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Submitted electronically through http://www.regulations.gov

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

Re: **Good Faith Determinations of Fair Value: File Number S7-07-20**

Dear Ms. Countryman,

Fidelity Investments ("Fidelity")[1] appreciates the opportunity to provide comments to the Securities and Exchange Commission ("SEC" or "Commission") on its proposed rule 17 CFR 270.2a-5 ("Rule 2a-5" or the "Proposed Rule") Under the Investment Company Act of 1940 (the "Act") regarding the fair valuation of investments of a registered investment company.[2]

Fidelity commends the SEC for its efforts in seeking to provide clarity to registered investment companies and their boards regarding fair valuation processes as well as the respective roles to be played by investment advisers and boards. We understand the SEC's goal in seeking to modernize its approach to fair valuation in light of the significant changes in the capital markets[3] since the Commission's last comprehensive pronouncements on fair valuation in 1970.[4]

We also agree with the SEC that proper valuation of investments is central to the successful operation of the mutual fund industry. As the Commission notes in the Release, "…proper valuation, among other things, promotes the purchase and sale of fund shares at fair prices, and helps to avoid dilution of shareholder interests," as well as impacts the accuracy of disclosure and fee calculations and compliance with investment policies and limitations.[5]

With its long history of managing a large number of open-end funds across all asset classes, Fidelity has extensive experience with valuing the full range of investments available to mutual funds. On any given day, Fidelity calculates approximately 1,450 fund net asset values

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[1] Fidelity is one of the world's largest providers of financial services, including investment management, retirement planning, portfolio guidance, brokerage, benefits outsourcing and many other financial products and services to more than 30 million individuals and institutions, as well as through 13,500 financial intermediary firms. Fidelity submits this letter on behalf of Fidelity Management & Research Company LLC, the investment adviser to the Fidelity family of mutual funds.
[2] *See* Good Faith Determinations of Fair Value, Release No. IC-33845; RIN 3235-AM71 (April 21, 2020) ("Release"), *available at* https://www.sec.gov/rules/proposed/2020/ic-33845.pdf.
[3] Release at 9-10.
[4] *See* Accounting for Investment Securities by Registered Investment Companies, Accounting Series Release No. 118 (Dec. 23, 1970), 35 Fed. Reg. 19986 (Dec. 31, 1970) ("ASR 118").
[5] Release at 6.

("NAVs"), comprised of an aggregate of approximately 75,000 unique securities. Fidelity also utilizes the services of a range of third-party pricing services and engages frequently on valuation matters with the four boards of trustees that collectively oversee the full array of mutual funds managed by Fidelity. Based on this experience, we believe there are opportunities to modify the Proposed Rule in order to reduce unnecessary burdens on boards and advisers, more closely align the role of fund boards in the Proposed Rule with boards' general duties of oversight and better conform the Proposed Rule with existing industry practices while still advancing the interests of fund shareholders.

I. EXECUTIVE SUMMARY

In the remainder of our letter, Fidelity discusses the following matters in detail and proposes certain modifications to Rule 2a-5.

- We support the SEC's approach in allowing fund boards to assign responsibility for the daily fair value processes to the fund's adviser subject to ongoing oversight because this approach is consistent with current industry practices and with a board's general duties of oversight. We also support the SEC's general description of how boards should effectively oversee the valuation process because it provides boards with the flexibility to determine the level of attention and scrutiny that is warranted based on the nature of the funds' investments.

- We believe that the proposed board reporting requirements are overly prescriptive and do not properly account for the fact that fund boards already work effectively with advisers to receive reporting best suited to the funds they oversee. We encourage the SEC to replace the detailed reporting requirements with a general requirement to receive periodic reporting on the operation of the fair value processes, which will allow boards to receive reporting that is appropriately tailored to the investments held by the funds they oversee.

- If the SEC decides to include specific reporting elements in the final rule, we request that more qualitative assessments of fair value processes, including discussions of the overall effectiveness of the processes, material valuation risks and resources, be provided annually rather than quarterly, similar to the approach taken by the SEC in Rules 38a-1 and 22e-4 under the Act. We believe that reporting on these matters over a longer time period will be more useful to a board in the exercise of its oversight duties because these factors tend not to change materially from quarter to quarter.

- We encourage the SEC to provide additional clarity on exactly what advisers will be expected to report to the board on price overrides, which we do not believe are a material event requiring additional board scrutiny.

- We recommend the SEC eliminate from the final release the recitation of the nine factors of additional information that a board *could* request from an adviser. The list likely will lead to lengthy and formulaic board reporting and does not properly account for the fact that boards are sufficiently knowledgeable and experienced in overseeing fair value

processes to know they can request this information at any time. Boards should be granted the deference to request and receive from advisers the information that is most relevant to each board based on the asset composition of the funds overseen rather than prescriptive and formulaic reporting.

- We encourage the SEC to modify the prompt board reporting elements of Rule 2a-5 by narrowing the range of reportable events to those of sufficient import to warrant additional board scrutiny, allow for reporting to be conducted in writing or through conversations, permit advisers to report this information to a designated representative of the board, if the board so chooses, and replace the overly restrictive three business day deadline with a requirement to report to the board within a reasonable amount of time.

- We believe that the detailed recordkeeping requirements for evaluated prices from pricing services are unnecessarily burdensome and should be eliminated in the final rule.

