July 20, 2020

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

Re: Proposed Rule 2a-5, Release IC-33845; File No. S7-07-20

Dear Ms. Countryman:

I appreciate the opportunity to provide the Commission with comments on Proposed Rule 2a-5 under the Investment Company Act of 1940 (the "1940 Act" or the "Act") entitled Fair value determination and readily available market quotations (the "Proposed Rule" or the "Proposal") as proposed on April 21, 2020 in Release IC-33845 (the "Proposing Release").

I would like to start out by commending the Commission and the Staff for undertaking this major rulemaking initiative concerning the valuation of fund assets. As recognized in the Proposing Release, there have been many changes in the securities markets, the mutual fund industry and the regulatory framework since the Commission last issued guidance in this area. As a result of those developments, the valuation process is far more complex today than it was when that guidance was added. All of which supports the Commission's undertaking this important rulemaking initiative.

By way of background, for the past two years, I have served as an Adjunct Professor of Securities Law at the Catholic University of America, Columbus School of Law, where I teach Securities Regulation: Compliance, a "transition to practice" class that focuses on compliance issues of registered investment advisers, registered investment companies and registered broker-dealers. Prior to 2018, I practiced law in the investment management field for 33 years, most recently spending 21 years at a major law firm, where I was a senior partner in the firm's financial services practice group.

I worked at the Commission's Division of Investment Management (the "Division") twice during my career. From 1985 to 1988, I served as an Attorney-Adviser and then as Special Counsel in the Office of Investment Company Regulation and the Office of the Chief Counsel. After leaving the Commission, I worked as an associate attorney at Shereff, Friedman, Hoffman & Goodman, a law firm that specialized in the regulation of investment companies and investment advisers and as in-house mutual fund counsel for a registered investment adviser affiliate of a major brokerage firm. In 1994, I returned to the Division as Associate Director and Chief Counsel, a position I held until 1997 when I returned to private practice.

Over the course of my career, I had extensive exposure to and experience advising on fund valuation issues, both as a regulator and as a private attorney representing mutual funds, independent directors and investment advisers. Having worked on valuation issues from all sides, I believe that my experience and perspective may be helpful to the Commission and the Staff as they tackle the difficult issues presented by the proposed rulemaking. I am respectfully submitting this comment letter on my own behalf and the comments herein are based on my understanding of the relevant law and industry practices. The comments are my own views and are not intended to reflect the views of my former colleagues or clients.

My comments begin with a background section discussing the approach to fair valuation historically taken by responsible fund boards and advisers. This is followed by a global comment advocating that the Commission take a modified principles-based approach to the rulemaking, similar in concept to the approach taken in the adoption of Regulation Best Interest. This global comment is followed by my comments on the provisions of the rule as proposed and my responses to a number of the requests for comment included in the Proposing Release. Unless otherwise indicated, my comments assume that a fund's board would rely on paragraph (b) of the proposed rule to assign responsibility for fair valuation to the fund's investment adviser, which I believe will likely be the case for the vast majority of the fund industry.

Valuation of Mutual Fund Assets – Background.

Over the approximately 50 years since the Commission last provided formal guidance on fund valuation, funds, boards of directors and investment advisers have developed and continually refined valuation policies and procedures that are reasonably designed to ensure that fund assets are accurately valued and that portfolio securities for which market quotations are not readily available are appropriately "fair valued." While the Commission's adoption in 2003 of Rule 38a-1 under the Investment Company Act of 1940 (the "1940 Act" or the "Act") specifically required Funds to adopt compliance policies and procedures with respect to fair value determinations, responsible advisers and fund boards had long had such procedures in place.

As recognized by the Commission, although a fund's board remains ultimately responsible for fair valuation decisions under Section 2(a)(41) of the Act, the simple fact is that boards do not meet on anything close to a daily basis and the vast majority of fund directors do not have the technical and financial expertise, or access to the necessary data, to make fair value decisions on a real time basis. Accordingly, the vast majority of fund boards, in recognition of the need for expertise and familiarity with the markets and fund investments, have chosen to rely on the fund's investment adviser to manage and conduct the day-to-day valuation of Funds assets. Obviously, this reliance raises a number of potential conflicts of interest, as fund advisers are typically compensated based on a percentage of the fund's net asset value and the compensation of fund portfolio managers may depend in large part on the performance of the fund.

Responsible investment advisers that manage funds are well aware of the potential conflicts of interest presented by their playing a role in the valuation process. Advisers and fund boards have taken steps to address those conflicts through the adoption and implementation of detailed valuation procedures that (a) set forth the process, and persons or parties responsible, for making fair value decisions, (b) describe the methodologies to be applied in making such decisions, (c) require fair valuation determinations to be made/approved by a valuation committee consisting of officers of the adviser and (d) require reporting regarding fair value determinations made, together with any material developments, to the fund's board.

One step commonly taken by fund advisers to manage the scope of any conflicts of interest is the retention of one or more third party pricing services to work with the fund's administrator to value the fund's portfolio on a daily basis, thereby obtaining independent input into the valuation process.[1] Of necessity, the valuation process is highly automated to allow asset values to be determined and fund net asset values to be calculated in time to meet the deadline for reporting of fund share prices to the NASDAQ Fund Network, which collects and disseminates mutual fund share prices to the media and the investing public, as well as to price purchases and sales of fund shares in accordance with Rule 22c-1 under the Act. The identity of primary and secondary pricing sources to be used for various types of fund assets is typically included in the valuation procedures and is approved by the fund's board as part of its approval of the valuation procedures.

By assigning (or having the board assign) responsibility for daily valuation of a fund's portfolio to third parties, an adviser can limit its role in much of the valuation process to monitoring and reviewing the daily valuation of the fund's portfolio. However, where evaluated prices provided by a pricing service may not be current or accurate or if no reliable current price (evaluated or otherwise) is available for a portfolio investment, it is the responsibility of the adviser to determine a "fair value" for the security. To address the potential conflicts of interest presented when an adviser plays that role, fund valuation procedures generally include specific provisions intended to manage or mitigate the conflicts and ensure that the fair values determined by the adviser take into account all material and relevant factors and do not unfairly benefit the adviser's interests or disadvantage the fund and its shareholders.

