

# GUGGENHEIM

July 21, 2020

## VIA ELECTRONIC DELIVERY

Vanessa Countryman  
Secretary  
U.S. Securities and Exchange Commission  
100 F Street, N.E.  
Washington, D.C. 20549-1090

Re: Good Faith Determinations of Fair Value (File No. S7-07-20)<sup>1</sup>

Dear Ms. Countryman:

Guggenheim Investments<sup>2</sup> (“Guggenheim” or “we”) appreciates the opportunity to respond to the request by the U.S. Securities and Exchange Commission (the “SEC” or “Commission”) for comments regarding the above-referenced release (the “Proposing Release”). We commend the Commission on the Proposing Release, which sets forth a process-, oversight- and reporting-based framework that seeks to ensure that funds’ valuations of their holdings accurately reflect their fair value. Guggenheim supports this endeavor and recognizes that accurately valuing the funds’ holdings is critical to the protection of fund shareholders and the success of our business and industry. We believe, however, that while the overall proposed approach is strong, there is a need to better take into account the challenges associated with applying what is in some instances an overly prescriptive approach to the process that is used to fair value thousands of securities each day.

### **Proposed Characterization of “Readily Available Market Quotations”**

The proposed rule defines a market quotation as 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.” This language tracks language defining “Level 1” inputs in the Financial Accounting Standards Board Accounting Standards Codification Topic 820 (“ASC Topic 820”) fair value hierarchy. Accordingly, under the proposed rule, funds would be required to fair value securities and assets that are valued using inputs classified as “Level 2” or “Level 3” inputs under ASC Topic 820.<sup>3</sup> In practice, the proposed rule’s definition of readily available market quotations would mean that the vast majority of the securities and assets in which a firm that focuses on debt securities invests – in our case, thousands of securities daily – would need to be fair valued and subject to all of the proposed rule’s requirements for determining fair value in good faith. The impact for

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<sup>1</sup> Good Faith Determinations of Fair Value. 85 Fed. Reg. 28734 (May 13, 2020).

<sup>2</sup> Guggenheim Investments represents the investment management business of Guggenheim Partners, LLC, which includes Guggenheim Partners Investment Management, LLC, Security Investors, LLC and Guggenheim Funds Investment Advisors, LLC. We refer to the funds under Guggenheim’s management as “Guggenheim Funds.”

<sup>3</sup> Under Section 2(a)(41) of the Investment Company Act of 1940, as amended (“1940 Act”), and Rule 2a-4 thereunder, securities for which market quotations are not readily available must be valued at “fair value as determined in good faith by the board of directors.”

our firm could be even greater, as we would likely implement the proposed rule's requirements for securities held by other client accounts in addition to those directly subject to the rule (e.g., private funds and separately managed accounts) in order to maintain consistency in processes across accounts. We believe that a number of these requirements would serve little or no purpose in the context of securities and assets valued using inputs classified as Level 2 inputs.

For securities or assets valued using unobservable inputs (i.e., Level 3 inputs), there is often significant judgment involved in the selection and application of inputs and, thus, the determination of a fair value. In those cases, we can appreciate the rationale underlying the proposed rule's requirements. However, in our view, the risks and potential conflicts of interest addressed by the requirements of the proposed rule are substantially lower, or even non-existent, in the case of securities and assets valued using Level 2 inputs (e.g., interest rates and yield curves). While there may be, in some cases, an element of judgment in valuing a security or asset using Level 2 inputs, the degree and scope of any such judgment is substantially less than for securities or assets valued using Level 3 (i.e., unobservable) inputs.

We propose that the final rule take into consideration the significant differences in risk and potential conflicts between valuing securities or assets using Level 3 inputs as compared to using Level 2 inputs. Accordingly, we recommend that the final rule characterize market quotations as readily available when the quotations are based on Level 1 inputs *or* Level 2 inputs. Such an approach would better reflect the significant differences in risk and potential conflicts between relying on Level 2 inputs and Level 3 inputs.