- Lastly, we encourage the SEC to make modifications in a few other areas relating to (a) the inclusion of personnel of affiliated entities in the fair value processes, (b) ensuring consistency with accounting guidance, and (c) the appropriate degree of specificity required in policies and procedures.

II. PERFORMANCE OF FAIR VALUE DETERMINATIONS

As the SEC observed in the Release, few, if any, fund boards are involved on a daily basis in the calculation and determination of fair values. Many in the industry, including Fidelity, have over the years grown comfortable with the investment adviser performing the day-to-day fair value functions subject to board oversight.[6] For a company such as Fidelity, which serves as the investment adviser to a large number of funds holding investments in thousands of securities across many asset classes, it would be impractical for the funds' boards to be involved directly in Fidelity's daily fair valuation processes. Fidelity's valuation processes, including fair value determinations, are carried out by a dedicated team with years of industry experience relying on multiple technology platforms, and require direct connections with third-party pricing services and the funds' independent auditors.

Requiring that the funds' boards be directly involved in these processes each day would be inconsistent with the notion that the role of a mutual fund board is to serve in an oversight capacity.[7] For larger companies like Fidelity, this requirement would heavily involve the board in the daily operations of the fund and the adviser, blurring the lines between board and

[6] Release at 31-32.
[7] *See, e.g.,* Independent Directors Counsel, SEC No-Action Letter, 2018 SEC No-Act. LEXIS 319 (Oct. 12, 2018) at 2 ("To protect shareholders, the Act requires that each fund be governed by a board that has a general oversight role over fund operations"), *referencing* Commission Guidance Regarding the Duties and Responsibilities of Investment Company Boards of Directors with Respect to Investment Adviser Portfolio Trading Practices, SEC Release No. IC-28345, 73 F.R. 45646 (July 30, 2008) at 45649, *citing* Report of the Senate Committee on Banking and Currency S. 2224, Investment Company Amendments Act of 1970, S. Rep. No. 91-184, 91st Cong., 2d. Sess. 32 (1969), at 6 (fund directors "have…overall fiduciary duties as directors for the supervision of all of the affairs of the fund").

investment adviser. In addition, such a role would demand an investment of time and effort that would preclude the board from effectively carrying out its other oversight duties on behalf of fund shareholders and would diminish the overall effectiveness of the board.

Based on prior guidance from the SEC,[8] the boards of trustees for Fidelity's funds have for many years assigned responsibility for the day-to-day fair value processes to Fidelity, subject to board oversight. That said, we nonetheless believe that the SEC's proposal to make explicit via rule the role to be played by fund boards and advisers can be a positive development. Such a rule could provide consistency across the industry and clearer indications of the means by which boards and advisers may meet their obligations.

While we support the SEC's description of the board's oversight role in the Release, as described further below, we believe that the prescriptive nature of the proposed periodic and prompt board reporting requirements will not serve the interests of fund shareholders and will require an unnecessary commitment of time, effort and resources by boards and investment advisers to just one area of fund operations. Furthermore, the reporting may become formulaic and designed to insulate boards and advisers from challenges to the board's oversight or the fair value processes rather than flexible and designed to provide the most useful information to boards based on the nature of the funds they oversee.

A. Description of Oversight

As described above, we support the basic framework established in the Proposed Rule under which a board may assign fair value determinations to the adviser subject to ongoing board oversight. We believe that such a framework properly reflects the general roles of the board and the investment adviser under federal and state law.[9] Furthermore, we believe that the SEC's description of the board's oversight duties is consistent with what an effective and properly functioning board should do and is consistent with current practices for the Fidelity funds.[10]

First, the SEC indicates that boards should approach their oversight duties with a "skeptical and objective view," and that "effective oversight cannot be a passive activity."[11] A board's exercise of its oversight duties in this manner can help to ensure that the adviser's fair value processes are designed and executed in an effective manner. While mistakes could still happen from time to time, effective board oversight can help to ensure that fair value processes result in accurate calculations of fund NAVs. Furthermore, this description is consistent with the manner in which an effective board would carry out all of its oversight duties. For example, a board should play an active and objective role when overseeing other areas, such as contract renewals, fund performance, compliance violations, the quality of services provided by the fund's auditors, etc.

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[8] *See* ASR 118, *supra*, at 19988 ("…the board may appoint persons to assist them in the determination of such value [of securities for which market quotations are not readily available] …").
[9] *See, e.g.,* Independent Directors Counsel, SEC No-Action Letter, *supra*.
[10] Release at 34-38.
[11] Release at 35.

Second, we believe that the description of the board's oversight duties properly accounts for differences across funds depending on the nature of the funds' investments. The Release is clear that the board's level of scrutiny can and should vary by the extent of the subjective inputs used in the fair value determination.[12] There are certain types of fair value determinations that, while still technically fair values, simply do not raise concerns to the same degree that others do. For example, we agree with the SEC that a board's level of scrutiny can be lower for publicly traded foreign companies than for the valuation of investments in private, early stage companies.[13] A publicly traded foreign company may require a fair value determination because of market movements or geopolitical developments between the time of the local market close and the time as of which the funds' NAVs are calculated, normally 4:00pm Eastern. However, the starting point for such fair value determinations is the closing price on the local exchange and the movement normally will be based on market-based proxies such as indices, currencies, depository receipts and futures. This is different from a private, early stage company where the degree of observable and objective inputs is limited.

