

Via Email

July 20, 2020

Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

Re: File No. S7-07-20

Dear Madam Secretary:

I am writing on behalf of the Council of Institutional Investors (CII), a nonprofit, nonpartisan association of U.S. public, corporate and union employee benefit funds, other employee benefit plans, state and local entities charged with investing public assets, and foundations and endowments with combined assets under management of approximately \$4 trillion. Our member funds include major long-term shareowners with a duty to protect the retirement savings of millions of workers and their families, including public pension funds with more than 15 million participants – true “Main Street” investors through their pension funds. Our associate members include non-U.S. asset owners with about \$4 trillion in assets, and a range of asset managers with more than \$35 trillion in assets under management.¹

The purpose of this letter is to provide you with our perspectives on the Securities and Exchange Commission (Commission) proposed “new rule . . . under the Investment Company Act of 1940 [(Act)] . . . that would address valuation practices and the role of the board of directors with respect to the fair value of the investments of a registered investment company or business development company” (Proposed Rule).² CII has long recognized that measuring financial instruments at fair value provides more useful information to investors than alternative available measurement approaches³ and is pleased to offer its comments on select provisions of the Proposed Rule of interest to many of our members.

¹ For more information about the Council of Institutional Investors (“CII”), including its board and members, please visit CII’s website at <http://www.cii.org>.

² Good Faith Determination of Fair Value, Investment Company Act Release No. 33,845, 85 Fed. Reg. 28,734, 28,734 (proposed May 13, 2020), <https://www.federalregister.gov/documents/2020/05/13/2020-08854/good-faith-determinations-of-fair-value>.

³ See, e.g., Stephen G. Ryan, Fair Value Accounting: Understanding the Issues Raised by the Credit Crunch, CII 1 (July 2008), https://www.cii.org/files/publications/white_papers/07_11_08_fair_value_accounting.pdf (“The more relevant question is whether fair value accounting provides more useful information to investors than alternative accounting approaches [and] [t]he answer to that question is ‘yes.’”).

Fair Value as Determined in Good Faith Under Section 2(a)(41)⁴ of the Act⁵

Pricing Services⁶

We generally support the provisions of the Proposed Rule that “would provide that determining fair value in good faith requires the oversight and evaluation of pricing services, where used.”⁷ We agree with the Commission that those provisions should “help ensure that pricing information received from pricing services serves as a reliable input for determining fair value in good faith.”⁸

We note that the experience “from the 2008 financial crisis shows that vendor assurances as to the quality of their pricing information may provide false comfort.”⁹ As a result, we would support further strengthening the provisions of the Proposed Rule to “include a specific requirement in the rule to periodically review the selection of the pricing services used and to evaluate other pricing services.”¹⁰

Recordkeeping¹¹

We generally support the provisions of the Proposed Rule “that would require that the fund maintain certain records.”¹² We agree with the Commission “that it is appropriate for the proposed rule to include a recordkeeping provision to facilitate compliance with the proposed rule and to permit effective regulatory oversight.”¹³

We would support revising the recordkeeping provisions of the Proposed Rule to require the board to maintain the records even when the board assigns fair value determinations to an adviser.¹⁴ We believe this revision is consistent with the Commission’s overall objective of implementing the recordkeeping “requirements effectively which, in turn, are designed to protect

⁴ Definitions; applicability; rulemaking considerations, 42 U.S.C. § 80a–2(a)(41) (Aug. 22, 1940), *available at* <https://www.law.cornell.edu/uscode/text/15/80a-2> (“‘Value’, with respect to assets of registered investment companies . . . means (A) . . . (i) with respect to securities owned at the end of the last preceding fiscal quarter for which market quotations are readily available, the market value at the end of such quarter; (ii) with respect to other securities and assets owned at the end of the last preceding fiscal quarter, fair value at the end of such quarter, as determined in good faith by the board of directors; . . . and (B) . . . (i) with respect to securities for which market quotations are readily available, the market value of such securities; and (ii) with respect to other securities and assets, fair value as determined in good faith by the board of directors; in each case as of such time or times as determined pursuant to this subchapter, and the rules and regulations issued by the Commission hereunder.”).