### **Pricing Service Oversight and Price Challenges**

The challenges associated with the proposed rule's definition of "readily available market quotations" are apparent when considering the rule's application to prices provided by pricing services (which frequently use Level 2 inputs). We are concerned that the rule could be interpreted to require the adviser to perform all of the same functions and maintain all of the same records with respect to fair valuations provided by pricing services and fair valuations determined by the adviser. The proposed rule includes provisions for oversight of pricing service providers, proposing to require establishment of a process for the approval, monitoring, and evaluation of each pricing service provider. In light of such a process, applying the proposed rule's requirements for establishing and applying fair valuation methodologies, testing fair valuation methodologies and maintaining documentation to support fair value determinations (as discussed in further detail below) in the context of fair valuations provided by pricing services would be duplicative and costly with little, if any, benefit.<sup>4</sup> This point is reinforced when considering that: (i) pricing services are generally subject to oversight by multiple firms, and in some cases are subject to regulatory oversight, meaning that pricing service providers are under continuous pressure to provide accurate valuations and improve their valuation processes; and (ii) pricing services generally are not subject to the same incentives and conflicts as an adviser in determining the fair value of portfolio investments. We believe a better approach would reflect the current industry practice of conducting due diligence on pricing service providers with ongoing oversight and would not involve applying the full scope of the proposed rule's requirements to fair valuations provided by pricing services.

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<sup>4</sup> We believe that these costs would be especially burdensome for smaller and mid-sized firms whose ability to incur the material expense associated with these requirements is limited and could ultimately impair the ability of such firms to offer funds that invest in fixed income securities, resulting in fewer investment options for mutual fund investors.

In addition to the proposed requirements for establishing a process for the approval, monitoring, and evaluation of each pricing service provider, the proposed rule would require establishment of criteria for initiating price challenges. We believe a better approach would be to require the establishment of a *process* for initiating price challenges. Such an approach would permit funds appropriate flexibility to respond and adapt to changing circumstances that may warrant price challenges and would better reflect current practices. It would also acknowledge the reality that criteria for price challenges can vary greatly depending upon circumstances such as security types and changes in market volatility.

### **Proposed Requirements Concerning Selection of Fair Valuation Methodologies and Inputs**

More generally, we are concerned that the proposed rule is overly prescriptive in certain circumstances, and we propose that the final rule permit funds greater flexibility to implement fair valuation practices tailored to their circumstances. We believe, for example, that the rigidity contemplated in connection with the requirement to select and apply a fair value methodology in a consistent manner, including specifying key assumptions and inputs, will be unnecessarily difficult in certain situations. It would not be unusual for different methodologies or inputs to be appropriate for securities of the same asset class or even for the same portfolio holding at different points in time, and documenting these methodologies or inputs in advance may unnecessarily restrict the ability of funds to respond to changing circumstances in a manner that is in the best interest of shareholders. Similarly, circumstances may arise for a specific security such that the adviser believes, in good faith, that the most appropriate fair valuation is to be obtained using certain inputs or methodologies not previously documented in the fund's fair valuation procedures according to the requirements of the proposed rule. The adviser should not be forced to value the security in a manner that it does not believe is most appropriate solely because these inputs or methodologies are not set forth in the procedures. In essence, the process of fair valuing securities is often subjective and/or dynamic and does not lend itself to an overly prescriptive approach.

In light of these concerns, we recommend that the final rule instead require adoption of valuation policies and procedures that specify *how* the funds will fair value securities – *i.e.*, the process that will be followed – and leave sufficient leeway for funds to adopt policies and procedures that would take into account the facts and circumstances surrounding the fair valued securities at the time of fair valuation in determining valuation methodologies, assumptions and inputs. We believe that this would not only reflect a more workable approach that better reflects industry practice while still addressing the concerns outlined in the Proposing Release, but also, and most importantly, would result in more accurate fair value determinations.

