

July 22, 2020

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

By e-mail: [rule-comments@sec.gov](mailto:rule-comments@sec.gov)

**Re: Proposed Rule 2a-5, Good Faith Determinations of Fair Value**

**(Release No. IC-33845; File No. S7-07-20)**

The New York State Society of Certified Public Accountants (NYSSCPA), representing more than 23,000 CPAs in public practice, business, government and education, welcomes the opportunity to comment on the above-captioned proposed rule.

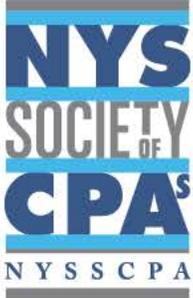
The NYSSCPA's Investment Management Committee deliberated the proposed rule and prepared the attached comments. If you would like additional discussion with us, please contact Michael A. Provini, Chair of the Investment Management Committee, at [REDACTED], Anthony J. Artabane, committee member, at [REDACTED] or Ernest J. Markezin, NYSSCPA staff, at [REDACTED]

Sincerely,

A handwritten signature in black ink that reads "Edward L. Arcara". The signature is written in a cursive style and is positioned over a faint, light blue watermark of the NYSSCPA logo.

Edward L. Arcara  
President

Attachment



**NEW YORK STATE SOCIETY OF  
CERTIFIED PUBLIC ACCOUNTANTS**

**COMMENTS ON  
PROPOSED RULE 2a-5, GOOD FAITH DETERMINATIONS OF FAIR VALUE**

**(Release No. IC-33845; File No. S7-07-20)**

**July 22, 2020**

**Principal Drafters**

**Anthony J. Artabane  
Michael A. Provini**

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Keith Lazarus  
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# **New York State Society of Certified Public Accountants**

## **Comments on**

### **Proposed Rule 2a-5, Good Faith Determinations of Fair Value**

**(Release No. IC-33845; File No. S7-07-20)**

The New York State Society of Certified Public Accountants (NYSSCPA) appreciates the opportunity to provide comments on the Securities and Exchange Commission's (the SEC or the Commission) Proposed Rule 2a-5, Good Faith Determinations of Fair Value (the Proposed Rule).

#### **General Comments**

We strongly support the Commission's efforts to modernize the regulations and guidance for the determination of fair value in good faith of investments held by investment companies registered under the Investment Company Act of 1940 (the Investment Company Act or the Act) and permit the board of directors to assign fair value responsibilities to the investment advisor while retaining responsibility for the policy approval function, oversight and monitoring role in the fair valuation process.

We offer the following comments for your consideration. We believe these comments will allow the Proposed Rule to better achieve the Commission's goal of setting a minimum regulatory framework for registered investment companies to make fair value determinations in a controlled manner while preserving important investor protection safeguards. We believe that incorporation of these comments will also permit each fund or fund complex to (i) address the unique risks presented by investments held by each fund in a more efficient manner and (ii) implement sound but somewhat less burdensome policies, procedures and controls, including effective oversight and monitoring by the fund's or fund complex's board of directors that provide reasonable assurance that fair value determinations are made in a risk controlled manner.

#### **Specific Comments and Detailed Suggestions**

The following comments are offered for the Commission's consideration. We have included discussion for those comments for which we have more detailed suggestions, or for which we believe additional commentary would be helpful for the Commission to better understand the comment and the supporting rationale.

**Comment 1.** We recommend that the Proposed Rule should specify a more flexible reporting, testing, oversight and monitoring regime for certain classes of investments that have a lower risk of material misstatement but do not meet the strict criteria for being classified as Level I investments. Alternatively, consideration should be given to scoping out such investments from the definition of securities required to be fair valued in good faith by the board of directors and permit the board of directors to determine whether securities similar in all respects to the

securities held constitute readily available investments for purposes of Section 2 (a) (41) of the Investment Company Act.

**Additional explanatory information regarding Comment 1:** While we generally support the adoption of the definitions of other than Level 1 fair value investments contained in ASC Topic 820 as "not readily available" investments for purposes of the Proposed Rule, the Proposed Rule is binary in nature. There are many classes of portfolio investments commonly held by registered investment companies (colloquially referred to as "Level II A investments") that do not meet the criteria for being classified as a Level I investment, yet present minimal risk of misstatement because of lack of subjective judgment or transparency of pricing inputs. Some of these include, but are not limited to, off the run treasuries, total return swaps on publicly traded securities or indices and forward currency contracts. They are generally priced by standard models commonly used by most market participants with readily available and observable market inputs. However, because the securities are not classified as Level I, the Proposed Rule would subject them to the same significant baseline requirements that apply to other Level II and Level III fair valued investments which are more subjective in nature and which may require more significant reporting, testing, monitoring and oversight controls.

