IDC Independent Directors Council
Promoting Excellence in Fund Governance

ICI: SEC’s Fair Value Proposal Improves and Modernizes Current Regulatory Framework

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Modifications Needed to Reflect Funds’ Practices

Washington, DC; July 16, 2020—The proposed fair value rule from the Securities and Exchange Commission (SEC) replaces a patchwork of guidance and appropriately acknowledges the importance of accounting standards to funds’ valuation process. It also rightly recognizes the complementary and essential roles that investment advisers and fund boards play in valuing securities, said the Investment Company Institute (ICI) in a comment letter filed today.

“Valuation is a data-intensive daily function that is critically important to determine the price of fund shares,” said ICI General Counsel Susan Olson. “This time-sensitive process requires fund advisers to coordinate with third-party service providers, including pricing services, subject to board oversight. We commend the Commission for seeking to improve and modernize the regulatory framework for funds fair valuing fixed-income and other portfolio securities. We also support the SEC rescinding existing valuation guidance and relying instead on accounting standards that are more comprehensive and better suited to the current valuation process.”

The Investment Company Act of 1940 (’40 Act) requires fund boards to determine in good faith the fair value of securities that do not have readily available market quotations. But fund practices and the complexity of valuation work have evolved, with directors overseeing and relying on investment advisers to carry out this function. ICI praises the SEC for acknowledging that the board is best suited to oversee the valuation process, while the investment adviser often is best suited to execute fair value responsibilities (pages 2, 6–7). The letter explains, however, that some of the proposal’s requirements need to more accurately reflect funds’ current practices.

No Single Methodology for Fair Valuation

Different assets pose distinct fair valuation risks and challenges, which require different practices. For example, the fair value practices for investment grade bonds substantially differ from those for private equity investments. ICI explains that though the current accounting standards for fair value take this into account, the SEC's proposal does not. The letter recommends that any final rule recognize that there is not a single methodology or process for determining fair value and that some of the proposed requirements should be modified accordingly (pages 3, 7–8, 16–17).

ICI's letter also notes that the proposal does not fully appreciate the role that pricing services play in valuing securities, which often includes establishing and applying methodologies to price fixed-income securities, under the adviser's continued oversight. ICI recommends that the final rule should explicitly allow both fund advisers and pricing services to establish and apply fair value methodologies (pages 3, 8–9).

Modify Onerous Recordkeeping Obligations

The SEC's proposal would require funds to keep detailed records documenting how they determine fair value for each security every day. ICI explains that this measure would be burdensome and costly—costs that the fund would not incur if not for the SEC's rule. To reduce these potential costs and burdens, ICI recommends requiring funds to keep detailed records only in instances where the fund establishes and applies its own fair value methodologies (pages 3, 8–9).

Tailor Board Reporting Requirements to Account for Directors and Funds' Different Needs

The SEC's proposal would require advisers to follow a detailed reporting regime that includes submitting written quarterly and "prompt" reports to fund boards. ICI explains why some of these proposed reporting requirements could, among other things, be inefficient and unnecessary. To enable boards to focus on relevant valuation issues and account for directors' and funds' different needs, ICI recommends that the adviser submit annual and quarterly reports on the valuation process, and any other reports upon the board's request (pages 10–12).

Additional Recommendations

ICI also gives other suggestions and improvements to the SEC's proposal, including:

- Recasting the rule as a safe harbor to better align with the '40 Act's good faith standard and accommodate funds' diverse and evolving fair value practices (pages 13–15)
- Enabling entities other than investment advisers to assume fair valuation responsibilities to more accurately reflect current practices (pages 15–16)
- Rationalizing price challenge requirements to better capture the price challenge process (pages 18–19)
- Extending the compliance period to 18 months to give funds and their service providers ample time to incorporate the rule's requirements into the valuation process (page 22)