

SEC Adopts New Rule for Good Faith Determination of Fair Value

On December 3, 2020, the Securities and Exchange Commission (SEC) adopted new rule 2a-5 (Rule 2a-5 or the Final Rule) under the Investment Company Act of 1940, as amended (1940 Act) that provides the requirements for determining the fair value of a fund's investments in good faith for purposes of section 2(a)(41) of the 1940 Act.¹ According to the SEC, the Final Rule is intended to provide a consistent framework and standard of baseline practices for fair value determinations, and applies to all registered investment companies and business development companies (BDCs). Although the key components of the Final Rule are similar to the proposed version published in April 2020 (the Proposed Rule), the SEC made a variety of changes to the Final Rule in response to public comments. The Final Rule will become effective March 8, 2021. The compliance date for the rule will be September 8, 2022.

This Alert will summarize the SEC's Final Rule and will conclude by highlighting certain important issues for fund boards and fund advisers to consider. The Alert also includes Exhibit A, which highlights a variety of key public comments that were made on the Proposed Rule, and how the Final Rule addresses those comments. Exhibit B is a marked version of the Final Rule that shows the changes that were made to the rule text between the Proposed Rule and Final Rule.

I. Background

- A. Valuation and Section 2(a)(41).** Proper valuation is important for many reasons, including because it is the primary determinant of a fund's net asset value which many funds use to determine the price at which shares are offered, redeemed or repurchased. Valuation also impacts the accuracy of asset-based and performance-based fee calculations; disclosures of fund fees, performance, and portfolio holdings; compliance with investment policies and limitations; and accounting and financial reporting obligations.

Section 2(a)(41) of the 1940 Act defines "value" as the market value of a fund's portfolio securities when market quotations for those securities are readily available, and, when market quotations are not readily available, the fair value of the security or asset, as determined in good faith by the fund's board of directors.

- B. Past Significant Regulatory Developments.** The SEC last comprehensively addressed valuation, including the role of the board in determining fair value, in two releases in 1969 and 1970: Accounting Series Release 113 (ASR 113) and Accounting Series Release 118 (ASR 118). In the Adopting Release, the SEC acknowledged that since the issuance of these two releases, markets and fund investment practices have evolved significantly.

The Proposing Release also described three significant regulatory developments since 1970 that have changed the way boards, advisers, auditors and other market participants approach valuation. These regulatory developments are:

¹ [Good Faith Determinations of Fair Value](#), Release No. IC-34128 (Dec. 3, 2020) (Adopting Release).

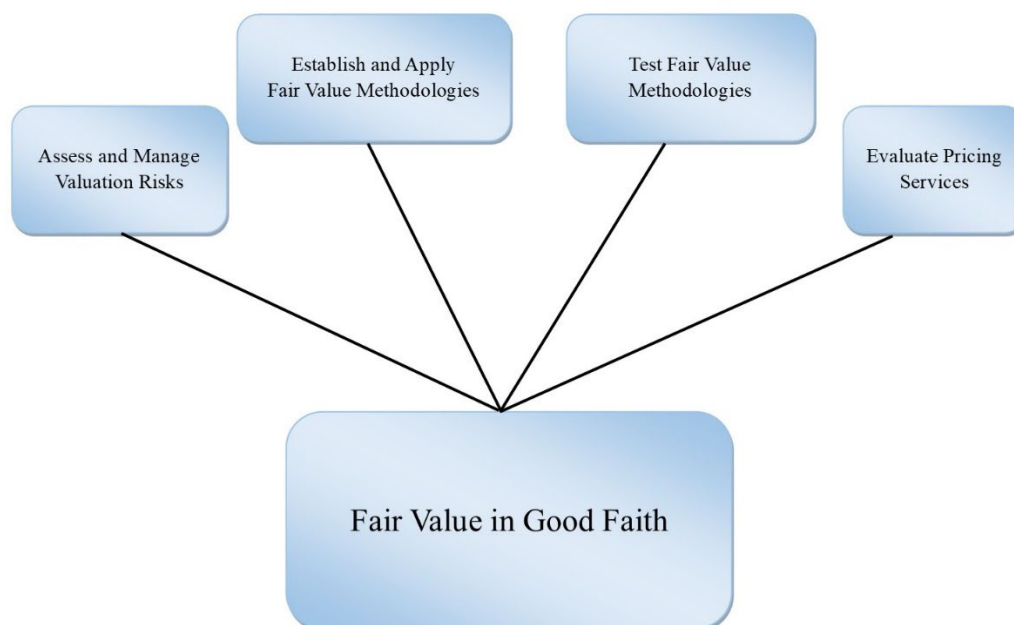
1. the *Sarbanes-Oxley Act of 2002* (Sarbanes-Oxley Act), which established the Public Company Accounting Oversight Board (PCAOB);
2. the *compliance rules* under the 1940 Act and the Investment Advisers Act of 1940, in particular rule 38a-1 (Rule 38a-1) under the 1940 Act, which requires funds to adopt compliance policies and procedures, including with respect to fair valuation determinations; and
3. the Financial Accounting Standards Board’s *ASC Topic 820: Fair Value Measurement* (ASC Topic 820), which defines the term “fair value” for purposes of accounting standards.