⁵ *See* 85 Fed. Reg. at 28,738-42.

⁶ *Id.* at 28,740-41.

⁷ *Id.* at 28,740.

⁸ *Id.*

⁹ Stradley Ronon, Insights & News, SEC Proposed New Rule for Good Faith Determination of Fair Value (May 14, 2020), <https://www.stradley.com/insights/publications/2020/05/client-alert-im-may-14-2020>.

¹⁰ 85 Fed. Reg. at 28,740.

¹¹ *See id.* at 28,741-72.

¹² *Id.* at 28,741.

¹³ *Id.*

¹⁴ *Id.* at 28,742 (“15. Where the board assigns fair value determinations to an adviser under proposed rule 2a–5(b), should the rule require the adviser, rather than the fund to maintain these records?”).

investors from improper valuations [and] . . . facilitate the board’s oversight of these functions when they are assigned to an adviser of the fund.”¹⁵

Performance of Fair Value Determinations¹⁶

Board Oversight¹⁷

We generally support the provisions of the Proposed Rule that “would permit boards to assign fair value determinations to an investment adviser, which would carry out all of the functions required under the proposed rule”¹⁸ We agree with the Commission that:

Permitting a fund’s board to assign fair value determinations to the adviser would allow the board to focus its time and attention on other matters related to the fund, such as the oversight of the investment adviser. This could lead to a more efficient use of boards’ resources and therefore improve funds’ governance for the benefit of fund investors.¹⁹

We also agree with the Commission “that, consistent with their obligations under the Act and as fiduciaries, boards [oversight of advisers] should seek to identify potential conflicts of interest, monitor such conflicts, and take reasonable steps to manage such conflicts.”²⁰ And in “doing so, the board should serve as a meaningful check on conflicts of interest of the adviser and other service providers involved in the determination of fair values.”²¹

Board Reporting²²

We generally support the provisions of the Proposed Rule that “would require the adviser, at least quarterly, to provide the board a written assessment of the adequacy and effectiveness of the adviser’s process for determining the fair value of the assigned portfolio of investments.”²³ For the reasons described previously, we are particularly supportive that those periodic reports would be required to include “a summary or description of . . . [a]ny material changes to the adviser’s process for overseeing the pricing services, as well as any material events related to its oversight of such services, such as changes of service providers used or price overrides.”²⁴ We would also

¹⁵ *Id.* at 28,766.

¹⁶ *See id.* at 28,742-48

¹⁷ *Id.* at 28,743-44.

¹⁸ *Id.* at 28,751.

¹⁹ *Id.*; *cf.* Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors to Ms. Ann E. Misback, Secretary, Board of Governors of the Federal Reserve System 1 (Nov. 16, 2017), [https://www.cii.org/files/November%2016%202017%20FRS%20Letter%20\(final\).pdf](https://www.cii.org/files/November%2016%202017%20FRS%20Letter%20(final).pdf) (“We agree that boards spending too much time satisfying supervisory expectations not directly related to the board’s core responsibilities can damage board effectiveness, and that financial institution boards at present can be overwhelmed by the quantity and complexity of information they receive.”).

²⁰ 85 Fed. Reg. at 28,743.

²¹ *Id.*

²² *See id.* at 28,744-47.

²³ *Id.* at 28,745.

²⁴ *Id.*

support a revision of those provisions to include an attestation or assessment of the advisers' independence.²⁵

Rescission of Prior Commission Releases²⁶

We generally support the provisions of the Proposed Rule to “rescind [Accounting Series Release (ASR)] ASR 113^[27] and ASR 118^[28] in their entirety.” We agree that rescinding the accounting and auditing guidance in ASR 118 and 113 and moving fully to Financial Accounting Standards Board guidance for accounting and Public Company Accounting Oversight Board guidance for auditing would likely simplify the valuation requirements and facilitate compliance without compromising the quality of the valuations.²⁹

We note that the Proposed Rule “does not address the views the Commission has expressed related to the use of amortized cost in valuing portfolio securities with maturity dates of 60 days or less.”³⁰ The Proposed Rule explains that such guidance does not need to be rescinded “because the Commission recently considered this topic in the 2014 Money Market Fund Release^[31], and we do not believe that further guidance in this area is required at this time.”³² On this issue, we respectfully disagree.

