Public Statement

Statement on Good Faith Determinations of Fair Value under the Investment Company Act of 1940 Final Rule

Commissioner Hester M. Peirce

Dec. 3, 2020

Let me begin by thanking the hardworking men and women of the Divisions of Investment Management and Economic and Risk Analysis, the Offices of the Chief Accountant, and General Counsel, and others at the Commission for their commitment to completing this difficult, long-overdue rulemaking. Fair valuation is one of many duties of modern mutual fund boards, It is one of the few duties specifically mentioned in the Investment Company Act and it is, without question, one of the board's more important responsibilities. Realistically, however, fair valuation is a big job, and the board needs the assistance of others in carrying it out. The rule we are adopting today gives boards a clear path for getting the help they need to perform their statutory duty. Although today's rule is a much-needed step forward, a non-exclusive safe harbor or a rule that gave boards more discretion would have been even better.

Thanks to the input of commenters, the rule we are adopting today is better than what we proposed. For example, the proposed recordkeeping obligations are now in a separate rule, 31a-4, which the Commission is also voting on today. Moving the recordkeeping obligations into a separate rule centralizes investment company recordkeeping requirements and removes the very real possibility under the proposal that a records-related transgression could lead to a board being found to have failed in its statutory fair valuation duties.

In response to commenters, the final rule also provides a bit of flexibility on a number of other issues. For instance, in a welcome improvement from the proposal, a valuation designee now will have 20 days to determine whether a matter is material and five days to report material matters to the board. Another positive change was the removal of the proposed mandatory quarterly assessments of the entire fair value process that valuation designees were to send to fund boards. The final rule instead requires valuation designees to submit reports containing board-requested information and information about material events that occurred during the previous quarter.

An even less prescriptive rule would have better showcased directors' judgment. Most fund boards take their valuation responsibilities with the utmost seriousness, a fact the adopting release acknowledges. By prescribing in detail how a fund board must meet its statutory obligation, we deprive them of the opportunity to tailor their approach to ensure that they get information that is useful to them in a timely manner. We heard as much from fund directors. The Mutual Fund Directors Forum warned, for instance, that "boards have significant expertise in structuring and engaging in the oversight process [and] [d]efining that process overly specifically by regulation is unlikely to improve the fair valuation of portfolio securities and risks reducing the effectiveness of board oversight."[1] The natural remedy for a non-responsive service provider is dismissal and replacement, not a potential Commission enforcement action. This possibility of fund boards being charged with violating

rule 2a-5 for transgressions that do not affect the actual valuation of fund assets fuels my opposition to the final rule's unnecessary level of prescription.

Along with many commenters, I see the value in allowing fund boards the freedom to tailor their valuation assessment processes to their funds' individual needs and circumstances by redrawing the provisions of rule 2a-5 as a non-exclusive safe harbor. Many, perhaps even *most*, fund boards would choose the procedural path that rule 2a-5 has laid out for them and would forgo the option to chart their own course, but boards that think they have a better way to conduct valuation should have the right to try. The prescriptive nature of the rulemaking could stifle fund boards' and advisers' initiative and innovation. We should be creating opportunities for fund boards to find better ways to do their jobs and serve fund interests, not box them in and limit their ability to adapt and grow. Once the rule is in place, I hope that the Commission will find ways to foster fund boards' efforts to think creatively in how they meet their obligations.

The decision not to craft the rule as a non-exclusive safe harbor should not be read to mean that the purpose of this rule is to trip people up on technicalities; its objective is to ensure that funds' assets are properly valued, not to create a basis for enforcement actions rooted in inconsequential departures from the rule's requirements.[2]

Again, my thanks go to the agency's staff who worked so hard on this proposal: Dalia Blass, Paul Cellupica, Sarah ten Siethoff, David Bartels, Alison Staloch, Joel Cavanaugh, Bradley Gude, Thoreau A. Bartmann, Brian McLaughlin Johnson, Kieran G. Brown, David J. Marcinkus, Zeena Abdul-Rahman, Jenson Wayne, Alexis Cunningham, Jeffrey Nick and Natalie Martin. I also want to thank commenters for the insights and wisdom they shared. The rule is better for their participation.

---

[1] Letter from the Mutual Fund Directors Forum, https://www.sec.gov/comments/s7-07-20/s70720-7455230-221037.pdf, at 2.

[2] The release contains the following statement: "While a board or adviser's failure to comply with the final rule's requirements may call into question the effectiveness of the fund's fair value process and its compliance program, the Commission underscores that the objective of the final rule is to ensure that a fund's assets are properly valued." Adopting Release following footnote 31.