II. The Final Rule

The Final Rule has two main parts. Paragraph (a) establishes requirements for the determination of fair value in good faith. Paragraph (b) permits fund boards to designate the determination of fair value to a “valuation designee,” subject to certain conditions and oversight. The remaining portions of the Final Rule mainly provide definitions.

A. Fair Value Determinations. The Final Rule provides four requirements for determining fair value in good faith with respect to a fund’s investments. These requirements are summarized below and in Diagram 1.

Diagram 1: Good Faith Fair Valuation Determination



1. Assess and Manage Valuation Risks. The Final Rule requires periodically assessing any material risks associated with the determination of the fair value of the fund’s investments, including material conflicts of interest, and managing those identified risks. The Adopting Release also provides the following non-exhaustive list of examples of valuation risks to help inform the process of assessing and managing valuation risks:

- the types of investments held or intended to be held by the fund and the characteristics of those investments;

- potential market or sector shocks or dislocations and other types of disruptions that may affect a valuation designee's or a third-party's ability to operate;
- the extent to which each fair value methodology uses unobservable inputs, particularly if such inputs are provided by the valuation designee;
- the proportion of the fund's investments that are fair valued as determined in good faith, and their contribution to the fund's returns;
- reliance on service providers that have more limited expertise in relevant asset classes, the use of fair value methodologies that rely on inputs from third-party service providers, and the extent to which third-party service providers rely on their own service providers (so-called "fourth-party" risks); and
- the risk that the methods for determining and calculating fair value are inappropriate or that such methods are not being applied consistently or correctly.

The Adopting Release does not mandate how frequently risks need to be assessed; rather it provides that the frequency of re-assessment depends on the particular fund and its risks, and generally should take into account changes in fund investments, significant changes in a fund's investment strategy or policies, market events, and other relevant factors.

2. Establish and Apply Fair Value Methodologies. The Final Rule requires establishing and applying fair value methodologies, which must entail:

- selecting and applying appropriate fair value methodologies, including specifying the key inputs and assumptions specific to each class or portfolio holding;
- periodically reviewing the appropriateness and accuracy of the methodologies selected and making any necessary changes or adjustments; and
- monitoring for circumstances that may necessitate the use of fair value.

Importantly, in the Adopting Release the SEC explained it continues to believe that there is no single methodology for determining the fair value of an investment because fair value depends on the facts and circumstances of each investment, including the relevant market and market participants, and that for any particular investment, there may be a range of appropriate values that could reasonably be considered to be fair value.

3. Testing of Fair Value Methodologies. The Final Rule requires testing the appropriateness and accuracy of the fair value methodologies, including identifying the testing methods to be utilized and the minimum frequency with which such testing methods are to be used. The Adopting Release, consistent with the Proposed Rule, provides that Rule 2a-5 does not require particular testing methods to be used or a minimum frequency for testing, explaining that these matters depend on the circumstances of each fund.

4. Pricing Services. Consistent with the Proposed Rule, the Final Rule requires oversight of pricing services when used, including establishing a process for the approval, monitoring and evaluation of each pricing service provider. The Adopting Release provides a list of factors that should, in general, be considered *before* deciding to use a pricing service, such as the:

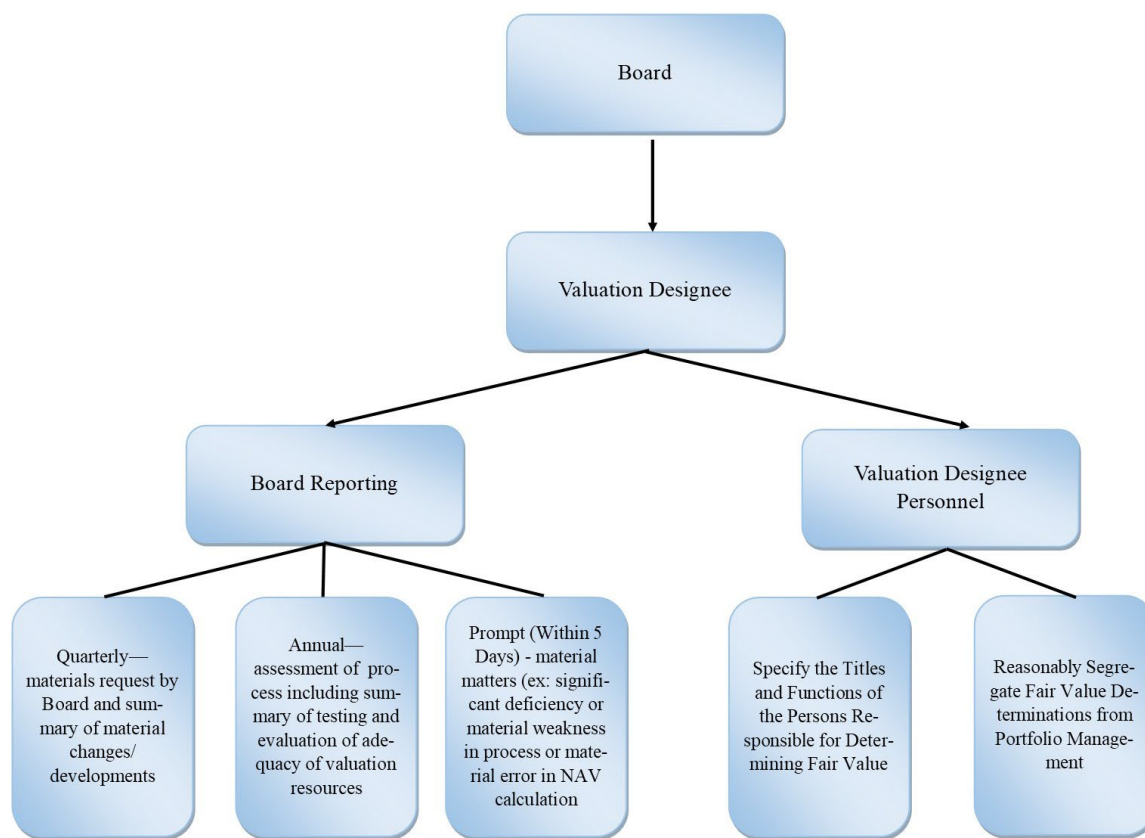
- qualifications, experience and history of the pricing service;
- valuation methods or techniques, inputs and assumptions used by the pricing service for different classes of holdings, and how they are affected (if at all) as market conditions change;
- quality of the pricing information provided by the service and the extent to which the service determines its pricing information as close as possible to the time as of which the fund calculates its net asset value;

