovernmental entities.

[14] Release, *supra* note 1, at 20. The valuation techniques discussed in ASC Topic 820 include techniques within the market approach, which uses prices and other information generated from market transactions in similar assets and liabilities; the income approach, which uses discounting in order to convert future amounts to a current amount; and the asset or cost approach, which is based on the amount required to replace an asset's service capacity.

[15] Rule 38a-1 under the 1940 Act requires a fund's board, including a majority of its independent directors, to approve the fund's policies and procedures, including those on fair value, and those of each investment adviser and other specified service providers. Rule 38a-1 would encompass a fund's obligations under the Proposed Rule, if adopted, and would require a fund's board to oversee compliance with the Proposed Rule. To the extent that adviser policies and procedures under the Proposed Rule would be duplicative of fund valuation policies under Rule 38a-1, a fund could adopt the policies and procedures under the Proposed Rule in fulfilling its Rule 38a-1 obligations.

[16] Release, *supra* note 1, at 37.

[17] *Id.* at 53–54.

[18] *Id.* at 37.

[19] *Id.* at 41.

[20] *Id.*

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[21] *See, e.g.*, Money Market Fund Reform, supra note 2, at n.896.

[22] Under the Proposed Rule, establishing and applying fair value methodologies requires the performance of the following functions, taking into account the fund's valuation risks: (1) selecting and applying in a consistent manner an appropriate methodology or methodologies for determining (and calculating) the fair value of fund investments, including specifying (i) the key inputs and assumptions specific to each asset class or portfolio holding, and (ii) which methodologies apply to new types of fund investments in which a fund intends to invest; (2) periodically reviewing the appropriateness and accuracy of the methodologies selected and making any necessary adjustments thereto; (3) monitoring for circumstances that may necessitate the use of fair value; and (4) establishing criteria for determining when market quotations are no longer reliable.

[23] Letter from Douglas Scheidt, Associate Director and Chief Counsel, Division of Investment Management, to Craig S. Tyle, General Counsel, Investment Company Institute (December 8, 1999).

[24] This report must include, at a minimum, a summary description of: (1) the assessment and management of material valuation risks required by the Proposed Rule, including any material conflicts of interest of the investment adviser (and any other service provider); (2) any material changes to, or material deviations from, the fair value methodologies established pursuant to the Proposed Rule; (3) the results of the testing of fair value methodologies required by the Proposed Rule; and (4) the adequacy of resources allocated to the process for determining the fair value of assigned investments, including any material changes to the roles or functions of the persons responsible for determining fair value pursuant to the Proposed Rule; (5) any material changes to the adviser's process for selecting and overseeing pricing services, as well as material events related to the adviser's oversight of pricing services (such as changes in the service providers used or price overrides); and (6) any other materials requested by the board related to the adviser's process for determining the fair value of assigned investments.

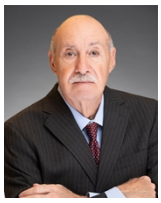
[25] *See* 17 CFR § 275.204-2. *See also* Compliance Programs of Investment Companies and Investment Advisers, SEC Release Nos. IA-2204, IC-26299 (Dec. 17, 2003) at section II.D.

[26] *See* 1940 Act Section 31(a) and Rules 31a-1 and 31a-2, 17 § CFR 270.31a-1 and .31a-2.

[27] 15 U.S.C. 78m(b)(2)(A).

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