In addition, the SEC's acknowledgment of the varying levels of attention and scrutiny that are warranted depending on the nature of a fund's investments properly allows the board to determine the appropriate level of attention based on the exercise of its business judgment. As noted above, the Release highlights the differences between a publicly traded foreign company and an early stage private company as one example of the broader point. The SEC does not then go into further detail listing out all security types requiring fair value determinations and categorizing those securities along a spectrum of the board scrutiny that is warranted. Instead, the SEC is entrusting boards to exercise their business judgment in determining which types of fair value determinations require more attention than others. We believe that this is the proper approach for the SEC to take both in drafting the Rule and, eventually, in enforcing its provisions after adoption.

B. Board Reporting

For the same reason, we believe that the overly detailed board reporting requirements in the Rule should be reconsidered. In the Release, the SEC acknowledges that the effective flow of information between the adviser and the board is "a critical part of a board's oversight."[14] We agree that a board cannot exercise its oversight duties effectively without receiving the information it deems most appropriate.

In the Release, the SEC claims that the requirements are "intended to help ensure that boards receive the amount and type of information *that they find most valuable* in overseeing the adviser."[15] (emphasis added). By ordaining the exact nature of the reporting in an overly detailed manner, the SEC has precluded a board from working together with the fund's adviser to develop the reporting that the board deems most valuable. Instead, if adopted as proposed, the reporting likely would be lengthy and formulaic. Advisers may construct reporting with the

[12] Release at 35-36.
[13] Release at 35.
[14] Release at 41.
[15] Release at 42.

primary goal of creating a record to protect the board and the adviser from challenges to the board's oversight or the adviser's fair value processes, rather than providing information that will allow boards to most effectively understand the primary drivers of fair value during the reporting period or what aspects of the process required the most attention. In the same way that a one size fits all approach is unworkable when determining fair values for different types of securities, board reporting requirements also should be flexible enough to allow the board to receive the information that is most appropriate for the securities held by the funds the board oversees.

Mutual fund boards have many years of experience with fair valuation processes and with fund oversight generally. With the assistance of counsel, boards can and already do work effectively with advisers to receive the reporting that makes the most sense for the board, taking into consideration the nature of the funds' investments, the role of affiliated and unaffiliated service providers and other relevant valuation risk factors. We encourage the SEC to eliminate the prescribed board reporting elements in Rule 2a-5 entirely and replace the proposed elements with a general requirement that the board receive periodic reporting on the operation of the fair valuation processes and material changes made to fair value policies and procedures. This will allow boards to work with advisers to determine the specific form and frequency of reporting that they deem most appropriate and valuable. Additionally, a more general requirement will allow reporting routines to be appropriately tailored and adapted over time as the fund's investments, market condition or other valuation risk factors change.

If the SEC elects in the final rule to describe in detail the specific elements of board reporting in a manner similar to the Proposed Rule, we believe that modifications should be made. We describe our concerns with both the periodic and prompt reporting requirements in detail below and offer suggestions for modifications that would make the requirements more effective while reducing unnecessary burdens on boards and advisers.

B(1). Periodic Board Reporting

Qualitative Factors

Under the Proposed Rule, advisers would be required to provide a written assessment of the adequacy and effectiveness of the adviser's fair value processes at least quarterly, which would include, at a minimum, six categories of information.[16] The six categories include qualitative elements such as a description of the assessment and management of material valuation risks and a discussion of the adequacy of resources devoted to the fair value process. Others are more quantitative in nature, such as back-testing results and information on deviations from assigned fair value methodologies. Fidelity proposes that the final rule require that the adviser's written assessment of the adequacy and effectiveness of its processes as well as the two qualitative elements be reported to the board annually rather than quarterly.

Rule 2a-5 would require advisers to include in the quarterly materials a description of the adviser's assessment and management of material valuation risks, including any material

[16] Rule 2a-5(b)(1)(i).

conflicts of interest involving the investment adviser.[17] While the prominence of particular valuation risk factors can ebb and flow over time in response to market developments or changes in fund investments, the inherent sources of valuation risks and the adviser's practices for managing and mitigating these risks do not generally change from quarter to quarter. Similarly, Rule 2a-5 also would require a quarterly assessment of the adequacy of the resources allocated to the fair value process.[18] If the expectation is that advisers would report to the board on items such as budget and headcount, these factors rarely change from quarter to quarter. Furthermore, it would be difficult for a board to determine whether the reported budget or headcount numbers are appropriate.

Because valuation risks and resources generally do not change materially from one quarter to the next, we expect that the reporting on these factors will become formulaic and repetitive. With no changes to report, the reporting would likely be repeated from quarter to quarter with no change. Reporting of this sort is unnecessary and does not encourage active participation by the boards in the oversight process. Instead, boards would be better served by receiving an assessment of these factors annually at most. Over a longer period of time in which to assess the program, the adviser can report more effectively on trends in its fair valuation processes, changes in asset composition, and material changes in the people and technology allocated to fair valuation.

We note that requiring a qualitative assessment of the fair value process annually would be consistent with the SEC's approach under both Rule 38a-1 and Rule 22e-4. In both cases, the board receives an annual report on the overall effectiveness of the compliance and liquidity risk management programs, respectively. As a matter of practice, the chief compliance officers of the Fidelity funds report to the fund boards quarterly on any material matters from the prior quarter. Rule 22e-4 requires ad hoc board reporting on certain issues. Similarly, we encourage the SEC to modify Rule 2a-5 to provide that the adviser reports to the board annually on the adequacy and effectiveness of the fair value processes, which could include coverage of valuation risks and resources.[19] We do not object to more frequent reporting of other information, which is consistent with our current practices, including reporting on material changes to or material deviations from fair value methodologies, results of testing, or other materials the board may request.