- pricing service’s process for considering price “challenges,” including how the pricing service incorporates information received from pricing challenges into its pricing information;
- pricing service’s actual and potential conflicts of interest and the steps the pricing service takes to mitigate such conflicts; and
- testing processes used by the pricing service.

Additionally, in a departure from the Proposed Rule, the Final Rule requires the establishment of a *process*, rather than *criteria*, for the circumstances under which price challenges would be initiated. The SEC explained in the Adopting Release that there can be a range of circumstances under which a price challenge may be warranted, some of which cannot be distilled into specific criteria in advance.

B. Performance of Fair Value Determinations. A fund board may choose to determine fair value in good faith for some or all of a fund’s investments by carrying out the functions described in Section II.A above. Alternatively, a board may designate such determinations to a “valuation designee.” As proposed, the valuation designee may be a fund’s adviser. In a change from the Proposed Rule, an officer of the fund may be designated if the fund is internally managed. In another departure from the Proposed Rule, the Final Rule does not permit boards to designate the fair value determinations to a fund’s sub-adviser. Although comments on the proposal recommended that boards be permitted to designate to other parties, including pricing services, the SEC declined to provide this expansion. The SEC did provide guidance about how the board and the designee could obtain assistance from others in fulfilling their duties under the Final Rule. Designations to valuation designees are subject to oversight and other requirements described further below and in Diagram 2. Regardless of its approach, a board will have significant oversight responsibility under the Final Rule.

Diagram 2: Requirements for Effective Designation from Board to Valuation Designee



1. **Board Oversight.** The Final Rule, consistent with the Proposed Rule, requires boards to oversee the valuation designee. The Adopting Release emphasizes that boards should approach a valuation designee's fair value determinations with a skeptical and objective view that takes the fund's particular valuation risks into consideration. The Adopting Release states that oversight cannot be a passive activity. Instead, the board should view oversight as an iterative process in which they ask questions and seek relevant information, request follow-up information when appropriate, and take reasonable steps to see that matters identified are addressed. In particular, the Adopting Release recommends the board should, among other things:
 - seek to identify potential conflicts of interest, monitor such conflicts, and take reasonable steps to manage such conflicts (e.g., those of the valuation designee and other service providers);
 - periodically review the financial resources, technology, staff and expertise of the valuation designee, and the reasonableness of the valuation designee's reliance on other fund service providers, relating to valuation;
 - consider the valuation designee's compliance capabilities that support the fund's fair value processes, and the oversight and financial resources made available for the fair value process;
 - consider the type, content and frequency of the reports the board receives. While a board can reasonably rely on the information provided, it is incumbent on the board to request and review such information as may be necessary to be fully informed of the valuation designee's process for determining fair value of fund investments; and
 - inquire about material matters it becomes aware of and take reasonable steps to see that they are addressed.

2. **Board Reporting.** In the event the board assigns fair value determinations to a valuation designee, the Final Rule requires the valuation designee to provide periodic and, in certain circumstances, prompt reports to the board regarding its performance of that responsibility. These reports must provide such information as may be reasonably necessary for the board to evaluate the matters covered in the report. They can take various forms, such as narrative summaries, graphical representations, statistical analyses, dashboards, or exceptions-based reporting. Based on comments, the SEC made changes to the reporting requirements that are intended to enhance flexibility of the reporting.
 - **Quarterly Reporting:** The valuation designee must provide to the board, at least quarterly, a written report of materials requested by the board related to the fair value of designated investments or the valuation designee's process for fair valuing fund investments. Additionally, the report must include a summary or description of material fair value matters that occurred in the prior quarter. This summary must include:
 - any material changes in the assessment and management of valuation risks, including any material changes in conflicts of interest of the valuation designee (and any other service provider);
 - any material changes to, or deviations from, the fair value methodologies; and
 - any material changes to the valuation designee's process for selecting and overseeing pricing services, as well as any material events related to the valuation designee's oversight of pricing services.
 - **Annual Reporting:** The valuation designee must provide to the board, at least annually, a written report assessing the adequacy and effectiveness of the valuation designee's process for determining the fair value of the designated portfolio of investments. This report must include, at minimum:

- a summary of the results of the testing of fair value methodologies; and
- an assessment of the adequacy of resources allocated to the process for determining the fair value of designated investments, including any material changes to the roles or functions of the persons responsible for determining fair value.
- **Prompt Reporting:** The Final Rule also requires the valuation designee to provide a written notification to the board on “the occurrence of matters that materially affect the fair value of the designated portfolio of investments.” Material matters for these purposes include, for example, a significant deficiency or a material weakness in the design or effectiveness of the valuation designee’s fair value determination process, or material errors in the calculation of the net asset value. Unlike the Proposed Rule, which mandated a three business day time period for making these reports, the Final Rule requires notifications to be provided to the board within a time determined by the board, but in no event more than five business days after the valuation designee becomes aware of the material matter.