Fund boards take their fair value responsibilities seriously and assigning responsibility for valuation functions to a fund's investment adviser is undertaken by necessity as the only practical means of calculating the fund's net asset value ("NAV") for purposes of pricing daily sales and redemptions of fund shares. In assigning valuation responsibilities boards have relied upon the guidance provided by the Commission and the Staff over the years, including the acknowledgment in ASR-118 that

> To the extent considered necessary, the board may appoint persons to assist them in the determination of [fair] value, and to make the actual calculations pursuant to the Board's direction. The board must also, consistent with this responsibility, continuously review the appropriateness of the method used in valuing each issue of security in the company's portfolio. The directors must recognize their responsibilities in this matter and whenever technical assistance is requested from individuals who are not directors, the findings of such individuals must be carefully reviewed by the directors in order to satisfy themselves that the resulting valuations are fair.[2]

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[1] There are, of course, other reasons that an investment adviser would seek to retain third parties to value fund portfolios, not the least of which is the number and complexity of securities held by the funds. The systems and the level of expertise provided by third party services are often essential to the ability of the fund to calculate and report its daily NAV on a timely basis.

[2] See Accounting Series Release 118 (Dec. 23, 1970). This guidance, has been applied and elaborated upon over the years by the Commission in the context of rulemaking and enforcement actions. *See e.g.* Money Market Fund Reform; Amendments to Form PF, Investment Company Act Release IC–31166 (July 23, 2014) at notes 890-899

In the Proposing Release, the Commission stated that its development of the rule have been informed by discussions between the Staff and fund boards, investment advisers, audit firms, trade groups and others.[3] The proposed rule as drafted clearly reflects those discussions in that many of the requirements of the rule closely track the procedures that have been developed by responsible fund boards and investment advisers to address their responsibilities with respect to the valuation of fund assets and fair value determinations.

<u>The Proposed Rule Should be Modified to Reflect a Principles-Based Approach</u> .

The concept of "good faith" as used in Section 2(a)(41) was intended to allow fund boards a certain degree of flexibility in making fair value determinations. The Commission recognized this in ASR-118, stating:

> "In some circumstances value can be determined fairly in more than one way. Hence, the standards set forth below should be considered guidelines, one or more of which may be appropriate in circumstances of a particular case. These standards should be followed, and a company's stated valuation policies should be consistent with them. Any variation from the standards should be disclosed in the financial statements or notes thereto even though the variation is in accordance with the company's stated valuation policy. In addition, any deviation from a stated valuation policy, whether or not in conformity with the standards, should be disclosed in the financial statements or notes thereto."

In 1999, in a letter addressing issues relating to funds' responsibilities for valuing portfolio securities, the Staff elaborated on this flexibility, stating:

> "We believe that "good faith" is a flexible concept that can accommodate many different considerations, including the incorporation of a variety of sources of information. Finally, we believe that the specific actions that a mutual fund board must take in order to satisfy its good faith obligation under Section 2(a)(41) of the 1940 Act will vary, depending on the nature of the particular fund, the context in which the board must fair value price, and, importantly, the pricing procedures adopted by the board.[4]

By setting forth specific, detailed requirements that a board would be required to satisfy in order to meet its obligation to determine fair value in good faith, the proposed rule would eliminate much of the flexibility currently allowed by the statute and prior Commission guidance. In an extreme case, the rule could result in a fund board or adviser being deemed to have not acted in good faith due solely to a failure to meet one of the rule's specific requirements.

As discussed above and as recognized by the Commission in the Proposing Release, responsible fund boards and advisers have developed detailed valuation procedures that are reasonably

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and accompanying text; *<u>In the matter of Calvert Investment Management, Inc.</u>*, Investment Company Act Release No. 32321 (Oct. 18. 2016) at note 3; *<u>In the matter of Jon D. Hammes, et al.</u>*, Investment Company Act Release No. 26290 (Dec. 11, 2003) at Paragraph D.2.

[3] See Proposing Release at page 14.

[4] See *<u>Investment Company Institute</u>* (pub. avail. Dec. 8, 1999).

intended to result in the calculation of fair value in good faith by or under the supervision of the fund board. The fund industry has operated under these procedures for years and has had the flexibility to modify the procedures as necessary to respond to changes in the fund's valuation needs and other surrounding circumstances.

The proposed rule has captured the fundamental valuation concerns addressed by responsible members of the industry in their valuation procedures, namely the. assessment and management of valuation risks, structuring the valuation process to address and mitigate the advisers' conflicts of interest, establishing, applying and testing of fair value methodologies, evaluation and monitoring of pricing services and board reporting and oversight. The flexibility afforded by the statutory good faith concept has enabled boards and advisers to structure and tailor their procedures to address these concerns in the context of the fund's operations, investments and policies.

The adoption of proposed rule 2a-5 as currently drafted would eliminate the flexibility under which boards and advisers have operated over the last 50 years. Instead of the flexibility afforded by the statutory language, the proposed rule would put into place a list of detailed requirements covering each of the concerns identified by the Commission. While these same areas of concern have already been addressed by responsible funds and advisers, practices vary and a fund's current valuation procedures may not line up with the requirements of the proposed rule. Most boards and advisers would be required to change their procedures to come into compliance with the new rule, abandoning the current procedures that have served them well over time.

To avoid this result and preserve the flexibility provided by the statutory good faith fair valuation requirement, I respectfully submit that the Commission should modify the rule to reflect a more principles-based approach to valuation. The approach I am advocating would, in many ways, be similar to the approach to valuation that has been historically taken by the Commission and the Staff and also would be similar to the approach taken by the Commission in adopting Regulation Best Interest.

The proposing release discussed a broad principles-based approach as an alternative that was considered but rejected in favor of establishing a framework of baseline practices that would be required of all funds, boards and advisers. The principles-based alternative that was considered

> "would not specify the types of fair value functions that must be performed, but instead would only state that funds should have in place policies and procedures, reporting, and recordkeeping that would allow fair values to be determined in good faith by the board of directors or the investment adviser."[5]

However, a principles-based approach to the rule would not have to be as broad as that described in the Proposing Release. Rather, the Commission could take a modified principles-based approach more along the lines of that taken in the formulation and adoption of Regulation Best Interest under the Securities Exchange Act of 1934 (the "1934 Act"). Regulation Best Interest establishes a standard of conduct for broker-dealers when they make recommendations to retail

[5] *See* Proposing Release at p. 103.

customers, requiring that they act in the best interest of the retail customer at the time the recommendation is made, without placing the financial or other interest of the broker-dealer ahead of the interests of the customer. The regulation sets out four specific component obligations with which a broker-dealer must comply, but takes a principles-based approach to compliance with those obligations.[6]

Applying this modified principles-based approach to the Proposed Rule, the Commission could require the determination of fair value in good faith to be conducted pursuant to policies and procedures adopted and implemented by the board of the fund and/or by the fund's adviser. The rule could require these procedures to be approved by the fund's board based on a specific finding that the fair value policies and procedures are reasonably designed to accomplish the determination of fair values in good faith as required by Section 2(a)(41) of the Act and Rule 2a-4.