### **Proposed Recordkeeping Requirements**

We recommend specifying that the proposed rule's requirement to maintain "[a]ppropriate 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 . . ." does not apply in the context of fair values obtained from pricing services. As noted above, under the proposed rule's characterization of readily available market quotations, a fair value determination would be required for thousands of debt securities *each business day*, including valuations obtained from pricing services. As a result, the recordkeeping requirement set forth in the proposed rule would be exceedingly costly and onerous to comply with, especially in light of the statement in the Proposing Release that ". . . appropriate documentation to support fair value determinations would include documentation that would be sufficient for a third party to verify the fair value determination," which appears potentially to contemplate records sufficient for a third party to recreate fair

value determinations.<sup>5</sup> We anticipate that the requirement, if adopted as proposed, would require the firm to hire additional valuation personnel with difficult-to-find credentials and experience, at significant expense, and without materially changing the accuracy of the valuations that are available under our current processes. We expect that we would also need to hire additional personnel in either the compliance or risk management group to monitor the process.<sup>6</sup>

In our view, the maintenance of information at this level of detail for thousands of fair valued securities on a daily basis would be cost prohibitive and would not improve the reliability of the fair value determinations. We are concerned that the level of effort and resources that would need to be devoted to maintaining the required documentation would detract from substantive fair valuation efforts, and, taken together with the proposed rule's other prescriptive requirements concerning selection and application of fair valuation methodologies, inputs and assumptions, we believe there is a risk of overemphasis on process and documentation at the expense of focus on the quality of fair valuations. These efforts and resources could, we believe, be better used to monitor fair values, conduct testing, look for market color (*e.g.*, broker quotes and transactions), and otherwise focus on the accuracy of fair values. Moreover, as discussed above, the proposed rule includes provisions for oversight of pricing service providers, proposing to require establishment of a process for the approval, monitoring, and evaluation of each pricing service provider. In light of such a process, applying the proposed rule's requirements for maintaining documentation to support fair value determinations in the context of fair valuations provided by pricing services would be duplicative and costly with little, if any, benefit.

We are also concerned that this proposed recordkeeping requirement could result in technical rule violations for firms (and, thus, potentially also statutory violations under Section 2(a)(41) if the proposed rule's structure is maintained) if they fail to neatly assemble in a file the information supporting the fair value determination for each of the many securities that are being fair valued for review by SEC staff during an exam. Indeed, under the proposed rule, a firm that is producing high quality, reliable fair valuations could nonetheless be found to be deficient with respect to its fair value process if it has not maintained the specified records for each of the many securities that it fair values each business day.

Finally, we note that, in analogous contexts, the SEC has not required that similar records be maintained. For instance, the recordkeeping requirements of the SEC's liquidity rule relate to copies of written policies and procedures, materials provided to the fund's board and materials related to certain compliance thresholds. The liquidity rule recordkeeping requirements do not include records related to the basis for each of the monthly or more frequent liquidity classification determinations for fund portfolio investments.

### **Board Reporting**

The proposed requirements for prompt board reporting also seem overly prescriptive without corresponding benefit. The proposed rule would require the adviser to report “. . . 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 that materially affect *or could have materially affected* the fair value of the assigned portfolio of

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<sup>5</sup> We also request that the SEC clarify that documentation “sufficient for a third party to verify the fair value determination” is not intended to mean documentation sufficient for a third party to fully recreate such fair value determination.

<sup>6</sup> In light of these anticipated hiring needs and associated ongoing expenses, it appears that the economic analysis notably underestimates the costs associated with this portion of the proposed rule.

investments, including a significant deficiency or material weakness in the design or implementation of the adviser's fair value determination process or material changes in the fund's valuation risks under paragraph (a)(1) of this section." We believe that, when significant fair value issues arise, which we believe to be an infrequent occurrence, advisers contact their funds' board(s) as a matter of course. In light of this practice, and consistent with the board's oversight role, we believe it would be more appropriate for the rule to require that the fair value policies and procedures required under the proposed rule reflect a timeframe for notifying the board of any material fair value issues. The policies and procedures could (but should not be required to) include examples of the types of such issues that would require "prompt" notification. We believe that this type of flexibility would allow boards and their advisers to tailor the notification requirements in a manner that reflects the board's preferred approach to oversight and would be consistent with the board's governance practices for other serious matters that may arise from time to time.