3. Specification of Responsibilities. The Final Rule requires the valuation designee to specify the titles of the persons responsible for determining the fair value of the designated investments, including specifying the particular functions for which the persons identified are responsible. The Final Rule also requires the valuation designee to reasonably segregate the process of making fair value determinations from the portfolio management of the fund, so that the portfolio manager may not determine, or effectively determine through exerting substantial influence, the fair values of portfolio investments. However, the segregation requirement does not prevent portfolio managers from providing inputs into the fair value determination process, because of the unique insights that portfolio management may have regarding the value of fund holdings. In addition, according to the SEC, funds could institute a reasonable segregation of functions through a variety of methods, such as independent reporting chains, oversight arrangements, or separate monitoring systems and personnel.

C. Readily Available Market Quotations and Cross-Trades. The Final Rule, consistent with the Proposed Rule, provides that a market quotation is readily available for purposes of section 2(a)(41) of the 1940 Act with respect to an investment 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. This standard is drawn from ASC Topic 820, and is consistent with the definition of a level 1 input in the fair value hierarchy outlined in U.S. GAAP. The Adopting Release makes clear that evaluated prices, indications of interest, and accommodation quotes are not considered readily available market quotations. The Adopting Release also states that certain securities (in particular fixed income securities) that previously have been viewed as having readily available market quotations and being available to cross-trade under rule 17a-7 (Rule 17a-7) under the 1940 Act may not meet the new definition and thus would not be available for such trades.

D. Policies and Procedures. In a departure from the Proposed Rule, the Final Rule does not separately require funds to adopt policies and procedures. The SEC explained in the Adopting Release that instead, Rule 38a-1 under the 1940 Act will require the adoption and implementation of written policies and procedures reasonably designed to prevent violations of the requirements of Rule 2a-5. The policies and procedures must be approved by the fund board. The SEC stated that the approach preserves flexibility to tailor the fair value policies and procedures to the unique facts and circumstances of the fund.

III. Recordkeeping

In a departure from the Proposed Rule, the SEC adopted Rule 31a-4 (the Recordkeeping Rule) separately, rather than as part of Rule 2a-5, to address the recordkeeping requirements that will be associated with fair value determinations. The SEC moved the recordkeeping requirements to a separate rule in part to address concerns expressed by some commenters that a recordkeeping failure alone should not be viewed as a fair valuation violation. The Recordkeeping Rule requires the documentation to be maintained for six years (as opposed to the five-year period in the Proposed Rule). For the first two years, the documents must be maintained in an “easily accessible place.” The Adopting Release explains appropriate documentation to support fair value determinations should include documentation that would be sufficient for a third party, such as the SEC staff, to verify, but not fully recreate, the fair value determination. When the fund has designated the performance of fair value determinations to the fund’s investment adviser, the adviser, and not the fund, will be responsible for maintaining these records. Additionally, when the fund has designated the performance of the value determinations to a valuation designee, the reports and other information provided to the board must include a specified list of the investments or investment types for which the valuation designee has been designated.

IV. Rescission of Prior SEC Releases and Related Guidance

With the adoption of Rule 2a-5, the SEC rescinded two prior releases, ASR 113 and ASR 118, and certain SEC staff letters and guidance relating to fair value determinations. The Adopting Release lists staff letters and guidance that were withdrawn or rescinded, and provides that any other staff guidance inconsistent or conflicting with the requirements of the Final Rule is superseded, even if not listed in the Adopting Release. As a result, the SEC attempts to put the fundamental guidance for fund valuation all in one place.

V. Key Observations

As stated above, funds are required to come into compliance with the Final Rule by September 8, 2022. Implementation of the Final Rule will require significant resources, and must be completed on a timeline that is similar to other new SEC rules that are applicable to many funds, including both fund use of derivatives and fund-of-funds.² During this period, fund boards and advisers should work together to determine how best to implement the Final Rule most effectively for their fund complex, including by considering the following issues:

Fund Boards

- 1. Directors remain responsible for fair valuations under the Final Rule. A number of commenters, including Stradley, requested that the Final Rule be made a safe harbor, in order to, among other things, make clear that the Final Rule does not provide the exclusive means of complying with the fair value obligations in the 1940 Act. The SEC did not make this change. In addition, despite urging from commenters to confirm that in exercising their valuation responsibilities, boards should be afforded protections under the business judgment rule, the SEC declined to do so. Although historically the SEC generally has not brought valuations cases against directors, boards and their counsel should carefully consider the liability impact of these decisions by the SEC and the Final Rule more generally.**
- 2. Although certain changes were made to ease the board reporting requirements, the Final Rule retains significant and detailed reporting requirements. As the implementation period moves forward, we expect funds, even those with robust existing board reporting on valuation, will be required to make changes to their reporting in order to comply with the Final Rule. For example, boards and advisers should structure prompt reporting to keep directors in an oversight role, rather than bringing them in to day-to-day valuation matters.**

² [Fund of Funds Arrangements](#), Investment Company Act Release No. 34045 (Oct. 7, 2020); [Use of Derivatives by Registered Investment Companies and Business Development Companies](#), Investment Company Act Release No. 34078 (Oct. 28, 2020).

