Press Release

SEC Modernizes Framework for Fund Valuation Practices

FOR IMMEDIATE RELEASE
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Washington D.C., Dec. 3, 2020 — The Securities and Exchange Commission today announced that it voted to adopt a new rule that establishes an updated regulatory framework for fund valuation practices. The rule is designed to clarify how fund boards of directors can satisfy their valuation obligations in light of market developments, including an increase in the variety of asset classes held by funds and an increase in both the volume and type of data used in valuation determinations.

The Commission last addressed valuation practices under the Investment Company Act of 1940 in a comprehensive manner in a pair of releases over 50 years ago. Since then, markets and fund investment practices have evolved considerably. Many funds now engage third-party pricing services to provide pricing information, particularly for thinly traded or more complex assets. In addition, significant regulatory developments have altered how boards, investment advisers, independent auditors, and other market participants address valuation under the federal securities laws. The rule recognizes and reflects these changes, including the important role that funds' investment advisers may play and the expertise they may provide.

"Main Street investors increasingly access our capital markets through funds and rely on them to value their investments properly," said SEC Chairman Jay Clayton. "Today's rule is designed to improve funds' valuation practices, including by providing for effective board oversight, for the benefit and protection of fund investors."

The rule establishes requirements for satisfying a fund board's obligation to determine fair value in good faith for purposes of the Investment Company Act. The rule requires a board or its valuation designee to assess and manage material risks associated with fair value determinations; select, apply and test fair value methodologies; and oversee and evaluate any pricing services used.

The rule recognizes that most fund boards do not play a day-to-day role in the pricing of fund investments, and so permits boards to designate the determination of fair value to certain parties. This designation will be subject to detailed conditions and oversight requirements, including specific reporting by the valuation designee both periodically and promptly; and clear specification of responsibilities and reasonable segregation of duties among the valuation designee's personnel. The rule makes clear that a board's effective oversight of this process must be active. In addition, certain policies and procedures must be adopted and implemented in connection with the rule. Finally, the Commission adopted a related recordkeeping rule requiring funds or their advisers to maintain certain documents related to fair value determinations.

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FACT SHEET

Good Faith Determinations of Fair Value Under the Investment Company Act of 1940

Highlights

The Commission voted to adopt a new rule providing a framework for fund valuation practices. New rule 2a-5 under the Investment Company Act of 1940 (the "Act") establishes requirements for determining fair value in good faith for purposes of the Act. The rule will permit boards, subject to board oversight and certain other

conditions, to designate certain parties to perform the fair value determinations. The rule also defines when market quotations are “readily available” for purposes of the Act, the threshold for determining whether a fund must fair value a security. The Commission also adopted new rule 31a-4, which provides the recordkeeping requirements associated with fair value determinations. Finally, the Commission is rescinding previously issued guidance on related issues, including the role of the board of directors in determining fair value and the accounting and auditing of fund investments.

Fair Value As Determined in Good Faith

New rule 2a-5 will require the performance of certain functions in order to determine in good faith the fair value of a fund’s investments. These functions include periodically assessing and managing material risks associated with fair value determinations, selecting, applying and testing fair value methodologies, and overseeing and evaluating any pricing services used.

Performance of Fair Value Determinations

Under the Act, securities and assets without readily available market quotations are valued at fair value as determined in good faith by a fund’s board of directors. The rule confirms that a board can make this determination itself. The rule also permits a board to assign the determination to a “valuation designee,” subject to additional conditions and oversight requirements. The valuation designee may be the fund’s investment adviser or, if the fund is internally managed, an officer of the fund. If the board designates the determination of fair value to a valuation designee, certain additional requirements apply, including:

- Board oversight of the valuation designee;
- Periodic and prompt reporting to the board; and
- Clear specification of the titles and functions of the persons responsible for fair value determinations, and reasonable segregation of duties among the designee’s personnel.

In addition, because a unit investment trust (“UIT”) does not have a board or investment adviser, the rule requires a UIT’s trustee or depositor to determine fair value in good faith.

Recordkeeping

In connection with the adoption of new rule 2a-5, the Commission also adopted new rule 31a-4 under the Act. This rule will require funds or their advisers to maintain appropriate documentation to support fair value determinations and, where applicable, documentation related to the designation of the valuation designee.

Readily Available Market Quotations

Under the Act, fund investments must be fair valued where market quotations are not “readily available.” The new rule provides 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.

Rescission of Prior Commission Releases and Review of Relevant Staff Guidance

In view of the new rule’s modernized framework for fund valuation, the Commission will rescind two releases, Accounting Series Release 113 (ASR 113) and Accounting Series Release 118 (ASR 118), which provide Commission guidance on, among other things, how to determine fair value for restricted securities. In addition, certain additional Commission guidance, staff letters and other staff guidance addressing a board’s determination of fair value and other matters will be withdrawn or rescinded.

What’s Next?

Rules 2a-5 and 31a-4 will become effective 60 days after publication in the Federal Register, and will have a compliance date 18 months following the effective date to provide sufficient time for funds and valuation designees to prepare to come into compliance with the rules. A fund may voluntarily comply with the rules after the effective date, and in advance of the compliance date, under certain conditions.

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Related Materials

- Final Rule