July 20, 2020

Vanessa A. Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090

RE: Good Faith Determinations of Fair Value
File No. S7-07-20

Dear Ms. Countryman,

Through past research and discussions in my graduate courses, historically, the Securities and Exchange Commission (SEC) were the prominent forefront supporters of historical cost accounting (Zeff, 2007). As the idea of valuation based upon fair values gained popularity in the 1970s because of inflation, the SEC approved revaluation techniques to be used by thousands of large companies (Zeff, 2007). Standards have moved accounting practice away from established concepts of historical cost and stewardship into concepts of investor decisions based on future cash flows and fair values. (Georgiou & Jack, 2011). The proposal sheds light on how the current rules and processes for valuation need updating. Proposed rule 2a-5 presents a specific framework on how to further institutionalize the use of fair values by requiring specific compliance by fund investments. The SEC proposes that "to determine the fair value of fund investments in good faith requires a certain minimum, consistent framework for fair value and standard of baseline practices across funds, which would be established by the proposed rule. The proposed rule would also permit a fund's board to assign fair value determinations to an investment adviser of the fund." Rule 2a-5 supports and defends the use of fair values in a safe, regulated way. Therefore, I strongly support the framework set forth in this proposal. Rule 2a-5 promotes the use of fair values to further comply with the Financial Accounting Standards Board (FASB) and International Accounting Standards Board (IASB) conceptual frameworks, as well as, results in limited economic consequences.

Discussion

The FASB's Statement of Financial Accounting Concepts No. 8 (2010) and the IASB Conceptual Framework for Financial Reporting (2010) both excluded prudence as a qualitative characteristic of useful financial information. Within the current framework, accounting requirements are 'relevance' and 'faithful representation.' This is the idea that financial statements are relevant so that they are capable of influencing the decisions of users and also that they are a faithful representation of the entity so that the information is complete, neutral and free from error. By taking 'conservatism' out of the conceptual framework, biases are eliminated. The IASB (2010, p. B18) states "Chapter 3 does not include prudence or conservatism as an aspect of faithful representation because including either would be inconsistent with neutrality… Deliberately reflecting conservative estimates of assets, liabilities, income or equity has sometimes been considered desirable to counteract the effects of some management estimates that have been perceived as excessively optimistic." Adopting fair values

avoids conservatism and works to provide the most relevant and faithfully representative information to users. Accordingly, it could be argued that the use of fair values creates a riskier environment for the user. Rule 2a-5 provides an extensive discussion on its requirements regarding assessing valuation risk, fair value methodologies, testing of fair value methodologies, pricing services, fair value policies and procedures, record keeping, and Board oversight (SEC, Proposed rule: *Good Faith Determinations of Fair Value*, 2020. Pgs. 17-34).

Schroeder *et al.* (2016) states "Economic consequences refers to the impact of accounting reports on various segments of our economic society. This concept holds that accounting practices that a company adopts affect its security price and value. Consequently, the choice of accounting methods influences decision making rather than just reflecting the results of these decisions." For example, if standard setters are considering a new regulation that requires a company to report liabilities it previously had not been required to show on its financial statements, it could lead to reduced capital flow, increased cost of capital, or cause failure. These adverse effects are all examples of potential economic consequences (Siegel, 2014) that affect not only the company but also its stakeholders. On the other hand, this new standard may also cause for more accurate and neutral information available; this positive effect is also considered an economic consequence (Siegel, 2014). Whether cost or benefit, someone is affected. It is up to standard setters to weight those consequences. Within the current proposal, the SEC provide a thorough discussion on the economic consequences that may be associated with rule 2a-5. This includes the costs, benefits, and reiteration of who will be affected.

Costs and Benefits

In Section III (C) Benefits *and Costs and Effects on Efficiency, Competition, and Capital Formation of Proposed Rule* the SEC lists out the economic consequences of rule 2a-5:

The Benefits:

- Reduces compliance costs because funds may expect less effort and time to design policies and procedures, reporting, and recordkeeping under the proposed rule than trying to determine appropriate compliance under the statute alone
- Allows boards to allocate more fair value responsibilities to an investment advisor to the fund and thus could free board resources tied to valuation and redirect them to oversight or other matters.
- Requires all funds to adopt specific policies and procedures related to fair value determinations.
- Proposes specific oversight of the investment's advisors' conflicts of interest. Therefore, assuming the current practices are less than those in the proposed rule, this rule could decrease the likelihood of inaccurate valuation. This is because the proposed rule creates a more robust valuation framework and increased oversight in certain circumstances.

The Costs:

- Funds and their boards will incur one-time costs to review the new requirements and modify their fair value practices.

- One-time incremental costs necessary to ensure compliance with the proposal could range from $100,000 to $600,000 per fund, depending on their current practices.
- Out of the 13,831 funds, 9986 would be affected by the proposed rule, and thus incur the one-time cost.
- For funds whose board assign fair value determinations, these costs will be borne by the investment advisor, and could ultimately be passed to the shareholder in the form of higher fees. For those whose board determines fair values themselves, this cost may be ultimately passed down to the shareholder in the form of higher operating expenses.
- Imposes ongoing costs on all funds that hold securities without readily available market quotations, requiring them to comply with the new guidelines.
- Mandate more detailed and specific procedures, potentially hindering funds from flexibility within designing policies and procedures that better fit their preferences, causing more costs.
- Increased role for investment advisors in fair value determinations, could create bias.

Accordingly, I agree that the prosed rule could lead to more efficient use of the boards' resources and therefore improving the funds' governance for the benefits of its investors. I agree that it will improve the efficiency of the fund operations by allowing for a more "principles-based" outlook on fair values. I also agree that although more autonomy is given to the investment advisory, rule 2a-5 provides a robust framework to mitigate any conflicts of interest. An ultimately, in regard to the costs, the SEC provides ample reason to believe that the costs incurred by funds will be on the smaller side of the spectrum due to the fact that many funds currently have fair values practices in place that are similar to the proposed rule. The closer a funds current practices are to the proposed rule, the lower the costs incurred are.

Conclusion

The proposal (SEC, 2020. pg. 88-89) states that "The proposed rule would provide an updated framework for valuation under the Investment Company Act that is more suitable to current market realities. The proposed rule retains the important safeguard of board oversight of fair value determinations, while making more efficient use of boards' time and expertise and recognizing the important role of fund investment advisers in the fair value determination process." Rule 2a-5 promotes the institutionalization of using fair values and complies with the current framework's accounting requirements of 'relevance' and 'faithful representation.' The proposed rule also provides a thorough discussion on economic consequences resulting in the conclusion that its benefits outweigh the costs. Not only in terms in monetary value, but in keeping in mind the effects on the shareholders and stakeholders.

Sincerely,

Ellie Davidson

References

https://www.sec.gov/rules/proposed/2020/ic-33845.pdf

https://www.sec.gov/comments/s7-07-20/s70720.htm

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Schroeder, R. G., Clark, M., & Cathy, J. M. (2016). *Financial Accounting Theory and analysis: text and cases.* Hooken, NJ: Wiley.

The FASB's Cost-Benefit Analysis presented by FASB Member Marc A. Siegel at the FEI-CFRI conference on November 17, 2014.

Zeff, S. A. (2007). The SEC Rules Historical Cost Accounting: 1934 to the 1970s. *SSRN Electronic Journal,* 49-62.