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July 21, 2020

Ms. Vanessa Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Re: File No. S7-07-20
Good Faith Determinations of Fair Value
Release No. IC-33845

Dear Ms. Countryman:

The law firm of Practus, LLP, is pleased to comment on the Securities and Exchange Commission's ("SEC") proposed new rule 2a-5 under the Investment Company Act of 1940, as amended ("1940 Act").[1] Proposed rule 2a-5 ("Rule 2a-5" or the "Proposed Rule") would establish requirements for determining the fair value in good faith of an investment company's investments and would permit boards to assign the determination to the fund's investment adviser, subject to board oversight and other conditions. The Proposed Rule would also define "readily available" market quotations for purposes of the 1940 Act.

Rule 2a-5 would replace the current mélange of fifty-plus year-old accounting releases, no-action letters and enforcement actions that currently govern investment company valuation practices. In our view, Rule 2a-5, if adopted as proposed, would provide some welcome certainty and predictability in an area that has increasingly lacked clear guidelines as investment types and investment markets have evolved. However, we believe that there are certain areas that the SEC should address explicitly, other areas that the SEC should clarify and still other areas that the SEC should modify, as we detail below.

1. **Readily Available Market Quotations**

    a. *Valuation of Instruments Other Than Securities*

The *Proposing Release* states that "[u]nder section 2(a)(41) of the [1940] Act, if a market quotation is readily available for a portfolio holding, it must be valued at the market value."[2] We agree that as a policy matter, all portfolio holdings for which market quotations are readily available should be valued at their market values. However, we do not believe that Section 2(a)(41) is as categorical as it is described in the *Proposing Release*. Rather, Section 2(a)(41)(B) states:

[1] *Good Faith Determinations of Fair Value*, Investment Company Act Rel. No. 33845 (Apr. 21, 2020), 85 FR 28734 (May 13, 2020) ("*Proposing Release*").
[2] *Id.*, 85 FR at 28748.

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> "Value" . . . (i) with respect to securities for which market quotations are readily available, [means] the market value of such securities; and (ii) with respect to other securities and assets, [means] fair value as determined in good faith by the board of directors.

We are aware that the SEC and its staff have taken the position that certain instruments that fall outside the definition of security for purposes of the Securities Act of 1933 and the Securities Exchange Act of 1934 nonetheless meet the definition of security for purposes of the 1940 Act.[3] However, we are not aware of the SEC or its staff having taken a position that instruments such as futures, swaps or forwards are securities for purposes of the 1940 Act. Because those instruments do not fall within the definition of securities for purposes of the 1940 Act, Section 2(a)(41) would literally require that they be fair valued by a fund's board.

Like the SEC, we believe that any portfolio holding for which market quotations are readily available should be valued at its market value. However, we believe that the SEC should explicitly use its rulemaking authority to require that portfolio holdings other than securities for which market quotations are readily available be valued at market value. We note in this regard that Section 6(c) of the 1940 Act gives the SEC the authority to exempt funds from the requirement that they fair value portfolio holdings other than securities for which market quotations are readily available, as long as those funds value those instruments at market value.[4] Furthermore, Section 38(a) of the 1940 Act gives the SEC the authority to define "securities for which market quotations are readily available" for purposes of Section 2(a)(41) to include non-securities.[5]

b. *Unadjusted Quotations*

Rule 2a-5(c) would provide that "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 . . . ." The requirement that quotations be unadjusted could lead to interpretive issues. While it appears that the SEC intended "adjustments" to refer to adjustments made by an issuer, quotations such as the Nasdaq Official Closing Price are often adjusted from the consolidated last sale price. We believe that the SEC should clarify that official closing prices determined by a securities exchange such as the New York Stock Exchange or Nasdaq do not constitute an adjustment for purposes of Rule 2a-5(c).

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[3] *See, e.g., Bank of America Canada*, SEC No-Action Letter (pub. avail. July 25, 1983) (notes); *Merrill, Lynch, Pierce, Fenner & Smith*, SEC No-Action Letter (pub. avail. July 25, 1983) (certificates of deposit).

[4] Section 6(c) provides, in pertinent part, that the SEC may adopt rules that "conditionally . . . exempt any person . . . from any provision or provisions of this subchapter . . . if and to the extent that such exemption is necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of this subchapter."

[5] Section 38(a) provides, in pertinent part, that the SEC "shall have authority from time to time to make, issue, amend, and rescind such rules and regulations and such orders as are necessary or appropriate to the exercise of the powers conferred upon the [SEC] elsewhere in this subchapter, including rules and regulations defining accounting, technical, and trade terms used in this subchapter . . . ."

2. **Due Diligence on Pricing Vendors**

Rule 2a-5 would provide that determining fair value in good faith requires the oversight and evaluation of pricing services, where used. The board or the adviser would have to establish a process for the approval, monitoring, and evaluation of each pricing service provider, and the *Proposing Release* sets forth a list of factors to consider in connection with this process. We note that the list of factors that an adviser or board must consider is more extensive than the list of factors articulated by the SEC in connection with the approval, monitoring, and evaluation of third-party service providers under Rule 38a-1 under the 1940 Act (the Investment Company Compliance Rule) – in particular, an adviser is not explicitly permitted to rely upon a third-party report in conducting its monitoring or evaluation of a pricing service.

Pricing Services	Third Party Service Providers
its qualifications, experience, and history	experience with the service provider
its valuation methods or techniques, inputs, and assumptions used for different classes of holdings, and how they are affected as market conditions change	service provider's compliance program as it relates to the types of services provided to the fund – third-party report satisfactory
its process for considering price "challenges," including how it incorporates information received from pricing challenges into its pricing information	types of compliance risks material to the fund – third-party report discussing these risks satisfactory
its potential conflicts of interest and the steps it takes to mitigate such conflicts	assess the adequacy of the service provider's compliance controls – third-party report assessing these controls satisfactory
the testing processes it uses	

We note that when the SEC adopted Rule 38a-1, one particular area of focus for the SEC was funds' valuation policies.[6] Yet the SEC required less granular oversight of service providers under Rule 38a-1 than it is requiring of pricing agents, that are themselves under the oversight of a fund's board or a fund service provider. We believe that, while the factors set forth in the *Proposing Release* may be appropriate and reasonable in many circumstances, they are overly prescriptive given the myriad types of securities and other assets in which funds invest, as well as the different business models employed by various pricing services. We believe that a more principles-based approach along the lines articulated in the Rule 38a-1 adopting release would better serve funds, fund boards and fund advisers.

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[6] *Compliance Programs of Investment Companies and Investment Advisers,* Investment Company Act Rel. No. 26299 (Dec. 17, 2003), 68 FR 74713, 74718 (Dec. 24, 2003).

We appreciate the opportunity to comment on the Proposed Rule. If you would like to discuss our comments further, please feel free to contact Ethan Corey at [redacted].

Very truly yours,

Practus, LLP

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