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[17] Rule 2a-5(b)(1)(i)(A).

[18] Rule 2a-5(b)(1)(i)(D).

[19] We note that the Director of the Division of Investment Management highlighted Rule 38a-1 as an example of a model that fund boards believe has worked effectively. In her statement, Ms. Blass noted that, "Finally, we heard that directors want clarity from regulators regarding their responsibilities – but not at the cost of effectiveness. Directors want principles, not checklists. They want to know their responsibilities and authorities, but they also want the flexibility to dig in where and how it counts. For example, I consistently heard from fund boards that they look to the fund compliance rule – rule 38a-1 – as a strong model for how compliance, management and boards should interact. In their view the rule strengthens the hand of fund boards and compliance personnel in a way that is principles-based, allowing funds the flexibility to tailor compliance policies and procedures to the needs of that particular fund." Remarks at the IDC – 2018 Fund Directors Conference, Oct. 16, 2018; available at https://www.sec.gov/news/speech/speech-blass-101618.

Price Overrides

Rule 2a-5 also would require quarterly reporting of information regarding pricing services used in the fair value process.[20] We do not object to reporting on any material changes to the adviser's process for selecting and overseeing pricing services as well as changes in the service providers used. Rule 2a-5, however, also would require reporting of price overrides, which the rule labels as a "material event related to the adviser's oversight of pricing services."[21]

We note that the Release and the Proposed Rule are unclear about whether summary statistics of price overrides are sufficient and whether this information is strictly required under the periodic reporting requirements or as optional supplemental information that a board could request, if relevant. Under the periodic reporting requirements, the report is to include a "summary or description" of, among other things, material events related to the adviser's oversight of pricing services, including price overrides.[22] Furthermore, in the Release, the SEC also includes summaries of price overrides in the list of supplemental information that a board *could* request.[23] If price override information is already required to be disclosed in the periodic reporting, we are uncertain why it is then also included in the list of supplemental information. In addition, the SEC states in question 32 of the Release that it is "proposing to require that *all* price overrides be reported as supplemental information to the board as part of the periodic report."[24] (emphasis added). Reading these three statements together, we are uncertain (i) whether information on price overrides must be reported quarterly or rather as supplemental information when the board requests and (ii) whether summary statistics are sufficient or the adviser is expected to provide a detailed list of all price overrides.

Fidelity currently provides summary statistics on price overrides to the fund boards on a quarterly basis. We believe this summary reporting is sufficient for the boards to exercise their oversight duties and encourage the SEC to adopt this approach in the final rule. If the SEC's intent is to require that a security-specific listing of each instance be reported, such reporting would be voluminous and at a level of detail that is inconsistent with the board's oversight function. Price overrides are a routine component of the valuation process. Each day, Fidelity assesses the validity and reliability of prices supplied by pricing services through procedures that involve comparisons to prior prices, secondary sources, trades, benchmark securities and other market-based observations. Ultimately, Fidelity may determine that a particular price is unreliable and decide to assign a fair value.

Fidelity also believes that the SEC should clarify what is meant by a price override. In our view, price overrides are limited to those instances in which the adviser determines that an evaluated price or similar estimate provided by a pricing service does not represent a reliable fair value. The SEC implies that a price override is any instance in which the adviser "seek[s] to

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[20] Rule 2a-5(b)(1)(i)(E).
[21] *Id.*
[22] *Id.*
[23] Release at 46.
[24] Release at 48.

contact the pricing vendor to question the basis for the pricing information."[25] The industry considers this questioning to be a "price challenge," which may or may not lead to a "price override" (i.e., when the adviser elects to use a price different from the price supplied by the pricing service). Furthermore, in the absence of a clear definition, an adviser may also interpret price override to include other instances where market quotations are not readily available (e.g., fair value determinations for exchange-traded foreign securities based on market developments after the local market close, trading halts, corporate actions or other reasons).

Additional Information

Lastly, Rule 2a-5 requires that the adviser's quarterly reporting include any other materials requested by the board related to fair value.[26] While we do not object to this element of the Proposed Rule, we are concerned with the SEC's recitation in the Release of nine categories of information that a board "could review and consider, if relevant."[27] If the Commission intended this list to be merely a helpful guide to boards of the sorts of information that they might find useful, we question its utility. Fund boards have many years of experience with effectively overseeing fair value processes and are already well aware that they can request any of this information at any time, if they deem it valuable in the exercise of their duties.

Our larger concern is that, over time, the categories of information the SEC has enumerated would become de facto elements of the required quarterly reporting across the industry. This process could be gradual and may occur for any number of reasons such as the expectations of those responsible for inspections and enforcement or concerns by boards that they are taking undue risk in *not* requiring this information each quarter. Boards may feel compelled to request all of this information to avoid being accused of deficient oversight. Likewise, for similar reasons, advisers may feel compelled to provide this information even in the absence of a board request.