3. The SEC clarified in the Adopting Release that the Final Rule permits auditors to use sampling and other techniques to verify the value of a fund's investments. Funds should consider whether to adopt these new approaches.

Fund Advisers

1. The SEC helpfully clarified in the Adopting Release that a violation of the Final Rule does not necessarily mean that the actual values ascribed to a particular fund's investments were in fact inappropriate, or, for example, that the fund has violated rule 22c-1 under the 1940 Act. Nonetheless, fund advisers to whom valuation responsibilities are formally designated under the Final Rule should carefully consider the liability implications of such a designation, including the requirement to specify the titles and functions of persons responsible.
2. We expect that all funds, even those with strong existing valuation policies and procedures, will be required to make changes to their compliance program in order to comply with the Final Rule.
3. Advisers should consider whether changes to specific methodologies for valuing particular instruments need to be made in light of the Final Rule.
4. Although the SEC raised questions about whether, in light of these rule changes, certain securities that previously have been viewed as available to cross trade under Rule 17a-7 may no longer be available for such trades, the SEC asked for further input on Rule 17a-7. We believe that there continues to be flexibility to make certain such trades under the new regime in appropriate circumstances.
5. The SEC does not permit formal designation of fair value determination responsibilities to pricing services under Rule 2a-5, but advisers should continue to focus on oversight and responsibility of pricing services, in light of the challenges in securing high quality pricing information during certain market environments. Shortly after adoption of the Final Rule, the SEC brought an enforcement action against a pricing service for compliance deficiencies relating to its delivery of pricing information to clients.³

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³ [In the Matter of ICE Data Pricing & Reference Data, LLC](#), Investment Advisers Act Release No. 5643 (Dec. 9, 2020).

David Grim Discusses the SEC's Valuation Rule With KPMG

[David Grim](#) joined Deputy Practice Leader for the KPMG Public Investment Management Practice Matt Giordano to present the podcast, "[What Does the New SEC Fund Valuation Framework Mean for You?](#)," on Jan. 11. In the two-part conversation, Grim discussed the new regulatory framework and its implications for fund boards and advisers.



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**Exhibit A:
SEC's Fair Valuation Final Rule
Highlights of Some Common or Notable Suggestions vs. Results in Final Rule and Adopting
Release**

Comments on the Proposing Release	Final Rule and Adopting Release
Safe Harbor	
Commenters suggested the SEC recast the Proposed Rule as a non-exclusive safe harbor in order to, among other things, make clear that the Rule does not provide the exclusive means of complying with the fair value obligations in the 1940 Act.	The SEC declined to formulate Rule 2a-5 as a safe harbor. The SEC stated that recasting the Final Rule as a safe harbor would not be appropriate, and that it is important to establish a minimum and consistent framework for fair value practices across funds in order to allow the Commission to articulate appropriate oversight measures to address valuation risks. According to the SEC, the Final Rule does not establish a single approach to making fair value determinations, but rather establishes a principles-based framework for boards to use in creating their own specific process for making the determinations.
Required Functions for the Determination of Fair Value in Good Faith	
Commenters requested the SEC clarify that the requirement to select and apply appropriate fair value methodologies “in a consistent manner” does not preclude a board or adviser, as applicable, from selecting different methodologies for different securities within the same asset class or sub-class.	The SEC included clarification in the Final Rule that the requirement is not meant to limit a board or valuation designee, as applicable, from using an appropriate methodology to fair value an investment, even if other investments within the same “asset class” are fair valued using a different appropriate methodology.
Commenters requested the SEC clarify that the requirement to select and apply fair value methodologies in a consistent manner does not restrict a board’s or adviser’s ability to change the selected methodology for an investment or asset class under appropriate circumstances.	The SEC modified the Final Rule to clarify that the requirement to apply fair value methodologies in a consistent manner does not preclude the board or valuation designee from changing the methodology for an investment if it would result in a measurement that is equally or more representative of fair value.
Commenters opposed as overly burdensome the proposed requirement that the board or adviser, as applicable, consider the applicability of the selected fair value methodologies to types of fund investments that a fund does not currently hold but in which it intends to invest in the future.	The SEC removed the requirement , agreeing that it could cause undue burdens, and explaining in any event that a fund will be required to value all investments it holds, regardless of whether it had a pre-determined methodology or not.
Certain commenters objected to the proposed requirement to establish criteria for determining when market quotations are no longer reliable.	The SEC removed the requirement from the Final Rule, agreeing that requiring, in advance, a list of specific criteria for determining when market quotations may no longer be reliable could limit the board’s or valuation designee’s flexibility to consider the full range of conditions that may affect the reliability of market quotations.
Commenters recommended the SEC clarify that calibration and back-testing are not required testing methods.	The SEC clarified that while calibration and back-testing are methods that should be used for testing the appropriateness and accuracy of funds’ fair