The rule could also set forth certain elements that must be addressed in the policies and procedures, generally listing topics such as the assessment and management of valuation risks (including conflicts of interest), periodic review of the procedures, board reporting and oversight, evaluation of pricing services, reviewing and testing methodologies and determining when market quotations are no longer reliable. Compliance with the rule would be principles-based, thereby providing boards and advisers with the flexibility to establish and implement valuation procedures that are designed with the particular funds and the adviser's structure and operations in mind, as long as each of the required elements has been adequately addressed.[7]

The Proposing Release stated that a drawback of the broad principles-based approach considered would be that funds "could be less certain on how to comply with the proposed rule" and that, by reducing certainty for funds, a principles-based approach could increase compliance costs to the detriment of fund investors and would not adequately ensure that the board provides sufficient oversight over the investment adviser's fair value determinations. However, the modified principles-based approach that I am recommending could avoid these potential problems.

By describing in the adopting release examples of procedures that the Commission believes would satisfy the required elements listed in the rule, the Commission could provide sufficient guidance to reduce considerably, if not eliminate, any uncertainty about how to comply with the rule.[8] Similarly, by requiring that the procedures provide for board review and reporting and describing the level of oversight that the Commission believes would satisfy the rule, the Commission could adequately ensure that a fund's board provides robust oversight of the adviser's fair value determinations. Finally, taking a modified principles-based approach would give boards and advisers the ability to review their existing procedures in light of the rule and continue to use those procedures after making any necessary modifications to address the

[6] *See* *Regulation Best Interest: The Broker-Dealer Standard of Conduct*, Release 34-86031 (June 5, 2019) ("Reg BI Adopting Release") at p. 73.
[7] In my detailed comments on the proposed rule below, I have noted some elements that could be required to be covered by a fund's valuation procedures under the modified principles-based approach.
[8] This approach would be similar to that taken by the Commission with respect to Regulation Best Interest. See Reg BI Adopting Release at p. 73 ("we are providing interpretations and guidance regarding the application of the specific component obligations and in particular what it means to make a recommendation in the retail customer's "best interest".")

required elements. This could actually reduce the costs of complying with the rule, to the benefit of fund shareholders. Board oversight could also be enhanced by requiring an annual review of the valuation policies and procedures by the Board.[9]

Accordingly, I urge the Commission to modify the Proposed Rule to reflect a modified principles-based approach to compliance.

Comments on the Proposed Rule.

Unless otherwise noted, the specific comments on the proposed rule text discussed below would apply only if the Commission decides to adopt Rule 2a-5 substantially as proposed without modifying the rule to take the modified principles-based approach discussed above.

Assessment and Management of Valuation Risks.

Proposed Rule 2a-5(a)(1) would provide that determining fair value in good faith would require the assessment and management of any material risks, including any material conflicts of interest. The identification of valuation risks and the addressing those risks is an important part of an adviser's valuation procedures, as well as a major part of the board's role when assigning fair valuation responsibilities to the fund's investment adviser. Accordingly, it is appropriate for the Commission to address those risks in the rule.[10]

Request for Comment #1.

The list of valuation risks included in the Proposing Release appears to be fairly comprehensive and should prove useful to fund boards when considering an adviser's fair valuation procedures. Funds and their advisers vary greatly, and boards, advised by counsel, are fully capable of assessing the pertinent risks in the context of the funds for which they serve. As it is extremely difficult, if not impossible, to predict with certainty the areas of valuation risk in an ever-changing marketplace, an attempt by the Commission to further define the risks that would need to be considered would be ill-advised. In fact, including additional detail or further definition of valuation risks could be read to limit the inquiries that the board would be required to make, thereby hindering the risk management process. Accordingly, including in the adopting release a general list such as that included in the proposing release strikes the right balance — generally describing areas of risk without providing too much detail.

One additional item that could be discussed in the adopting release is the impact that a market or other disruption could have on the ability of an adviser and any third party service providers to continue to operate and value fund portfolio securities if their facilities are closed or otherwise

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[9] This would be similar to the role of the Board in approving and receiving reports under Rule 38a-1, the 1940 Act compliance rule. It also should be noted that Rule 38a-1 would cover the valuation procedures and policies, making the fund's chief compliance officer ("CCO") responsible for reporting to the board regarding the operation of the policies and procedures, any material changes made since the date of the last report, any material changes to the policies and procedures recommended as a result of the CCO's annual review and any material compliance matters that occurred under the procedures.

[10] If the Commission adopts the principles-based approach advocated above, Assessment and Management of Valuation Risks could be one of the elements required to be addressed in a fund's valuation procedures.

unavailable. The recent (and ongoing) pandemic has demonstrated the importance of having the ability to operate offsite or remotely. While this risk goes beyond pricing and encompasses all aspects of fund operations, it is certainly something that could have implications in the valuation context.

Request for Comment #2.

As discussed in more detail in the discussion below of the proposed periodic reporting requirements, the periodic board reports required of advisers that have been assigned valuation responsibilities should include a description of any material changes that have occurred in the valuation risks previously considered by the board. A review by the board of valuation risks, the valuation processes of the adviser and the manner in which those risks are managed or mitigated may be advisable in many cases, particularly if a substantial portion of a fund's investments require fair valuation or if the adviser's operations present conflicts of interest that may not have been adequately addressed. However, as recognized in the Proposing Release, whether an annual review is appropriate will depend on the particular circumstances. For example, the board of a fund that invests in few or no fair valued securities and whose portfolio consists for the most part of securities for which there is an established and active market, may well conclude that an annual review is not necessary. The rule appropriately recognizes this and does not specify a frequency for the periodic review of the risks. Similarly, the rule should not specify particular market or investment strategy risks that would require a reassessment of valuation risks. The need for such a review and reassessment should be left in the hands of the fund's board, as advised by counsel.

***Selection and Application of Fair Value Methodologies*.**

Proposed Rule 2a-5(a)(2) would require the establishment and application by the adviser (in the case where fair valuation responsibility has been assigned by the board) of methodologies for fair valuation of both existing fund investments and new types of fund investments in which the fund intends to invest. These methodologies would be required to be consistently applied and to specify the key inputs and assumptions specific to each asset class or portfolio holding of the fund. The adviser also would be required to (i) periodically review the appropriateness and accuracy of the methodologies and to make any necessary adjustments, (ii) monitor for circumstances that my necessitate the use of fair value and (iii) establish criteria for determining when market quotations are no longer reliable. Each of these proposals is discussed below.[11]

Selection and Application of Methodologies.