If that occurs, the amount of information that advisers would be required to produce, and boards would be expected to review, each quarter would be unnecessarily lengthy and difficult for boards to consume effectively. While some, though not all, of these elements by themselves perhaps could be manageable for boards and advisers in a particular quarter (e.g., narrative summaries on pricing errors), the collective weight of these elements together would be significant. In addition, it is unclear how fund boards are to approach some of the information that would be provided. For example, stale price reports or reports on portfolio holdings whose price has changed outside of predetermined ranges do not necessarily imply that the adviser's processes are deficient. The board may be left wondering what the information implies and what response, if any, it should take. Accordingly, we encourage the SEC to eliminate the recitation of the nine categories of information the board could request because fund boards already are sufficiently sophisticated, knowledgeable and experienced in overseeing fair valuation to know what information would be most valuable to them in the exercise of their duties.

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[25] Release at 45, fn 109.
[26] Rule 2a-5(b)(1)(i)(F).
[27] Release at 46-47.

B(2). Prompt Board Reporting

In addition to the quarterly board reporting requirements, Rule 2a-5 also would require advisers to report certain matters to boards in writing promptly, which the Proposed Rule defines as three business days or less after the adviser becomes aware of the matter.[28] As a threshold matter, Fidelity does not oppose a requirement for prompt reporting to boards of "certain issues as they arise that may require their immediate attention."[29] However, Fidelity has concerns that this provision as proposed is overly broad and would result in excessive reporting to the board of matters that would not require immediate attention.

The Proposed Rule requires written reporting within three business days of matters that "materially affect or could have materially affected the fair value of the assigned portfolio of investments" and "material changes in the fund's valuation risks."[30] This broad scope would result in advisers reporting a level of granularity of details that is inconsistent with the board's oversight function on matters where the board would not be expected to take any action. For example, a one-day technology issue at a pricing service may cause an adviser to fair value more securities on that day, which arguably could trigger prompt reporting to the board. The Release also suggests that a significant increase in price challenges or overrides likely would reflect a material change to the fund's valuation risks that should be promptly reported to the board.[31] Neither of these instances, however, imply that the adviser's fair value processes are deficient or in need of additional scrutiny nor do they require immediate action by the board in response to the reporting. We suggest that the SEC reconsider this requirement and instead require prompt escalation to the board of issues that would more likely require, in the board's and the adviser's judgment, their immediate attention, such as significant breakdowns in the fair value processes or circumstances that arise that are not contemplated by, or require departure from, established procedures.

The events of March and April 2020 can help illustrate the degree to which the prompt reporting requirements, as currently constructed, may not accomplish their intended goals. Between mid-March and late April, the number of fair value determinations for the Fidelity funds increased significantly compared to the last several years. These fair value determinations arose because of greater volatility in domestic and foreign equity markets, more frequent instances in which Fidelity determined that a pricing service's evaluated prices were unreliable or unavailable, higher instances of fair value determinations for fixed income securities and volatility in certain discrete sectors such as commercial real estate. These events did not necessarily all arise on the same day, but rather occurred at different intervals throughout the period.

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[28] Rule 2a-5(b)(ii).
[29] Release at 49.
[30] *Id*.
[31] Release at 49, fn. 113. We additionally question whether the example provided by the SEC would in fact represent a material change to the fund's valuation risk and should be reportable under the prompt reporting framework as proposed. Price challenges and overrides are not uncommon occurrences and represent a critical component of the process to oversee pricing services. We do not believe that an increase in this activity is necessarily indicative of a material increase in risk.

If Rule 2a-5 had been in effect during this period, it is likely that Fidelity would have felt compelled to provide written reports to the funds' boards because market events arguably "affected the fair value of the assigned portfolio of investments." Most significantly, in several instances multiple written reports would have been delivered in a narrow window of time as developments arose, especially in the latter half of March. Fidelity would have experienced a new event that impacted fair valuation and then immediately would have had to shift to notifying the boards in writing. Then, in multiple succession every few days, Fidelity would have had to repeat the exercise. Doing so would have taken valuable time away from those responsible for carrying out the fair value processes at Fidelity, who already were working diligently given the fluid nature of market events. In addition, the matters that we would have reported in writing every few days could have been reported to the boards on a less urgent basis and in meetings rather than in writing with no decrease in the degree or effectiveness of the boards' oversight. The earlier receipt of written reporting would have provided information to the boards and allowed the boards to ask questions of the adviser but would not have resulted in the boards taking any immediate action. As such, waiting a few days would not have resulted in any different outcomes.

In practice, Fidelity did in fact have conversations with its fund boards during this period on a range of matters, including fair valuation. If Rule 2a-5 had been in place, the reporting may have been more frequent, though less effective, and would have diverted resources from other important time sensitive matters. These recent developments illustrate the degree to which fund boards already receive reporting on a sufficiently prompt basis during periods of market stress.

The SEC should also reconsider the three-day reporting requirement for matters that must be promptly reported. Once the adviser becomes aware of a reportable matter, it has only three business days in which to complete the written board reporting. The SEC acknowledges in the Release that circumstances may require additional time to resolve matters. In those instances, the SEC would allow the adviser an additional three business days.[32] Fidelity believes that, in many instances, this is too short of a timeframe in which to provide meaningful reporting to the board. From time to time, an adviser may detect an issue with a particular fair value determination or a series of determinations with similar circumstances. First, it may take several days to identify with specificity the cause of the underlying issue. For example, if the issue is based on technology, this may require a detailed review of the coding, which can take a few days to complete. Second, it may then require several days of analysis to conclude that the issue is present and decide on corrective measures. In addition, if the matter could qualify as a significant deficiency or material weakness, the fund's independent audit firm will also be conducting its own analysis, requiring internal deliberations and consultations with its national office. While everyone involved in the fair value process understands the critical importance of resolving matters quickly given that fund NAVs are calculated each business day, some matters simply take longer to resolve than the SEC contemplates in Rule 2a-5 and the Release.