We believe that the Proposed Rule should provide for a more balanced reporting, testing, monitoring and oversight regime for such investments due to the lower risk of misstatement. Such requirements could be limited to the investment advisor's reporting of the initial risk assessment of fair valuing such investments and the initial approval by the board of directors of the models or other methods and type of significant inputs used to value such investments. Such requirements may also limit annual reporting to the board of directors to (i) any material weakness or significant deficiency in internal control over such fair valued investments (ii) any material errors in the fair valuation of such investments which resulted in a restated fund net asset valuation during the year and (iii) any significant changes in the models or inputs previously approved.

As an alternative to the above recommendation, consideration should be given to scoping out such investments from the definition of securities required to be fair valued and to permit the board of directors to determine whether securities similar in all respects to these securities constitute readily available investments for purposes of Section 2 (a) (41) of the Investment Company Act..

**Comment 2.** The Proposed Rule should include a significance or de minimis threshold for each fund for Level II and Level III investments (excluding those Level II investments described in the first comment above). Such threshold, if not exceeded by the fund, would eliminate, or greatly reduce, the frequency and scope of reporting, testing, monitoring and oversight required by the Proposed Rule.

**Additional explanatory information regarding Comment 2:** As we noted in the additional explanatory information under Comment 1 above, the Proposed Rule and all the requirements therein apply to a fund if it holds one investment that does not meet the strict definition of a Level 1 investment. Accordingly, if a fund has one or a limited number of Level II or Level III positions, it would be required to implement the full requirements of the Proposed Rule in order to permit the board of directors to assign fair valuation responsibilities to the investment advisor. Full implementation would be required even in those circumstances where the assessed risk of a

material misstatement of such investments was not high relative to the fund's overall net assets. We do not believe this was the intended consequence of the Proposed Rule or of the Commission's historical approach to regulation.

It is not unusual for a fund to have such limited fair valued investments for a variety of reasons. Occasionally, an investment held in a fund that holds substantially all Level I investments may stop trading. In addition, a fund with substantially all Level I investments may infrequently acquire a Level III investment (e.g., very small investment in a private security) or as part of an ancillary investment strategy which is not significant to the execution of its primary investment strategy through Level I investments (e.g., obtaining warrants in connection with purchasing Level I investments). It is typical for the board of directors of such funds to be aware of the possibility of the market events and to have discussed and approved the ancillary strategies during the periodic meetings which usually include some level of portfolio discussion with the investment advisor.

We believe that the Proposed Rule should include a clear de minimis threshold for each of (i) Level II investments (excluding those Level II investments described in Comment 1 above) and (ii) Level III investments. The de minimis threshold could be set as a level of net assets for Level II investments and either an absolute level of net assets or some combination of the absolute level of net assets and the number of such Level III investments. For example, the de minimis threshold for Level II investments could be 2% to 3% of net assets and the de minimis threshold for Level III investments could be 2% to 3% of net assets and a limit of 15 such investments. A combined aggregate threshold could be 5% for open end funds. The thresholds for closed end funds may be set slightly higher as they do not trade at net asset value but at a market price for which net asset value is a primary but not the sole consideration. While these amounts may exceed financial statement materiality, the level of potential misstatement is the difference from the recorded value and not the absolute value of the investment. Accordingly, we believe a threshold of 50 basis points for each Level would be extremely conservative and most likely unwarranted.

As additional safeguards, for funds with Level II and Level III investments below the de minimis threshold, the Proposed Rule may require (i) initial approval of the valuation models, methods and types of inputs to the extent such investments or class of investment are known (ii) annual reporting to the board of directors of the fair valuation calculations and (iii) quarterly reporting of the significant matters described in the additional explanatory information to Comment 3 below.

Also, as an additional safeguard, and instead of detailed testing by the investment advisor, the Proposed Rule may continue to require the 100% testing of the valuation of only the Level II and Level III investments as part of the annual audit.

While we offer these more detailed suggestions to be helpful, the main comment is to establish a de minimis threshold for the Level II and Level III investments.

**Comment 3.** We believe that many of the quarterly reporting requirements contained in the Proposed Rule could be performed on an annual basis without significantly compromising the effectiveness of the risk assessment for fair valued investments, the operational execution of the fair valuation process and the monitoring and oversight of the fair valuation process.