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	value methodologies in many circumstances, the Final Rule does not require calibration and back-testing , nor does it preclude boards or valuation designees, where applicable, from using other appropriate testing methods.
Commenters stated that requiring funds to establish specific criteria , such as objective thresholds, for price challenges, is too rigid and that the circumstances under which a fund might initiate a price challenge are not always objective or based on set criteria.	The SEC modified the Final Rule to require funds to establish a process, rather than criteria, for initiating price challenges.
Commenters argued that policies and procedures required by the Proposed Rule are already required by the Compliance Rule and urged the SEC to clarify the interaction between fund obligations under the Compliance Rule and the policies and procedures required under the Proposed Rule.	The SEC removed the requirement for separate policies and procedures under Rule 2a-5 , explaining the Compliance Rule by its terms requires the adoption and implementation of written policies and procedures reasonably designed to prevent violations of the requirements of Rules 2a-5 and 31a-4.
Performance of Fair Value Determinations	
Commenters asked the SEC to expand the types of entities that could perform fair value determinations on behalf of the board beyond the fund's adviser , suggesting the SEC permit any entity the board determines has sufficient expertise and capacity to conduct the fair value determinations.	The SEC declined to expand permissible designees beyond the adviser (except in the case of an internally managed fund (see below)), explaining "it is critical for the entity actually performing the fair value determinations to owe a fiduciary duty to the fund and be subject to direct board oversight whenever possible." This means, for example, that a board cannot formally designate the responsibilities under the Final Rule to a pricing service.
Commenters questioned the use of the phrase "assign" in the Proposed Rule, arguing that the scope of an assignment for these purposes would be unclear.	The SEC changed the wording of the Final Rule to provide that the board may "designate" the performance of fair value determinations to a valuation designee , rather than "assign" such determinations. The SEC stated that "designating" better describes the relationship between the board and valuation designee.
Commenters pointed out that internally managed funds have no adviser , and instead rely on certain officers of the fund to perform tasks that advisers typically perform.	The SEC changed the Final Rule to permit an internally managed fund's board to designate an officer or officers of the fund to perform the fair value determination if it does not have an adviser.
Some commenters expressed concerns that the Proposed Rule allowed a fund's sub-adviser to perform the fair value determinations.	The SEC changed the Final Rule to provide that boards may not designate the performance of fair value determinations to a sub-adviser , but noted that boards and valuation designees may

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	seek the assistance of their fund's sub-advisers as they see appropriate.
Commenters stated that trustees should not be the only parties permitted to perform fair value determinations for unit investment trusts (UITs).	The SEC agreed and changed the Final Rule to provide that either the UIT's depositor or trustee may perform the fair value determinations.
Commenters requested the SEC clarify that the party carrying out fair value determinations could engage third parties to assist with certain functions of the fair value determination process.	The SEC agreed, explaining it "believe[s] that whether the board or the valuation designee makes fair value determinations under the Final Rule, it may of course obtain assistance from others in fulfilling its duties. It may, for example, seek assistance from pricing services, fund administrators, sub-advisers, accountants, or counsel, " and that such advice can take "different forms."
Commenters asked the SEC to confirm that in exercising their valuation responsibilities, boards should be afforded protections under the business judgment rule.	Unlike its approach in the derivatives and liquidity rules, the SEC declined to do so, stating that it is instead providing guidance it believes should be more useful to directors than the more generalized principles of the business judgment rule , as the new guidance specifically relates to directors' oversight responsibilities under section 2(a)(41) of the 1940 Act and the Final Rule.
Commenters raised concerns regarding the proposed periodic reporting requirements , including that they were " overly prescriptive, " and objected to the level of required quarterly reporting to the board.	The SEC revised the periodic reporting requirements in the Final Rule. Specifically, the Final Rule requires an annual written report assessing the adequacy and effectiveness of the valuation designee's process for determining the fair value of the designated portfolio of investments, testing results, and adequacy of allocated resources, rather than quarterly as proposed. Additionally, the Final Rule requires a quarterly written report consisting of materials requested by the board, and a summary or description of material fair value changes or events that occurred in the prior quarter.
Commenters objected to the three-business-day prompt board reporting period for certain valuation matters.	The SEC extended the time period in the Final Rule to five business days but allowed boards to prescribe a shorter time period if they determine it is necessary for their oversight responsibilities.
Recordkeeping	
Commenters stated that the recordkeeping requirements as proposed would add additional costs, and suggested that the proposed recordkeeping requirements would be more	The SEC moved the recordkeeping requirement out of Rule 2a-5 and into new Rule 31a-4 under section 31 of the 1940 Act. In a change from the proposal, the Final Rule does

