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Ms. Vanessa Countryman  
Secretary  
U.S. Securities and Exchange Commission  
100 F Street NE Washington, DC 20549

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July 21, 2020

Re: Good Faith Determinations of Fair Value, 85 Fed. Reg. 28,734 (May 23, 2020)

Dear Ms. Countryman,

IHS Markit is pleased to comment on the Securities and Exchange Commission's ("SEC" or "Commission") proposed rulemaking concerning Good Faith Determinations of Fair Value ("Proposal"). IHS Markit is a global information and services company that provides data, insight, and solutions across 17 industries, including financial services.<sup>1</sup> IHS Markit is a NYSE-listed public company under the ticker "INFO." IHS Markit has approximately 15,000 employees in 35 countries, including over 5,000 employees in the United States with offices in 21 states and the District of Columbia.<sup>2</sup>

Among its Financial Services products and services,<sup>3</sup> IHS Markit is a leading independent pricing service provider for corporate, government, sovereign, agency and municipal bonds, securitized products, derivatives, and loans<sup>4</sup> used by many 40 Act funds that would be subject to the Proposal. We use inputs from multiple sources that are either aggregated to calculate composite levels or fed into a dynamic model to produce a price validated against the parameters for millions of instruments daily.

We offer these comments from the perspective of a leading pricing service provider<sup>5</sup> that supports many 40 Act funds' fair value determinations (as well as other financial institutions). We hope that the Commission finds these comments useful as they

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<sup>1</sup> For more information regarding IHS Markit's solution offerings for these 17 industries, please see <https://ihsmarket.com/products.html>.

<sup>2</sup> See <https://ihsmarket.com/about/locations.html>.

<sup>3</sup> See <https://ihsmarket.com/industry/financial-markets.html>.

<sup>4</sup> See <https://ihsmarket.com/products/pricing-and-reference-data.html>.

<sup>5</sup> We use the term "pricing service provider" in this comment letter as this is the term used in the rulemaking to refer to what we would consider both "pricing service providers" and "valuation service providers."

consider a final rulemaking.

## **I. Executive Summary**

We generally agree with the Proposal and believe it will provide a governance framework that will improve U.S. capital markets' function by providing 40 Act fund investors increased confidence in the accuracy of valuation data. Among other things and as detailed below, IHS Markit recommends the Commission make amendments to the Proposal that:

- Encourage competition among pricing service providers by encouraging or requiring at least annual reviews of pricing service providers.
- Ensure that all sources of input data used in fair valuations are regularly scrutinized as potential sources of valuation risk.

## **II. Comments on Request for Comment Questions ("RFCQs")**

### **1. Valuation Risk**

*1. Is this requirement appropriate? Should we further define what risks would need to be considered or provide guidance on the types of valuation risks that a fund may face? Are there additional sources or types of valuation risk that we should address? If so, what sources?*

We generally agree with the Proposal's suggested sources of valuation risk and agree the list of factors should not be prescriptive. We do think that the factor "reliance on service providers that have more limited expertise in relevant asset classes" by itself could deter competition in the market for pricing services and therefore recommend that the Commission incorporate a requirement to review pricing service providers at least annually. This suggestion is explored in Proposal at RFCQ 11 and our response to that question provides further detail on this point.

We also recommend the Commission clarify that valuation risk reviews also specifically consider the market structure for the asset, including the liquidity, volume, transparency and reliability of inputs. We note, for example, that reliance on a single input source could give rise to valuation risk because of, among other things, the risk of conflicts of interest.

*2. Should we require a certain minimum frequency for re-assessing valuation risk (e.g., annually or quarterly)? Should the rule specify types of market events or investment strategy changes that would require a reassessment of valuation risk? If so, what events or changes should prompt such a review?*

We have observed that many of our customers' boards engage in reviews of their fair valuation practices, including considerations of valuation risk, at least annually so an annual valuation risk review requirement would be unlikely to impose much of a marginal cost. We have noted that customers that engage in periodic fair value assurance or validations with external pricing service providers have a high degree of confidence in their fair valuations.

*3. Should we provide any further guidance on how valuation risk should be managed?*

We would suggest the Commission not just direct funds to assess valuation risk, but also provide guidance on how a fund board or their advisor might prudently mitigate valuation risk. To provide three examples the Commission should consider including in a final rulemaking:

- We have observed many funds mitigate valuation risk through diversification of sources of data and pricing service providers used to determine fair values or ensuring that the vendor(s) they use also use a diverse, transparent, and reliable set of inputs.
- To provide another and related example of mitigating valuation risk, we note that in some thinly-traded securities some funds use dealer-provided indicative buyback prices as the primary or even sole basis to fair value these notes, particularly non-vanilla (structured) notes. Dealers provide these buyback prices as indicative values for these debt products and generally do not commit to execute at these buyback prices. These indicative buyback prices utilize values for certain valuation inputs that may be inconsistent with those which would be determined by reference to observable market data. We have observed customers mitigate the valuation risk associated with relying on indicative buyback prices by also considering additional market data and discounted cash flows as inputs to the price.
- Under certain circumstances, where the potential conflicts of interest are high in using a fund advisor to perform valuations, e.g., where the fair value model relies on unobservable inputs and/or provides for a wide range of valuations and/or involves considerable discretion, we note that some funds will elect to periodically obtain fair value assurances or validations with independent pricing service provider(s).