We also recommend aligning the proposed rule's periodic board reporting requirements with the board reporting requirements of Rule 38a-1 under the 1940 Act and the liquidity rule.<sup>7</sup> For example, rather than a quarterly assessment of the adequacy and effectiveness of the adviser's fair value determination process, an annual assessment would be more appropriate, as many of the reporting items under the proposed rule's periodic reporting regime would be unlikely to experience changes so frequently as to warrant quarterly reporting. This would be particularly true for items like the assessment and management of material valuation risks and the adequacy of resources allocated to the fair value determination process. The rule could then provide for quarterly reporting with respect to material changes to fair valuation policies and procedures and other material matters involving fund valuation.

### **Potential Impact on Capital Availability for Debt Financing**

We are concerned that the rigidity of the proposed rule could have the unintended effect of causing funds to avoid certain securities that are otherwise viewed as attractive investment opportunities. Consider, for example, the prior discussion of the proposed requirement to select and apply a fair value methodology in a consistent manner, including specifying key assumptions and inputs. As noted above, circumstances may arise for a specific security such that the adviser believes, in good faith, that the most appropriate fair valuation is to be obtained using certain inputs or methodologies not previously documented in the fund's fair valuation procedures according to the requirements of the proposed rule. To avoid encountering these situations, funds and advisers might be inclined to forego investment opportunities that are otherwise attractive but could present these types of valuation challenges. At sufficient scale, we believe this could not only impact the fund industry's ability to pursue attractive investments, but also could materially affect the amount of capital available for debt financing.

### **Structure of Proposed Rule**

Finally, we believe that the final rule should be structured as a safe harbor rather than as the exclusive means by which fair value is determined in good faith. While certain elements of the proposed rule may enhance the fair valuation process, providing a single prescribed approach for determining fair value in good faith could be quite burdensome without a corresponding benefit in terms of the quality of fair values determined.

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<sup>7</sup> See Rule 38a-1(a)(4)(iii) (requiring the fund chief compliance officer to provide, no less frequently than *annually*, a written report to the board addressing, among other things, the operation of the policies and procedures of the fund and certain service providers); Rule 22e-4(b)(2)(iii) (requiring the fund board to review, no less frequently than *annually*, a written report prepared by the liquidity program administrator addressing, among other things, the operation of the funds' liquidity risk management program and assessing the adequacy and effectiveness of its implementation).

We believe that a safe harbor rule would offer the opportunity for firms to meet the rule's requirements and achieve comfort with respect to their processes but also to have the option, in line with industry practice today, to rely on other methodologies to achieve accurate fair valuations even if different from those prescribed by the rule. We believe this would be more consistent with the notion of "good faith," which is designed to accommodate various relevant facts and circumstances and a range of different practices.<sup>8</sup> It would also help to avoid potential statutory violations under Section 2(a)(41) of the 1940 Act in connection with non-substantive violations of any of the numerous elements of the proposed rule. Structuring the final rule as a safe harbor would also be consistent with the approach taken by the SEC in other contexts.<sup>9</sup>

If the final rule is not structured as a safe harbor, we then believe it should be much less prescriptive than the proposed rule to allow for different but equally effective approaches to fair value determinations to continue in effect. The changes suggested in this letter would further this purpose, more closely align the final rule to current practices and reduce the costs of implementing the rule.

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We wish to reiterate our appreciation for the SEC's diligent and thoughtful approach to the proposed rule. Thank you again for taking the time to consider this letter, and please feel free to contact me at [REDACTED] with any questions.

Sincerely,



Amy J. Lee  
Deputy General Counsel  
Guggenheim Investments

cc: Guggenheim Funds' Boards of Trustees

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<sup>8</sup> See, e.g., Accounting for Investment Securities by Registered Investment Companies, Accounting Series Release No. 118 (Dec. 23, 1970) ("No single standard for determining 'fair value . . . in good faith' can be laid down, since fair value depends upon the circumstances of each individual case.").

<sup>9</sup> See, e.g., Rule 17e-1 under Section 17(e)(2) of the 1940 Act. Where Section 17(e)(2) prohibits certain fund affiliates from receiving remuneration for effecting certain transactions that exceed "the usual and customary broker's commission," Rule 17e-1 provides that certain remuneration will be *deemed* not to exceed "the usual and customary broker's commission" if certain requirements are met. In the same way, the final rule could be structured to *deem* a fair value determination to be a fair value determined in good faith within the meaning of Section 2(a)(41) if certain requirements are met.