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appropriate as a rule under section 31 of the 1940 Act.	not require detailed records relating to the specific methodologies a pricing service applied and the assumptions and inputs a pricing service considered when providing each piece of pricing information. The fund or adviser will not be required to maintain the internal records of the pricing service or the specific inputs the pricing service used for each piece of pricing information it provides to the funds.
Readily Available Market Quotations	
Commenters asked the SEC to amend the proposed definition of readily available market quotations to include securities valued using level 2 inputs in the U.S. GAAP hierarchy , including evaluated prices.	The SEC declined to amend the definition to include securities valued using level 2 inputs in the U.S. GAAP hierarchy.
A number of commenters raised concerns that the proposed definition of readily available market quotations may disrupt current cross trade practices under Rule 17a-7 under the 1940 Act.	The SEC adopted the definition as proposed, stating that “As a result, certain securities that had been previously viewed as having readily available market quotations and being available to cross trade under Rule 17a-7 may not meet our new definition and thus would not be available for such trades. ” The SEC also noted that potential revisions to Rule 17a-7 are on its rulemaking agenda, and invited input from the public on these issues.
Existing Commission Guidance, Staff No-Action Letters, and Other SEC Guidance	
Commenters suggested the SEC clarify that certain guidance provided in the 2014 Money Market Funds Adopting Release relating to the valuation of thinly traded securities and to pricing services is being superseded by Rule 2a-5 and the related guidance in the Adopting Release.	In a change from the proposal, the Final Rule and the guidance in the Adopting Release supersedes the guidance on thinly traded securities and the use of pricing services the SEC issued in 2014. However, the SEC declined to modify or supplement prior guidance regarding the use of the amortized cost method, explaining that the guidance remains “relevant, adequate, and appropriate.”
Some commenters urged the SEC to provide more time beyond the proposed one-year transition period.	The SEC adopted an 18-month transition period.

EXHIBIT B:
Comparison of Proposed Rule to Final Rule

§ 270.2a-5 Fair value determination and readily available market quotations.

(a) Fair value determination. For purposes of section 2(a)(41) of the Act (15 U.S.C. 80a2(a)(41)) and § 270.2a-4, determining fair value in good faith with respect to a fund requires:

(1) Assess and manage risks. Periodically assessing any material risks associated with the determination of the fair value of fund investments (“valuation risks”), including material conflicts of interest, and managing those identified valuation risks;

(2) Establish and apply fair value methodologies. Performing each of the following, taking into account the fund’s valuation risks:

(i) Selecting and applying in a consistent manner an appropriate methodology or methodologies for determining (and calculating) the fair value of fund investments, provided that a selected methodology may be changed if a different methodology is equally or more representative of the fair value of fund investments, including specifying:

~~the (A) The~~ key inputs and assumptions specific to each asset class or portfolio holding; ~~and~~

~~(B) Which methodologies apply to new types of fund investments in which a fund intends to invest;~~

(ii) Periodically reviewing the appropriateness and accuracy of the methodologies selected and making any necessary changes or adjustments thereto; and

(iii) Monitoring for circumstances that may necessitate the use of fair value; ~~and~~

~~(iv) Establishing criteria for determining when market quotations are no longer reliable;~~

(3) Test fair value methodologies. Testing the appropriateness and accuracy of the fair value methodologies that have been selected, including identifying the testing methods to be used and the minimum frequency with which such testing methods are to be used; and

(4) Evaluate pricing services. Overseeing pricing service providers, if used, including establishing:

~~the (i) The~~ process for ~~the approval~~approving, monitoring, and ~~evaluation of~~evaluating each pricing service provider; ~~and~~

~~(ii) Criteria for~~ initiating price challenges; as appropriate.

~~(5) Fair value policies and procedures. Adopting and implementing written policies and procedures addressing the determination of the fair value of fund investments that are reasonably designed to achieve compliance with the requirements described in paragraphs (a)(1) through (4) of this section; and~~

~~(6) Recordkeeping. Maintaining:~~

~~(i) Appropriate documentation to support fair value determinations, including information regarding the specific methodologies applied and the assumptions and inputs considered when making fair value determinations, as well as any necessary or appropriate adjustments in methodologies, for at least five years from the time the determination was made, the first two years in an easily accessible place; and~~

~~(ii) A copy of policies and procedures as required under paragraph (a)(5) of this section that are in effect, or were in effect at any time within the past five years, in an easily accessible place.~~

(b) Performance of fair value determinations. The board of the fund must determine fair value in good faith for any or all fund investments by carrying out the functions required in paragraph (a) of this section. The board may choose to ~~assign~~designate the valuation designee to perform the fair value determination relating to any or all fund investments ~~to an investment adviser of the fund~~, which ~~would~~shall carry out all of the functions required in ~~paragraphs (a)(1) through (5)~~paragraph (a) of this section, subject to the requirements of this paragraph (b). ~~If the board of the fund does not assign fair value determinations to an adviser to the fund, the fund must adopt and implement the policies and procedures required under paragraph (a)(5) of this section and maintain the records required by paragraph (a)(6) of this section.~~

(1) Oversight and reporting. The board oversees the ~~adviser~~valuation designee, and the ~~adviser~~valuation designee reports to the fund's board, in writing, including such information as may be reasonably necessary for the board to evaluate the matters covered in the report, as follows:

(i) Periodic reporting.