²⁵ Cf. Council of Institutional Investors, Corporate Governance Policies § 5.2b Independent Consultants and Advisors to the Compensation Committee, [https://www.cii.org/files/03_10_20_corp_gov_policies\(1\).pdf](https://www.cii.org/files/03_10_20_corp_gov_policies(1).pdf) (“The committee should annually disclose an assessment of its advisors’ independence . . .”).

²⁶ 85 Fed. Reg. at 28,749-50.

²⁷ Statement Regarding “Restricted Securities,” Accounting Series Release No. 113 (Oct. 21, 1969), <https://www.sec.gov/rules/interp/1969/ic-5847.pdf>.

²⁸ Accounting for Investment Securities by Registered Investment Companies, Accounting Series Release No. 118 (Dec. 23, 1970), <https://www.sec.gov/rules/interp/1970/ic-6295.pdf>.

²⁹ See Letter from Susan Olson, General Counsel, Investment Company Institute, to Ms. Vanessa A. Countryman, Secretary, Securities and Exchange Commission 2 (July 16, 2020), <https://www.sec.gov/comments/s7-07-20/s70720-7433367-220249.pdf> (“proposal will facilitate fund compliance by replacing decades of guidance appearing in Commission releases, staff letters, and accounting series releases with: . . . the valuation framework established by the Financial Accounting Standards Board”); KPMG, SEC proposes modernized fund valuation framework 5 (2020), <https://advisory.kpmg.us/content/dam/advisory/en/pdfs/2020/sec-proposes-modernized-fund-valuation-framework.pdf> (“By rescinding this guidance for accounting and PCAOB guidance for auditing, they have simplified the requirements”); 85 Fed. Reg. at 28,758 (“the proposed rule and the rescission of existing no-action letters and guidance would increase certainty because funds would follow a single rule rather than following various no-action letters and guidance when determining fair values, which could ultimately reduce compliance costs [and] [l]ower costs of compliance for funds ultimately could benefit fund investors to the extent that any cost savings would be passed down to them in the form of lower fund operating expenses”).

³⁰ 85 Fed. Reg. at 28,750.

³¹ Money Market Fund Reform; Amendments to Form PF, Securities Act Release No. 9,616, Investment Company Act Release No. 31,166, Investor Adviser Act Release No. 3,879, 79 Fed. Reg. 47,736 (July 23, 2014), <https://www.federalregister.gov/documents/2014/08/14/2014-17747/money-market-fund-reform-amendments-to-form-pf>.

³² 85 Fed. Reg. at 28,750.

As previously indicated, we believe fair value provides more useful information to investors than other alternative measurement approaches, including the amortized cost method.³³ Per review of the 2014 Money Market Fund Release, it is unclear to us why the guidance contained therein providing for the use of the amortized cost method for certain securities under certain circumstances should be retained.³⁴ We, therefore, would support a revision to the provisions of Proposed Rule to require fair value for those securities.

Thank you for considering our views on this matter. Please contact me with any questions.

Sincerely,

A handwritten signature in cursive script that reads "Jeff Mahoney".

Jeffrey P. Mahoney
General Counsel

³³ See, e.g., Stephen G. Ryan, Fair Value Accounting: Understanding the Issues Raised by the Credit Crunch, CII at 4-6 (describing “issues [with the amortized cost method], all of which arise from its use of untimely historical information about future cash flows and risk-adjusted discount rates”).

³⁴ 79 Fed. Reg. at 47,812 (“We generally believe that a fund may only use the amortized cost method to value a portfolio security with a remaining maturity of 60 days or less when it can reasonably conclude, at each time it makes a valuation determination, that the amortized cost value of the portfolio security is approximately the same as the fair value of the security as determined without the use of amortized cost valuation.”).