[32] Release at 50-51.

Lastly, under Rule 2a-5 as proposed, the adviser would report promptly either to the full board or to a committee of the board comprised of a majority of independent directors.[33] While we recognize that standard, quarterly reporting should be provided to the full board or to a designated committee, we recommend that the SEC allow prompt reporting to be provided to an independent director designated by the board to receive such prompt reporting, if the board so chooses. In practice, this person likely would be the chair of the board's fair valuation committee, if one exists. Doing so will allow boards the flexibility to design their reporting processes in a manner that most suits their needs and may, in many circumstances, avoid the need to schedule a full committee or board meeting in a short amount of time. Upon receiving the reporting, the independent director could decide to request a full committee or board meeting in order to apprise the other directors and to consider any actions to be taken, if necessary.

We encourage the SEC to modify the prompt reporting requirements by narrowly tailoring the reportable events to those of sufficient import to warrant additional board scrutiny, allow for the reporting to be conducted either in writing or through conversations and be provided to a designated independent director if the board wishes to do so, and replace the overly restrictive three business day deadline with a provision that would allow an adviser to report to the fund board within a reasonable amount of time. We believe that these changes would allow for a more workable provision that avoids unnecessary reporting, within a timeframe that allows for more productive dialog with boards, resulting in more effective oversight.

III. FAIR VALUE AS DETERMINED IN GOOD FAITH

The Proposed Rule sets forth six categories of requirements that must be met for a fair value determination to be deemed to have been made in good faith, as required by the Act. In broad terms, the requirements relate to the assessment and management of valuation risks, the consistent application of fair value methodologies, testing of those methodologies, ongoing oversight of pricing services, the adoption of written policies and procedures and recordkeeping.[34] We note that these requirements describe the processes that must be followed by an adviser or the board when making fair value determinations rather than describing with specificity the substantive elements of a proper fair value determination for different types of investments.

We believe that the SEC's approach in focusing on procedural elements rather than establishing by rule how particular investments should be fair valued is appropriate. The SEC's focus on process properly recognizes that determining fair values is not a one size fits all exercise, with the factors that an adviser considers varying significantly across different types of investments. Trying to establish by rule the substantive elements for different investments would require frequent amendments by the SEC to keep the rule in line with market developments. Instead, providing flexibility to advisers and boards to manage the substantive elements of a good fair value determination is essential if the rule is to serve the interests of fund shareholders most effectively.

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[33] Rule 2a-5(e)(3); *see also* Release at 33.
[34] Rule 2a-5(a)(1)-(6).

While we agree with the general approach taken by the SEC, we believe modifications should be made to the six categories of requirements. In particular, we are concerned that the recordkeeping requirements will impose significant burdens on advisers with little benefit to mutual funds and their shareholders. We describe these concerns in detail below and suggest modifications to the recordkeeping and other requirements that we believe will result in a more effective and workable rule.

A. Recordkeeping – Fair Value Determinations; Valuation Methodologies

The Proposed Rule requires the maintenance of two types of records. First and most significantly, funds would be obligated to maintain for five years appropriate documentation in support of each fair value determination, including "information regarding *specific methodologies applied and the assumptions and inputs considered when making fair value determinations*."[35] (emphasis added) We believe that this requirement is overly and unnecessarily burdensome on funds and advisers when applied in instances where prices are obtained from third-party pricing services.

This requirement is tied directly to the second element of the six-category framework under which a proper fair value determination would require that the adviser select and apply in a consistent manner an appropriate methodology for determining fair value, including the specification of the "key inputs and assumptions specific to each class or portfolio holding."[36] Reading these two requirements together, Rule 2a-5 would establish a framework under which the adviser must (i) apply a predetermined methodology that results in a particular value for a security calculated based on the application of the inputs and assumptions as manifested on that day and (ii) maintain records of these inputs and assumptions, as well as the fair value itself, in order to allow others to verify the determination for five years.

Rule 2a-5 is clear that prices received from third-party pricing services are not deemed readily available market quotations and, thus, would be considered fair value determinations, when the service is not merely passing through a quoted price in active markets for identical investments.[37] The Commission reinforces this point in the Release by noting that "evaluated prices are not, by themselves, readily available market quotations."[38]

In considering the recordkeeping and methodology requirements when adopting the final rule, we encourage the SEC to distinguish between prices received from third-party pricing services and those fair value determinations that are made by the adviser in-house based on more subjective and less observable inputs.

In calculating the funds' NAVs each day, Fidelity relies on evaluated prices received from pricing services for a range of securities including corporate bonds, mortgage-backed

[35] Rule 2a-5(a)(6)(i).
[36] Rule 2a-5(a)(2)(i)(A).
[37] Rule 2a-5(c).
[38] Release at 59.

securities and municipal bonds, among others. As part of its ongoing oversight of pricing services, Fidelity analyzes and provides feedback to pricing services on the *types* of inputs and assumptions that the pricing services evaluate when setting and transmitting an evaluated price. This oversight is performed both when Fidelity first makes the decision to receive prices on a particular asset class from a pricing service and on an ongoing basis as part of Fidelity's routine oversight practices. While Fidelity can and does request the specific data on the inputs and assumptions for a particular day's evaluated price on a security when necessary, this information is not automatically supplied by the pricing services. Furthermore, it is unrealistic to expect that an adviser would scrutinize the minutia of every evaluated price it receives from the pricing services daily. Instead, the standard data feeds from the pricing services include the evaluated price and a security identifier, which allows Fidelity's systems to apply the evaluated price to each fund that holds the security.