**Additional explanatory information regarding Comment 3:** Since the overall risk assessment, the models and inputs used and the established operational processes and procedures would likely not materially change for many fair valued investment securities or class of securities on a quarterly basis, we believe that consideration should be given to limiting the required quarterly items to the reporting of significant deficiencies or material weaknesses identified in the design or implementation of internal control over the fair valuation process, material changes in previously assessed valuation risks (including changes due to significant market events), adoption of new valuation models for new Level II and Level III investments made during the quarter and material changes in fair valued Level II and Level III investments which caused a restatement of the fund's net asset value and similar matters of significance.

Other required items such as testing results and information regarding the investment advisor's oversight of pricing services could be presented on an annual basis. Boards of directors that find this information useful or desirable on a quarterly basis to adequately monitor the fair valuation process after considering the unique risk factors in the fund(s) they oversee could request such information.

We also suggest that the Commission consider further limiting the prompt reporting requirements to matters such as a material weakness or significant deficiency in internal control over fair valuation of securities and changes to valuations which resulted in a restatement to a fund's net asset valuation. Consideration should also be given to lengthening the time for reporting a significant matter to the board of directors to ten business days from the three day period included in the Proposed Rule.

In practice, the evaluation of pricing issues surrounding fair valued investments, particularly Level III investments which require highly subjective judgments, typically requires an assessment of the facts by and discussions with personnel from several groups or departments including accounting, compliance, portfolio management, and possibly third-party administrators and pricing consultants, if applicable. The potential assessment of a material control deficiency after the determination that a pricing error has occurred also typically requires the involvement of personnel from several groups or departments which usually include independent accountants and senior management of the investment advisor. Typically boards of directors or audit committees have a clear understanding with the fund's management as to the timing of notification when the determinations are being made on such significant matters. Lengthening the reporting period to ten business days may permit more time for proper assessment of these significant matters as well as a more reasoned determination of the impact on other similar investments or other funds, the impact on investors, other remediation actions to be taken by the investment advisor or administrator and required enhancements to internal control over the fair valuation process.

**Comment 4.** While we concur that testing of a fair valuation process is important, we believe that the Proposed Rule should expand the parties permitted to perform such testing. These parties may include advisor affiliated service organizations, third-party pricing services, third-party administrators, and qualified professional service firms.

**Additional explanatory information regarding Comment 4:** We believe that testing of any process can be designed in many ways and be effectively performed by various parties.

Considering the dispersion of the use of fair valued securities in the industry, the range of risk presented and the many different operational environments which exist, we believe that the Proposed Rule should be clarified to permit other parties who currently have testing functions or expertise to be permitted to be used in the testing process. With the increased organizations and entities available, each fund or fund complex can best determine how to effectively and most cost efficiently accomplish the testing objectives to address the unique risks presented by each fund's fair valued investments.

**Comment 5.** We support the proposed rescission of ASR 113 and ASR 118 as the accounting and valuation guidance included in United States Generally Accepted Accounting Principles (U.S. GAAP), in particular, ASC Topic 820 and ASC Topic 946, provide more comprehensive and up-to-date valuation guidance on the range of investments currently available to U.S. registered investment companies.

**Comment 6.** We support the proposed rescission of the specific requirement in ASR 118 for independent auditors of the fund to verify all quotations of securities with readily available market quotations at the balance sheet date and allow independent auditors to apply appropriate test procedures, as determined applicable, in accordance with current PCAOB auditing standards and subject to appropriate agreement with a fund's audit committee or board of directors.

**Comment 7.** Considering the importance of the fair valuation process and the Commission's estimate that the Proposed Rule would likely be adopted by a significant number of registered investment companies, we believe it would be appropriate to lengthen the proposed implementation period from one year to 18 months from issuance of an amendment to the rule by the SEC.

**Comment 8.** We believe the Commission should formally extend the comment period by at least one month in order to allow fund groups more time to analyze the impact of the Proposed Rule, discuss it with the funds' directors and provide additional comments which may be helpful to the Commission in making possible amendments to the Proposed Rule.

**Additional explanatory information regarding Comment 8:** We noted that as of July 10, 2020 only approximately a half dozen comment letters were listed on the SEC's website. Considering the significance of the impact of the Proposed Rule, we expected more industry participants to have commented. Perhaps the initial and continuing impact of the Covid 19 restrictions has not allowed timely focus on the Proposed Rule. Formally extending the comment period by at least one month, and preferably to September 1, 2020, would allow funds and fund complexes and other industry participants who have only recently focused on the Proposed Rule additional time to assess and comment upon the provisions of the Proposed Rule.

We believe this extension would be particularly beneficial to smaller and medium sized fund groups which would likely be more significantly impacted by the cost of, and management resources devoted to, initial implementation as well as ongoing compliance with the Proposed Rule. Additional comment letters may also provide more transparency into the cost of implementation which may support or modify the Commission's cost/benefit assessments included in the Proposed Rule.