The requirement for establishing and applying fair value methodologies for each investment or type of investment in which the fund invests or intends to invest largely mirrors the current requirements under Section 2(a)(41), as developed by the Commission and the Staff in Releases AS-113 and AS-118 and subsequent releases and guidance. I would note, however, that there may be multiple methodologies that could be used to value securities in an asset class and that

[11] The Selection and Application of Fair Value Methodologies, the review and adjustment of methodologies used and monitoring for circumstances requiring fair valuation could be elements required to be covered by a fund's valuation procedures if the Commission adopts the modified principles-based approach discussed above.

different methods of valuation may be appropriate for different securities in the same asset class. To reflect this, the Commission should clarify that it would be appropriate under the rule for an adviser to establish several methodologies to be used to value securities in a particular asset class and note that different securities in an asset class could be fair valued using different methodologies.[12]

Reviewing and Adjusting Methodologies.

Periodic review of the appropriateness and accuracy of the methods used to fair value fund investments and making adjustments where warranted is an important part of the fair valuation process and is appropriately addressed in the rule. However, the Commission should clarify that a methodology used to value a security can be changed to a new methodology (and not simply 'adjusted'). This could be accomplished by addicting "or changes" immediately following the word "adjustments" in paragraph (a)(2)(B) of the proposed rule.

The Commission should also specifically address the situation where, due to a change in circumstances, an adviser changes the methodology used to fair value a security to a methodology that has not previously been selected for that asset class or reviewed with the board. If a change in methodology is both justifiable and appropriate under the circumstances, it should be acceptable under the rule as long as the new methodology is (i) added to the procedures and (ii) subsequently reported to the board no later than the next quarterly report. The Commission should confirm that such a change of methodology would be acceptable under the rule. Such confirmation would remove a possible disincentive to an adviser's making a necessary or appropriate change to the methodology used to fair value an investment.[13]

Monitoring for Circumstances that Require the Use of Fair Value.

Requiring that an adviser monitor for circumstances that might require that a security be fair valued is appropriately included in the rule. Among other things, requiring an adviser to establish specific criteria for determining when market quotations are no longer reliable should help to address the possibility of an unscrupulous individual declaring a valid market price to be unreliable in order to substitute an artificial price and avoid a negative impact on the fund's net asset value or performance. Many advisers address this possibility by requiring a decision of whether a market price has become unreliable to be made by a Valuation Committee rather than by the fund's portfolio management team.[14] The Commission should consider specifically requiring that an adviser describe the process by which decisions regarding the reliability of

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[12] Of course, the methodology selected for a particular investment would have to be consistently applied to fair value that investment unless and until there are circumstances where it would be appropriate to change the methodology to be more representative of the investment's fair value.

[13] Such confirmation may also serve to protect an adviser or its personnel that use a new valuation methodology from becoming the subject of an enforcement action under Rule 38a-1 based solely on a failure to follow a fund's existing procedures.. Of course, if the new valuation methodology is not appropriate or is not added to the adviser's procedures or reported to the board, the Commission would not be precluded from bringing an enforcement action under appropriate provisions of the 1940 Act and the rules thereunder.

[14] If members of a fund's portfolio management team are represented on the Valuation Committee, some advisers do not permit those members to vote on any matters that would or may have an impact on the portfolio of the fund.

market quotations would be made and identify the persons responsible for making those decisions.

Testing of Fair Value Methodologies.

It is appropriate for the rule to include a requirement that an adviser test the appropriateness and accuracy of the methodologies used to fair value fund investments.[15] While not always conclusive, back-testing and calibration can provide valuable information to an investment adviser seeking to monitor and assess the accuracy of using a fair value methodology for a particular investment.[16]

Request for Comment #7.

The Commission should not require specific tests to be used, nor should the rule provide a minimum frequency for testing. These items are best left to the investment adviser, subject to the oversight of the board, which is in a better position to determine the tests to be used and the frequency with which they should be applied. In fact, recommend that the Commission delete the word "minimum" from paragraph (a)(3) of the rule and leave the frequency of testing to the discretion of the adviser and the board.

Evaluation and Oversight of Pricing Services.

Pricing services are widely relied upon in the fund industry, both for (i) the collection and reporting of market prices for those securities for which market quotations are available and (ii) obtaining evaluation prices to serve as a key input when determining fair values for securities like corporate and municipal bonds that are not actively traded. Given the importance of the data that pricing services provide to funds and advisers, the inclusion of a requirement in paragraph (a)(4)(A) of the proposal requiring the establishment of a process governing the approval, monitoring and evaluation of each pricing service used is appropriate.[17]

With respect to the proposed requirement in paragraph (a)(4)(B) that the adviser establish its criteria for initiating price challenges, the Commission should consider expanding that requirement (or the related discussion in the Adopting Release) to specifically include in this requirement the establishment of a process for carrying out price challenges and resolving any differences where the pricing service and the adviser do not agree on the outcome of the challenge.[18]

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[15] Testing of fair value methodologies could also be included as a required element to be covered in a fund's valuation procedures under the principles-based approach discussed above.

[16] Many fund groups regularly compare the fair value used for a security with the price received upon the ultimate disposition of that security. In addition, some fund groups that use a particular pricing service test the accuracy of the prices provided by that service by periodically comparing those prices to the prices determined by a different pricing service.

[17] Evaluation and oversight of pricing services could be included as a required element to be addressed in a fund's valuation procedures under the principles-based approach discussed above.

[18] Initiating numerous price challenges with respect to a fund's portfolio securities could call into question the accuracy of prices provided by a pricing service and perhaps indicate a need to reevaluate the use of the pricing

Request for Comment #11. The rule should not require periodic review of pricing services. If the adviser is monitoring the performance of a pricing service and there have been few, if any, serious problems, the adviser should be able to continue to use that service. Of course, if there are serious problems or the needs of the fund change, the adviser could decide to stop using the pricing service. However, that decision should be left to the adviser and no periodic review by the board is necessary.

***Fair Value Policies and Procedures*.**

The requirement in paragraph (a)(5) of the proposed rule that the adviser adopt and implement written policies and procedures addressing the fair value of investments is appropriately included in the rule. As discussed above, funds and their investment advisers presently have such procedures in place under Rule 38a-1.

Request for Comment #12. Most valuation procedures of funds and their advisers address not only fair valuation, but also the processes for valuing all fund assets, listing assets by type and indicating the source(s) of prices for each type. While it is not necessary to include a reference to this in the rule, the Commission should include a statement in the release recognizing that fair value procedures may be included in a broader set of procedures governing the valuation of fund assets.

***Recordkeeping*.**

With respect to the recordkeeping requirement relating to the retention of supporting documentation, it is unclear whether the five year retention period commences at the time the initial fair valuation determination occurs or at the time that the fund last held the security that was fair valued. I assume that the latter reading was intended, but the language is a little unclear and should be clarified.