Fidelity does not believe it is necessary to receive and maintain on a daily basis detailed information on each of the inputs and assumptions that went into each evaluated price because of its prior review of the *types* of inputs and assumptions used by the pricing services for each class, and because Fidelity retains the right to request and receive the information when appropriate.[39] Requiring by rule that funds receive and retain all of this information would result in a large expenditure of resources for information that is not customarily used or retained by funds today. Instead, it is sufficient that advisers have the ability to request and receive this information on individual securities when the adviser deems it appropriate to analyze an evaluated price in greater detail.

As noted above, one of the SEC's stated reasons for the recordkeeping requirement is to allow "a third party to verify the fair value determination."[40] Currently, the key third-party that performs verification of the prices assigned to each security is the fund's independent auditor. For evaluated prices received from a third-party pricing service, the auditor does not parse through the evaluated price in greater detail by analyzing data on the inputs and assumptions used by the pricing service for each supplied price. Instead, the auditor tests the valuation used in the fund's financial statements by obtaining prices independently through its own third-party service provider(s).

While Fidelity believes that the recordkeeping requirements for prices received from a third-party pricing service should be modified in the final rule, we acknowledge that fair value determinations that are developed by an adviser based on subjective inputs may call for retention of records as set forth in Proposed Rule. For example, Fidelity agrees that it is appropriate for an adviser to maintain information on each of the inputs and assumptions that it used in a pricing model for a private placement security. Because the degree of observable inputs is limited and because the valuation analysis is internally generated, we acknowledge that advisers should be

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[39] To illustrate this difference in greater detail, a pricing service may take into consideration information on the likelihood of defaults, pre-payments and losses when establishing a price for a mortgage-backed security. Fidelity is comfortable that these inputs are appropriate to consider when setting that price. Unless Fidelity deems it appropriate to evaluate the price in greater detail, we do not request and do not automatically receive the probabilities that the pricing service assigned to each of these factors when setting the price.
[40] Release at 30.

required to maintain additional information about the determination. When adopting the final rule, we encourage the SEC to apply the new recordkeeping requirements to only those fair value determinations that are made by the adviser in-house based on more subjective and less observable inputs.

B. Recordkeeping – Policies and Procedures; Interplay with Rule 38a-1

Under the second recordkeeping element in Rule 2a-5, funds would maintain a copy of the current written fair value policies and procedures, which are required separately by the rule,[41] as well as any policies and procedures that were in effect for the last five years.[42] We have no concerns with this requirement and believe that it is reasonable for the Commission to expect that funds would maintain these documents for at least five years.

In the Release, the Commission acknowledges the interplay between Rule 38a-1 under the Act and the Proposed Rule[43] and requests comment on whether the Commission has been sufficiently clear on the interaction between the two rules.[44] With respect to the adoption and retention of fair value policies and procedures, we believe that it has and that no further clarification is required. Rule 38a-1 requires that funds maintain policies and procedures that are reasonably designed to prevent violation of the federal securities laws, including policies and procedures related to valuation.[45] In addition, Rule 38a-1 requires that a fund's board approve the adviser's compliance policies and procedures.[46] Each year, the boards of the Fidelity funds approve fair value policies and procedures, which are also deemed to constitute a portion of the funds' compliance policies and procedures as required by Rule 38a-1. Under Rule 2a-5, the required policies and procedures would belong to the adviser in circumstances in which the board has assigned fair value responsibilities to the adviser. As the Commission acknowledges in the Release, the fund could then adopt the adviser's Rule 2a-5 policies and procedures in fulfilling its obligations under Rule 38a-1.[47]

IV. OTHER MATTERS

In addition to the foregoing matters, Fidelity provides comments below on a few other aspects of the Proposed Rule.

A. Segregation of Duties

The Proposed Rule would require the adviser to reasonably segregate the process of making fair value determinations from the portfolio management of the fund.[48] We believe that the SEC's proposal, which balances the important role that a portfolio manager may serve in

[41] Rule 2a-5(a)(5).
[42] Rule 2a-5(a)(6)(ii).
[43] Release at 26-27.
[44] *See* Question 13 of the Release on p. 28.
[45] Rule 38a-1(a)(1).
[46] Rule 38a-1(a)(2).
[47] Release at 27.
[48] Rule 2a-5(b)(2).

providing information on particular fund holdings with potential conflicts of interest, is an appropriate formulation. As the Proposed Rule rightfully acknowledges, in many circumstances, the fund's portfolio manager or persons in related functions may be the most knowledgeable person at an investment adviser regarding a fund's portfolio holdings. For this reason, it may be appropriate for portfolio managers to provide input into the process for determining the fair value of fund investments. On the other hand, we recognize that incentives (particularly related to compensation and performance evaluations) could, if left unchecked, present conflicts with the fair value determination process.

We support the Proposed Rule's requirement that advisers take steps to reasonably segregate the process of making fair value determinations from the portfolio management of the fund. Many factors can inform what is the most appropriate and effective method for achieving such a segregation and, accordingly, practices may vary. By not being overly prescriptive in this regard, the Proposed Rule would allow advisers and boards to determine the appropriate level of portfolio manager involvement in a manner that still protects the interests of fund shareholders.