~~(i) Periodic reporting. At least quarterly, an assessment of the adequacy and effectiveness of the investment adviser's process for determining the fair value of the assigned portfolio of investments, including, at a minimum, a summary or description of:~~

(A) At least quarterly:

(1) Any reports or materials requested by the board related to the fair value of designated investments or the valuation designee's process for fair valuing fund investments; and

(2) A summary or description of material fair value matters that occurred in the prior quarter, including:

~~(A) The~~(i) Any material changes in the assessment and management of ~~material~~ valuation risks required under paragraph (a)(1) of this section, including any material changes in conflicts of interest of the ~~investment adviser~~valuation designee (and any other service provider);

~~(B) i~~(ii) Any material changes to, or material deviations from, the fair value methodologies established under paragraph (a)(2) of this section; and

(iii) Any material changes to the valuation designee’s process for selecting and overseeing pricing services, as well as any material events related to the valuation designee’s oversight of pricing services; and

(B) At least annually, an assessment of the adequacy and effectiveness of the valuation designee’s process for determining the fair value of the designated portfolio of investments, including, at a minimum:

~~(C) The~~1) A summary of the results of the testing of fair value methodologies required under paragraph (a)(3) of this section; and

~~(D) The~~2) An assessment of the adequacy of resources allocated to the process for determining the fair value of ~~assigned~~designated investments, including any material changes to the roles or functions of the persons responsible for determining fair value under paragraph (b)(2) of this section; and

~~(E) Any material changes to the adviser’s process for selecting and overseeing pricing services, as well as material events related to the adviser’s oversight of pricing services (such as changes in the service providers used or price overrides); and~~

~~(F) Any other materials requested by the board related to the adviser’s process for determining the fair value of assigned investments; and~~

(ii) Prompt board notification and reporting. The ~~adviser reports promptly (but in no event later than three business days after the adviser becomes aware of the matter) on matters associated with the adviser’s process~~valuation designee notifies the board of the occurrence of matters that materially affect ~~or could have materially affected~~ the fair value of the ~~assigned~~designated portfolio of investments, including a significant deficiency or material weakness in the design or ~~implementation~~effectiveness of the ~~adviser’s~~valuation designee’s fair value determination process, or material ~~changes in the fund’s valuation risks under paragraph (a)(1) of this section;~~errors in the calculation of net asset value, (any such matter or error, a “material matter”) within a time period determined by the board (but in no event later than five business days after the valuation designee becomes aware of the material matter), with such timely follow-on reporting as the board may determine appropriate; and

(2) Specify responsibilities. The ~~adviser~~valuation designee specifies the titles of the persons responsible for determining the fair value of the ~~assigned~~designated investments, including by specifying the particular functions for which they are responsible, and reasonably segregates ~~the process of making~~ fair value determinations from the portfolio management of the fund; ~~and~~ such that the portfolio manager(s) may not determine, or effectively determine by exerting substantial influence on, the fair values ascribed to portfolio investments.

~~(3) Records when assigning. In addition to the records required in paragraph (a)(6) of this section, the fund maintains copies of:~~

~~(i) The reports and other information provided to the board as required under paragraph (b)(1) of this section; and~~

~~(ii) A specified list of the investments or investment types whose fair value determination has been assigned to the adviser pursuant to this paragraph (b), in each case for at least five years after the end of the fiscal year in which the documents were provided to the board or the investments or investment types were assigned to the adviser, the first two years in an easily accessible place.~~

(c) Readily available market quotations. For purposes of section 2(a)(41) of the Act (15 U.S.C. 80a-2(a)(41)), 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.

(d) Unit investment trusts. If the fund is a unit investment trust, and the initial deposit of portfolio securities into the unit investment trust occurs after the effective date of this section, the fund's trustee or depositor must carry out the requirements of paragraph (a) of this section. If the initial deposit of portfolio securities into the unit investment trust occurred before the effective date of this section, and an entity other than the fund's trustee or depositor has been designated to carry out the fair value determination, that entity must carry out the requirements of paragraph (a) of this section.

(e) Definitions. For purposes of this section:

(1) Fund means a registered investment company or business development company.

(2) Fair value means the value of a portfolio investment for which market quotations are not readily available under paragraph (c) of this section.

(3) Board means either the fund's entire board of directors or a designated committee of such board composed of a majority of directors who are not interested persons of the fund.

(4) Valuation designee means the investment adviser, other than a sub-adviser, of a fund or, if the fund does not have an investment adviser, an officer or officers of the fund. * * * *

5. Add § 270.31a-4 to read as follows: 209 § 270.31a-4 Records to be maintained and preserved by registered investment companies relating to fair value determinations.

(a) Appropriate documentation. Every registered investment company shall maintain appropriate documentation to support fair value determinations made pursuant to 17 CFR 270.2a-5 for at least six years from the time that the determination was made, the first two years in an easily accessible place.

(b) Records when designating. If the board of a registered investment company has designated performance of fair value determinations to a valuation designee under 17 CFR 270.2a-5(b), in addition to the records required in paragraph (a) of this section, the registered investment company must maintain copies of:

(1) The reports and other information provided to the board as required under 17 CFR 270.2a-5(b)(1) for at least six years after the end of the fiscal year in which the documents were provided to the board, the first two years in an easily accessible place; and

(2) A specified list of the investments or investment types whose fair value determination has been designated to the valuation designee to perform pursuant to 17 CFR 270.2a-5(b) for a period beginning with the designation and ending at least six years after the end of the fiscal year in which the designation was terminated, in an easily accessible place until two years after such termination.

(c) Party to maintain. If the board of a registered investment company has designated performance of fair value determinations to its investment adviser under 17 CFR 270.2a-5(b), such investment adviser shall maintain the records required by this section. If the investment adviser is not so designated, the fund shall maintain such records.

By the Commission.

Dated: ~~April 21~~December 3, 2020.