More importantly, the proposed recordkeeping provisions should not be a part of Rule 2a-5, but should be moved to a rule under Section 31 of the 1940 Act. Moving the recordkeeping requirement in this manner would accomplish two goals. First, while not all recordkeeping requirements applicable to funds are to be found in the rules under Section 31, placing the requirements under that rule would have the benefit of helping to centralize the recordkeeping requirements under the Act. Doing so would place the requirement in a rule where one would naturally look to determine a fund's recordkeeping obligations.

Second, moving the recordkeeping requirement out of Rule 2a-5 would ensure that the requirements for determining fair value in good faith are limited to substantive requirements, thereby making it clear that a board will not be deemed to have failed to meet its obligation to fair value an investment in good faith solely by reason of a failure to keep the required records.

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service that produces the challenged prices. Alternatively, depending on the surrounding circumstances, numerous or repeated price challenges could also serve as a "red flag" that could trigger an inquiry into the motives behind the challenges.

While recordkeeping is obviously important to the Commission's ability to oversee the industry, a substantive provision defining the concept of fair value in good faith should only include substantive provisions that pertain directly to the making of the fair value determination.

Request for Comment #15.

Where the board assigns fair value determinations to the adviser, the adviser should be required to maintain the required records. However, the Commission should include a statement, whether in the rule or in the adopting release, requiring the adviser to agree to provide the records to the fund upon request.[19] While ordinarily this would not be an issue, it could become one in the event that an adviser ceases to manage a fund.

***Assigning the Determination of Fair Value to an Investment Adviser of the Fund*.**

Paragraph (b) of proposed Rule 2a-5 would permit a fund board to assign the determination of fair value to an investment adviser to the fund, subject to oversight by the Board. I strongly support this provision, which essentially mirrors current industry practice. However, while the rule permits a fund board to assign fair valuation to an investment adviser, it does not state a specific standard or finding that the board must make in connection with an assignment. The Commission should add a required finding to the rule that must be made by the board before fair valuation responsibility can be assigned. For example, the rule could require that, prior to assigning fair value responsibility, the board must satisfy itself that the adviser has the appropriate resources to fair value fund investments in good faith and has put into place policies and procedures that are reasonably designed to ensure compliance with the rule.

Requests for Comment #19 and #20.

The Commission should modify paragraph (b) of the proposed rule to allow a fund board to assign the determination of fair value to any person upon a determination by the board that the person has the expertise and capacity to carry out that role and meet the requirements of the rule. Expanding the rule in this manner would provide fund boards with the flexibility to assign the determination of fair value to the fund's administrator or to another party in whom the board has confidence. For example, such a change would allow the board of a so-called "turnkey" fund[20] to assign the determination of fair value to the administrator of the fund. To the extent the administrator requires input from the adviser of a particular portfolio of the fund, the administrator could obtain that input and factor it into the valuation process.

The Commission could require any party other than an adviser to whom a board wishes to assign the determination of fair value to enter into a contract directly with the fund to provide such

[19] Such a requirement would be similar to that provided in Rule 31a-3(a) under the Act, requiring an agreement by a party maintaining records on behalf of another to the effect that the records are the property of the other party and will be surrendered promptly on request.

[20] A turnkey fund is a series mutual fund that is created, sponsored and registered by a fund administrator, that then offers to unaffiliated investment advisers the opportunity to manage separate series of the fund without becoming responsible for the overall management of the fund. The administrator is responsible for all aspects of fund operations other than providing investment advice to the portfolios. Accordingly, the board of a turnkey fund ordinarily would look to the fund administrator, rather than to the investment advisers, for assistance with valuation.

services. That contract could be required to include provisions comparable to those found in the fund's advisory contract pertaining to the description of compensation, termination of the contract without penalty, termination in the event of an assignment and the appropriate standard of care.[21]

Requests for Comment #22 and #23.

The assignment of responsibility for valuation decisions to the primary adviser of a multi-managed fund is, in my experience, in accord with current industry practice. It would seem to make sense to allow the board to assign valuation responsibilities to a single party, which would then be allowed to delegate portions of that responsibility to other parties, while remaining ultimately responsible for all valuation actions taken.[22] On the other hand, if the Commission determines to allow valuation tasks to be assigned to several parties, the final rule or the adopting release should remind boards of the need for coordination among those parties and suggest the designation of one party (most likely the principal adviser) to be responsible for that coordination.

Request for Comment #25.

Under state laws governing corporations and business trusts, fund directors/trustees have fiduciary duties of care and loyalty to the fund. Boards are responsible, under both State law and the Investment Company Act, for overseeing management and protecting the interests of the fund and its shareholders. Moreover, as the Commission has pointed out, the Board's duties with respect to the determination of fair value are non-delegable. For these reasons, fund boards, and particularly those directors who are not "interested persons" of the fund, can be relied upon to exercise robust oversight when assigning responsibilities for fair valuation to the adviser of the fund or, for that matter, to any other party. Additional steps such as requiring a third party review or an attestation by the adviser are not necessary to protect the interests of the fund or its shareholders.[23]

Request for Comment #26.

Section 2(a)(41) defines the value of a security for which market quotations are not readily available as the "fair value as determined in good faith by the board of directors". This language would seem to imply that fair value decisions should be made by or under the auspices of the

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[21] See Sections 15(a) (compensation, termination and assignment) and 17(i) (setting forth a minimum standard of care) of the 1940 Act.

[22] For example, the board of a multi-managed fund might assign valuation responsibilities to the fund's primary investment adviser. A subadvisor to one of the funds could make recommendations regarding valuation to the Valuation Committee of the primary adviser in much the same manner as an internal portfolio manager might do for a fund that is not subadvised. All final decisions regarding valuation would be made by the Valuation Committee, subject to the supervision of the fund board.

[23] It also should be noted that Section 36(a) of the 1940 Act provides the Commission with the authority to bring an action in federal court against an investment adviser or a fund director for a breach of fiduciary duty involving personal misconduct. This section provides yet another incentive for a fund's directors and its investment adviser to exercise objective, good faith judgment when valuing fund assets and calculating the fund's NAV or when assigning and overseeing those responsibilities to the adviser or another party.

board as a whole. On the other hand, the 1940 Act was not intended to displace state law that does not conflict with any provision of the Act or the rules, regulations or orders thereunder.[24] State laws governing the creation and operation of corporations and business trusts typically permit a board to empower a committee of the board to act on behalf of the entire Board in connection with most matters.[25] If a fund's Articles of Incorporation or Declaration of Trust permits delegation to a committee of the board to act on behalf of the entire board, the designation of a committee as contemplated by the proposed rule should be sufficient. Accordingly, I believe that the rule as proposed in this regard does not present a problem and need not be changed.