B. Involvement of Other Personnel in Fair Value Processes

As noted above, we support the framework set forth in Rule 2a-5 in which a board may assign fair value determinations to the adviser subject to ongoing board oversight. In adopting a final rule, we encourage the SEC to acknowledge in the adopting release that the adviser may involve officers and employees of entities affiliated with the adviser when carrying out its duties.

In Fidelity's case, the boards of trustees of the Fidelity funds have delegated responsibility for the day-to-day fair valuation processes to Fidelity, who in turn has formed a committee to carry out these responsibilities each day. The committee is led by the funds' President and Treasurer and is comprised of employees of the funds' adviser as well as employees of an affiliated entity that serves as the funds' accounting and pricing agent. The latter entity is responsible for fund accounting, daily NAV calculations and shareholder reporting, among other responsibilities. We believe that including in the committee's deliberations employees of our affiliated accounting and pricing agent who are responsible for the daily NAV calculation process has enhanced the overall quality of Fidelity's fair value processes. While we recognize the important role of a fund's investment adviser in making fair value determinations, we believe that personnel of other affiliated entities can provide valuable insights into the process and we encourage the SEC to acknowledge that the adviser may include officers and employees of affiliated entities when performing its responsibilities under the rule.

C. Readily Available Market Quotations

In the Proposed Rule, the SEC seeks to clarify what it means for a market quotation to be "readily available" for purposes of Section 2(a)(41) of the Act. A market quotation would be readily available only when it is a quoted price in active markets for identical investments that the fund can access that day.[49] Furthermore, the SEC notes in the Release that fair value "must

[49] Rule 2a-5(c).

be used in all other circumstances."[50] While we recognize that the SEC is mirroring the binary formulation set forth in Act, by doing so the SEC is perpetuating inconsistencies with current accounting guidance.

The Financial Accounting Standards Board in its release on Fair Value Measurement defines fair value as the price that would be received to sell an investment in an orderly transaction between market participants at the measurement date.[51] According to ASC 820, a fair value measurement is made up of one or more inputs, which reflect assumptions that market participants would make in valuing the investment. The most reliable evidence of fair value is a quoted price in an active market. In other words, the accounting guidance holds that all security prices are fair values and the question then is how to derive that fair value. When a quoted price is not available, entities use a valuation approach to measure fair value, maximizing the use of observable inputs and minimizing the use of unobservable inputs.[52] In this formulation, fair value determinations run along a spectrum from instances in which a quoted price is available to instances in which there are few, if any, observable inputs.

By tagging every price that is not a readily available market quotation as a "fair value determination" the SEC's framework does not account for differences in determinations along this spectrum. There are, in fact, significant differences in fair value determinations that are developed based largely on an adviser's own assumptions and judgement, such as a determination related to a private placement investment, and those that are informed by objective inputs that can be easily corroborated (e.g., based on the security's last trade price, based on prices or quotes for similar securities, etc.). The former category requires significantly more time and attention to carry out effectively and carries a greater risk of potential conflicts of interest, thus calling for additional board oversight and recordkeeping. There are also differences within the latter category based on the extent to which the price is based on observable inputs.

In adopting a final rule, we encourage the SEC to account for the differences in fair value determinations. This could impact many components of Rule 2a-5, including recordkeeping, board reporting, and the degree of specificity in policies and procedures, among other matters.

D. Valuation Methodologies; Policies and Procedures

Rule 2a-5 requires that the fund or adviser select and apply in a consistent manner one or more appropriate methodologies, including "specifying the key inputs and assumptions specific to each asset class or portfolio holding."[53] In addition, Rule 2a-5 would require that the written policies and procedures be reasonably designed to achieve compliance with the requirement

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[50] Release at 58-59.
[51] Fair Value Measurement (Topic 820), Financial Accounting Standards Board, Accounting Standards Update No. 2011-04 (May 2011) ("ASC 820").
[52] *Id*. at 3-5.
[53] Rule 2a-5(a)(2)(i)(A).

regarding the selection and consistent application of the fair value methodologies, among other matters.[54]

It is not practical to expect that key inputs and assumptions specific to each asset class or portfolio holding be predetermined in the written valuation policies and procedures. Such a requirement would not allow funds the flexibility to make necessary and appropriate adjustments based on prevailing facts and circumstances. Instead, we encourage the SEC to modify Rule 2a-5 to require that the policies and procedures outline the factors and considerations that a fund *may* take into account in selecting and applying valuation methodologies. As noted above, accounting guidance requires that funds value portfolio investments in a manner that maximizes the use of relevant observable inputs and minimizes the use of unobservable inputs. The existence and availability of observable inputs such as publicly available information about actual events or transactions are generally to be prioritized. This requirement necessitates that advisers actively survey the marketplace and adjust valuation approaches as observable inputs materialize. To require that fund companies set the specific key inputs and assumptions ahead of time in the written policies and procedures would not provide advisers sufficient flexibility to comply with the accounting guidance.

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Fidelity would be pleased to provide further information, participate in any direct outreach efforts the Commission undertakes, or respond to questions the Commission may have about our comments.

Sincerely,

cc: The Honorable Jay Clayton, Chairman
The Honorable Allison H. Lee, Commissioner
The Honorable Hester M. Peirce, Commissioner
The Honorable Elad L. Roisman, Commissioner

Dalia Blass, Director, Division of Investment Management

[54] Rule 2a-5(a)(5).

Fidelity INVESTMENTS