Request for Comment #27.

It seems unlikely that a board would assign a fair value determination to the fund's investment adviser for only some of the fund's investments, while determining the fair value of other investments on its own. Nevertheless, this should be permitted as it is impossible to foresee every circumstance. However, no additional requirement or guidance covering this possibility is necessary. Rather, the board should simply have to comply with the provisions of paragraph 2a-5(a) with respect to any investments for which it determines fair value.

Oversight and Reporting[26]

Proposed paragraph 2a-5(b)(1) would require an adviser to whom a fund's board has assigned fair value responsibilities to report to the board periodically, providing an assessment of the adequacy and effectiveness of the investment adviser's process for determining fair value of investments, including certain information. Such reporting would largely mirror the reporting currently done by advisers on valuation issues, although the reported information and their frequency of the reports varies from adviser to adviser. The proposed periodic reports would be required on at least a quarterly basis, which I believe is an appropriate interval and lines up with the quarterly board meeting schedule that is common among fund groups . However, as discussed below, some of the information that would be required by the proposed rule to be in the quarterly reports is more appropriately reported on an annual, rather than a quarterly, basis.

Material Valuation Risks.

The quarterly report would be required to include a description or summary of the adviser's assessment and management of material valuation risks, including any material conflicts of interest. Identifying and managing material valuation risks is an important part of ensuring that fair value is determined appropriately. However, once the material risks have been identified and a system put into place to manage those risks, they are unlikely to change from quarter to quarter in the absence of material changes in the risks themselves or gaps discovered in the procedures designed to address those risks. Requiring that a complete summary or description of the assessment and management of the risks be included in each quarterly report may well result

[24] *See* Section 50 of the 1940 Act.

[25] *See e.g.* MD Corp & Assn Code, Section 2-411(a)(2019).

[26] Oversight and board reporting could also be included as required elements of a fund's valuation procedures under the principles-based approach discussed above.

in largely identical “boilerplate” language being included in every report. Such repetitive language would be of limited value to directors seeking to exercise meaningful oversight of the adviser’s fair valuation process.

I recommend that the Commission modify paragraph (b)(1)(i)(A) to limit the required quarterly information regarding valuation risks to any (a) material changes to the valuation risks previously presented to the board; (b) material changes to the manner in which the adviser or third party seeks to manage valuation risks; (c) material developments relating to the management of valuation risks, including any material issues that have arisen and any steps that have been taken to address those issues. Making this change would ensure that pertinent information will be presented to the Board, while avoiding repetitive descriptions of risks and procedures that could obfuscate other information on which the board should focus its attention.

If the Commission decides to require the reporting to the board of a complete summary or description of the assessment and management of all valuation risks identified, l would recommend that such complete summary be delivered to the board on an annual basis.

Material Changes to or Deviations from Fair Value Methodologies.

I agree with the Commission that a summary or description of any material changes to or deviations from the fair value methodologies previously presented to the board should be included in a quarterly report to the Board.[27]

Testing Results.

Reviewing the results of any testing of fair value methodologies is an important part of a board’s exercise of meaningful, robust oversight of an adviser’s fair valuation of a fund’s portfolio securities. However, I would suggest that such results be required to be included in the quarterly report *only* if those results indicate that the methodology tested consistently overvalues or undervalues one or more fund investments and the results lead to a material adjustment to, or replacement of, the methodology for valuing those investments. All other results of testing could be covered in an annual report to the Board, much as the results of compliance testing are reported in the annual report of the Chief Compliance Officer (“CCO”) under Rule 38a-1.

Resources.

The adequacy of resources allocated to the fair valuation process is information of which the board should be aware when overseeing the process. This information would be part of the initial package of information presented to the board at the time the fair valuation is first assigned to the adviser. The quarterly report to the board should include only information regarding material changes to the resources allocated, including any material changes to the roles or functions of the persons responsible for determining fair value. A more complete description of the resources allocated to the fair valuation process could be provided to the board on an annual basis.

[27] Reporting material changes to or deviations from fair value methodologies could be included as a required element of a fund’s valuation procedures under the principles-based approach discussed above.

Oversight of Pricing Services..

Any material changes to an adviser's process for overseeing pricing services is information that should be brought to the attention of the board and is appropriately included in the quarterly report requirement.

Other Materials Requested by the Board.

Rule 2a-5(b)(1)(i)(F) would require an adviser to whom fair valuation responsibility has been assigned to provide any other materials related to the adviser's process for determining fair value that may be requested by the Board. The Proposing Release suggests several possible categories of information that a board may wish to request as part of its oversight. With respect to the categories on that list, information regarding price overrides may be particularly important to a Board's exercise of its oversight responsibility.

Given an adviser's potential conflicts of interest with regard to valuation decisions, a fund's board should examine price overrides carefully to ensure that those decisions are not being made for the purpose of artificially inflating or adjusting the fund's NAV. However, price overrides should not necessarily be added to the list of required reporting. If an adviser's procedures provide for prompt and meaningful internal review of overrides and/or include other measures intended to ensure the integrity of the process, in the absence of information to the contrary, a board may conclude that it does not need to receive information regarding price overrides on a regular basis.[28] However, in the Adopting Release, the Commission should consider adding a cross-reference to the discussion of price overrides and conflicts of interest elsewhere in the release to the discussion of this item in the Adopting Release.

With respect to information concerning pricing errors and any remedial action taken in response to such errors, the Commission should consider adding such reporting to the quarterly report if the amount of the error is material, *i.e.* if the error had a material impact on the price of fund shares (or would have had such an impact in the absence of remedial action taken). Alternatively, the Commission could add language to the discussion of Prompt Reporting in the Adopting Release clarifying that material pricing errors would fall within the category of information required to be reported promptly.

Request for Comment #31.

With respect to whether a board should receive specific information on each individual portfolio holding that has been fair valued, many fund groups already provide their boards with some form of that information. The Commission should not require such information to be provided, but should allow the board to decide whether they would find that information helpful. If, however, the Commission does decide to require the reporting of this type of information, I would suggest limiting it to any fair valued positions that exceed a specified percentage of the portfolio (whether individually or in the aggregate).

[28] Presumably, any material deviation from the procedures governing price overrides would be reported to the board under 2a-5(b)(1)(i)(B).

Request for Comment #32.

With respect to price overrides, my comments are reflected in the discussion above. With regard to reporting of price challenges, the Commission should not require such reporting. An adviser may challenge prices that are provided by a pricing service to better understand the inputs that are resulting in that price or to make sure that the pricing service is taking into account relevant information. Requiring price challenges to be reported could discourage advisers from making such challenges, while providing information that generally would be of limited value to the Board.

Request for Comment #34.

An investment adviser that assumes fair valuation responsibility is in a much stronger position to evaluate the operations of a pricing service and the accuracy of the prices provided than the board. Accordingly, no additional requirements regarding pricing services should be added and specific approval by the board of each pricing service that an adviser proposes to use should not be required. Rather, the adviser would presumably identify the pricing services it intends to use at the time the valuation responsibility is assigned by the board as part of its valuation procedures and possibly on an annual basis. The adviser would be responsible for all aspects of fair valuation, including the selection and monitoring of pricing services. The responsibility of the board with respect to the use of pricing services should be limited to reviewing and approving the adviser's process for selecting and monitoring of the pricing service, as well as overseeing the resulting valuations.

Prompt Board Reporting.

Proposed Rule 2a-5(b)(ii) would require prompt reporting to the adviser of matters associated with the valuation process that materially affect, or could have materially affected, the fair value of the assigned portfolio of investments. While prompt reporting of developments that actually materially affect the fair value of the portfolio is an appropriate part of the reporting requirements,[29] requiring such reporting for a matter that "could have materially affected" the fair value of the portfolio could pick up matters that are not problematic and that do not require immediate board attention. Take, for example, a matter that occurs, but is detected and remedied by the adviser before it affects the value of the fund's portfolio. While that matter, if material, should certainly be brought to the attention of the board as part of the next quarterly report, prompt review by the Board would not be necessary. Accordingly, the Commission should modify the prompt reporting requirement in the rule to limit it to matters that have had or will have a material impact on the fair value of the portfolio.

Request for Comment #36.

The trigger for prompt reporting is appropriately set in the proposed rule as the time at which the adviser becomes aware of the matter.

[29] Prompt board reporting of material developments could be included as a required element of fund valuation procedures under the principles-based approach discussed above.

Requests for Comment #39, #40 and #41.

The circumstances surrounding matters that require prompt reporting will vary greatly and may involve multiple parties. Before reporting to the Board, an adviser ideally would want to have a solid understanding of the facts in order to make a materiality determination and develop a plan to address the issue presented. Depending on the circumstances and the parties involved, this may take more than three days. While three days seems like a good time period for the report, it may not be possible to prepare a written report or to report all of the facts at that time. The rule should be amended to require that notice and an oral summary be given within three days, with a follow up written report as soon as practicable thereafter.

Request for Comment #42.

If the report is made to a committee of the board, the committee would ordinarily report to the entire board at the next regularly scheduled meeting of the board. While this is not a requirement of state corporate law, it is a common practice of corporate governance and may be reflected in a fund's by-laws. While the Commission could include this reporting as a requirement, I don't think it is necessary to put it into the rule.

Request for Comment #43.

The rule should permit a board to designate one of the independent directors to receive prompt reports. Such a provision would be particularly helpful in the case of small fund boards. The Commission could state in the Adopting Release that it assumes that this individual director would apprise the rest of the board of the report, as would be expected by a board that designates a director for this role.

Segregation of Portfolio Managers

As acknowledged in the Proposing Release, a fund's portfolio manager is frequently the person who is most knowledgeable about the fund's portfolio securities and the markets for those securities. However, as the Commission has pointed out, the portfolio manager of a fund has a substantial conflict of interest in that the manager's compensation and reputation are often tied to the performance of the fund. This conflict has, in some cases, led unscrupulous managers to use price overrides or agreements with broker-dealer personnel to manipulate the valuation of fund portfolio securities.[30] Accordingly, boards and advisers must strike a balance – establishing procedures and oversight to allow portfolio managers to participate in valuation decisions, while ensuring that a manager does not have an unrestrained ability to make or change valuations without proper review and concurrence.

[30] See *e.g* *In the Matter of Thomas M. Rogge*, Release IC-20908 (Feb 22, 1995)(Portfolio manager provided assumptions to a broker-dealer representative who used them to overvalue fund portfolio securities);. *In the Matter of Kyle R. Kirkland*, Release IC-25199 (Sept 28, 2001)(Principal of a broker-dealer and portfolio manager overvalued fund portfolio securities); *In the Matter of Morgan Keegan & Company, Inc., James C. Kelso and Joseph Thompson Weller*, Investment Company Act Rel. No. 29704 (June 22, 2011)(Portfolio manager influenced a broker-dealer to change pricing information and made unwarranted price adjustments on fund portfolio securities).

Some funds and advisers have sought to address this issue by (i) allowing portfolio managers to raise issues with prices reported by pricing services and recommend price challenges and price overrides and (ii) limiting the portfolio manager's authority to making recommendations and (iii) placing the final decision-making authority regarding all valuation issues in the hands of the valuation committee, which may be composed of compliance, legal, finance and operations personnel. While a portfolio manager may be a member of the valuation committee, he or she is not permitted to vote on any matters that affect the fund he or she manages. Such a procedure, combined with board reporting and review, can effectively prevent a portfolio manager from unlawfully manipulating the valuation of fund portfolio securities.

Notwithstanding the foregoing, the Commission should not address segregation of portfolio managers as a separate provision in the rule. While the topic is of critical importance, it falls within the rule's requirements regarding the Assessment and Management of Risks, which specifically includes conflicts of interest and is properly addressed in that context.

Defining "Readily Available Market Quotations.

Paragraph (c) of Proposed Rule 2a-5 would define the term "Readily Available Market Quotations" for purposes of section 2(a)(41) of the 1940 Act, stating 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, provided that a quotation will not be readily available if it is not reliable."*(emphasis supplied)*

The Status of Municipal Securities.

The proposed definition raises a question about whether municipal securities could continue to be treated as securities for which market quotations are readily available. Unlike equity securities, municipal bonds trade on a decentralized over-the-counter ("OTC") market, with investors placing their orders directly with dealers. Dealers execute an order by either committing dealer capital or by searching for a holder of the security to serve as a counterparty to the purchase order or for a party that is interested in acquiring the security in the case of a sell order, with the dealers charging a mark-up or a commission on their trade.[31] Moreover, due to a historically low default risk and the fact that almost half of outstanding municipal bonds are held by individuals, with another 20% or so held by mutual funds, municipal bonds tend to be "buy-and-hold" investments that trade infrequently.[32]

While many municipal bonds can be sold readily, the securities do not trade on a daily basis. Historically, funds have treated municipal bonds as having readily available market quotations

[31] See Wu, Simon Z. and Vieira, Marcelo, *Mark-Up Disclosure and Trading in the Municipal Bond Market*, Research Paper, Municipal Securities Rulemaking Board, (July 2019) at page 3.
[32] See Brancaccio,Giulia. Li, Dan and Schurhoff, Norman, *Learning by Trading: The Case of the U.S, Market for Municipal Bonds*, (Nov. 2017) at pp. 6-7, available at *https://economics.yale.edu/sites/default/files/brancaccio_jmp.pd*f

based on the availability of dealer bid and ask prices. However, given the reference in the proposed definition to "active markets," a question arises as to whether municipal bonds would be considered to fall within the proposed definition. The Commission should clarify that municipal bonds can fall within the definition and can continue to be deemed to be securities for which market quotations are readily available.

Effect on the Scope of Rule 17a-7.

The question of whether municipal securities would be considered to have "readily available market quotations" as that term is defined in the proposed rule also has serious implications for the ability of funds to rely on Rule 17a-7 under the Act to execute cross trades in municipal securities.

Rule 17a-7 exempts certain purchases and sales of securities ("cross trades") between registered funds that are affiliated persons of each other (or affiliated persons of such affiliated persons) from the prohibitions of Section 17(a) of the 1940 Act. The rule sets forth certain conditions that must be met in order to rely on the exemption, the first of which is that a transaction relying on the rule must be a purchase or sale "*of a security for which market quotations are readily available*".[33] The Commission has previously stated that the phrase "which market quotations are readily available" is intended to have the same meaning that ascribed to it under Section 2(a)(41) of the Act and Rule 2a-4 thereunder.[34] Accordingly, the determination of whether municipal securities can be deemed to have readily available market quotations under proposed rule 2a-5 may well determine whether municipal funds can continue to rely on Rule 17a-7 to effect cross trades in their portfolio securities.

Prior to 1981, Rule 17a-7 was available only for transactions in securities that had as their principal market either (i) a national securities exchange or (ii) the OTC market if the security was entered in an inter-dealer quotation system sponsored and governed by the rules of a national securities association registered under Section 15A of the Securities Exchange Act of 1934 (the "1934 Act). The Commission amended Rule 17a-7 in 1981 to make the exemption available to "any transaction in a security for which market quotations are readily available" as long as the transaction was effected at the current market price as defined in the rule and the other conditions of the rule were met.[35]

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[33] Rule 17a-7(a).

[34] *See* *Exemption of Certain Purchase or Sale Transactions Between a Registered Investment Company and Certain Affiliated Persons Thereof*, Investment Company Act Release IC-11136 (April 21, 1980)(proposing amendments to Rule 17a-7) at note 16.

[35] *See* *Exemption of Certain Purchase or Sale Transactions Between a Registered Investment Company and Certain Affiliated Persons Thereof*, Investment Company Act Release IC-11676 (March 10, 1981)(adopting amendments to 17a-7). The exemptive relief provided by Rule 17a-7 is also conditioned on (i) the transaction being consistent with the policy of each participating fund, (ii) no brokerage commission, fee (except for customary transfer fees), or other remuneration being paid in connection with the transaction, (iii) the fund board, including a majority of the independent directors, adopting procedures that are reasonably designed to provide for compliance with the rule and periodically reviewing such transactions, (iv) the fund's board satisfying the fund governance standards of rule 0-1(a)(7) under the 1940 Act and (v) certain recordkeeping requirements being satisfied.

Since the 1981 amendments, municipal funds have relied on the exemptive relief provided by Rule 17a-7 to effect cross trade securities between funds in the same fund family.[36] For example, a single state municipal bond fund that needs cash to pay redemptions may rely on the rule to sell portfolio securities to a national municipal bond fund managed by the same adviser that has cash to invest. To permit this practice to continue, the Commission should clarify that municipal bonds can fall within the definition of securities that have readily available market quotations.[37] To take the opposite position would make unlawful a longstanding common practice that has benefitted both buying and selling funds has not caused investors any harm.[38]

Reliance on Section 6(c) as Rulemaking Authority for Rule 2a-5.

The Proposal lists Section 6(c) of the 1940 Act as one source of authority for the proposal of Rule 2a-5. Section 6(c) provides the Commission with broad authority to exempt any person, security or transaction (or classes of persons, securities or transactions) from any provision of the Act to the extent that such exemption is necessary or appropriate in the public interest and is consistent with the protection of investors and the purposes fairly intended by the the policy and provisions of the Act.[39] Over the years, Commission has relied on Section 6(c) to adopt key exemptive rules under the Act, such as the recent rule regarding Exchange Traded Funds.[40] as well as to issue numerous exemptive orders upon application. The exemptive authority provided by the section has allowed the Commission to permit innovative business practices and investment products where appropriate, notwithstanding the broad prohibitions in the Act. However, the adoption of Rule 2a-5 does not require the Commission to exercise its exemptive authority under Section 6(c).

Proposed Rule 2a-5 does not purport to exempt any person, security or transaction from any provision of the Act. Nor does the Proposing Release discuss or propose any such exemption. Rather, the rule would prescribe requirements for determining fair value in good faith.

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[36] It should be noted that, when the Commission proposed the amendments to Rule 17a-7 to extend the rules coverage to all securities for which market quotations are readily available, municipal securities were specifically mentioned as an example of the securities that the amendments were intended to cover. See Release IC-11136, supra note 27, at note 16.

[37] Many funds rely on pricing services to provide prices to value their portfolios on a daily basis. Where the prices of municipal securities are based on dealer quotes, they would be considered to be market values and would be used to value the bonds. However, where the prices are "evaluated" prices, they would be considered as input into the fund's fair valuation process.

[38] Taking the opposite position also would arguably raise issues under the Administrative Procedure Act, in that it could be seen as effectively amending Rule 17a-7 without providing notice and an opportunity for public comment as required by the APA. See 5 U.S.C. Section 551.

[39] Section 6(c) reads:

> The Commission, by rules and regulations upon its own motion, or by order upon application, may conditionally or unconditionally exempt any person, security, or transaction, or any class or classes of persons, securities, or transactions, from any provision or provisions of this title or of any rule or regulation thereunder, 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 title.

[40] See Exchange-Traded Funds, Release Numbers 33-10695 and IC-33646 (Sept. 25, 2019)(adopting Rule 6c-11 under the 1940 Act and related disclosure amendments).

Accordingly, while the other sections cited as legal authority, Sections 31(a)&(c) and 38(a), provide the Commission with ample authority to propose and adopt Rule 2a-5, the rule is not an exemptive rule and Section 6(c) should not be cited as legal authority for the rule.

Again, I appreciate the opportunity to comment on the proposed rule. If you have any questions or wish to discuss my comments, please feel free to call me at 202.302.2522 or send me an email at jwmurph2009@gmail.com.

Sincerely,

Jack W. Murphy

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