2. Fair Value Methodologies

*4. This requirement includes several specified elements, discussed above, relating to the fair value methodologies. Are these elements appropriate? Are*

*there additional elements that commenters believe should be included under this requirement? Should we modify or remove any of the proposed elements? Should we require application of the methodologies in a reasonably consistent manner, or as consistently as possible under the circumstances?*

We agree that the specified elements are appropriate in relation to fair value methodologies. In addition, we would highlight the importance of maximizing the use of observable market data when assessing the fair value of illiquid assets. Utilizing market-based measures of risk and return provides a crucial insight into market conditions at the valuation date and what could be achieved for the illiquid investment in an orderly transaction.

We also agree with detailed disclosure of rationales behind the choice of methodologies and justification for changes in methodologies and/ or weightings. This should also include why certain methods or proxies have been decided against as useful to the determination of fair value.

*6. Are there investments for which it is not feasible to establish a methodology in advance? If so, how should the rule address such situations? Is it clear what new investment types a fund may “intend” to invest in? Should we provide any further guidance on this? What processes do funds currently follow before investing in new types of investments to help to ensure that, after making the investment, the board will be in a position to determine fair value if required?*

We note that many customers have a process to ensure that a methodology and supporting pricing service provider are in place to cover the new investments. We understand that current best practice is to test the new security fair value methodology.

### 3. Testing of Fair Value Methodologies

*7. Should the rule require particular testing types or minimum testing frequencies? For example, should we require tests to occur at least weekly, monthly, or quarterly? If so, should the frequency required be dependent upon the type of instrument? Should the rule require all funds to use certain types of testing, such as back testing and calibration, at a minimum? Are certain types of methodology testing inappropriate or irrelevant for certain investment types?*

With respect to the frequency of testing, we have observed that many of our 40 Act fund customers engage back testing at least annually. For private market investments, we note there is a limited number of transactions and/or the portfolio

asset is idiosyncratic in its structure and therefore does not lend itself to a comparability analysis for the purpose of backtesting. In these cases, calibrations can prove to be more useful in ensuring more reliable fair valuations.

*8. What other types of testing of fair value methodologies are commonly used?*

Pricing service vendors like IHS Markit offer back testing services for 40 Act and other customers. We recommend the Commission clarify in a final rulemaking that funds can utilize backtesting reports from pricing services. This would enable funds to leverage at a lower cost and with greater accuracy back testing capabilities of specialist pricing service vendors.

To provide an example of a kind of common testing, we note the use of “trade studies” to compare evaluated prices against contemporaneous (or near contemporaneous) executed trade prices. These trade studies can be performed by a pricing service provider or can be performed in-house by relevant pricing experts.

*9. Should the rule require specified actions based on the results of the testing? If so, what would those actions be?*

Pricing services as well as our 40 Act customers that engage in back testing generally adjust their methodologies to address issues, particularly systematic or methodology issues identified in back testing. We believe the Proposal is fairly clear on this point but perhaps some 40 Act funds would benefit from guidance or clarification that beyond “assessments” of fair value methodologies, the duty to “determine fair value in good faith” implies taking steps to identify and address deficiencies uncovered as a part of the fair value compliance program, including issues identified as a part of back testing.

#### 4. Pricing Services

*10. Do commenters agree that the proposed rule should require oversight of pricing service providers, if used? Should the rule cover any service providers other than pricing services? If so, which service providers should be included? Should the rule further clarify who qualifies as a pricing service?*

We support the Proposal’s requirement for 40 Act funds’ boards and fair value advisors to oversee pricing service providers’ performance and selection. This is already a common practice among customers. We would also recommend the Commission to consider commensurate scrutiny of data from sources other than pricing service providers that are used as an input into fair values. See our answer to RFCQ 3 for additional discussion of how relying on counterparty indicative

buyback prices could adversely affect valuations.

The Proposal suggests boards evaluate “whether the pricing service continues to have competence in valuing particular securities and maintains an adequate control environment” through “on-site visits.”<sup>6</sup> In order to ensure that the costs associated with these on-site examinations are commensurate with the underlying valuation risks, we would recommend the final rulemaking clarify that physical examinations are appropriate in instances where there is an identified need for a physical examination due to identified valuation risks that can be allayed cost-effectively through an on-site examination vs. a virtual examination of the pricing data service providers. An example of a valuation risk that can be allayed cost-effectively through an on-site examination could be instances when the pricing service provider is affiliated with a market participant, giving rise to clear potential conflicts of interest. In many other cases, a completed due diligence questionnaire may be sufficient to ensure that adequate controls exist and are followed.

In the absence of additional clarification from the Commission regarding the circumstances in which on-site examinations are warranted we think many funds will err on the side of caution and request on-site visits routinely even when valuation risk considerations do not warrant such expenditures of resources. This will result in these on-site examinations leading to costs in excess of potential benefits for both the fund and its pricing service providers.

*11. Should there be a specific requirement in the rule to periodically review the selection of the pricing services used and to evaluate other pricing services?*

We recommend the Commission consider a specific requirement to re-evaluate pricing service providers on at least an annual basis or at the minimum encourage such reviews when valuation risks are sufficiently elevated. Such a requirement would encourage market discipline and competition among pricing service providers. We note that such a requirement would partly offset the anti-competitive effect of one of the Proposal’s suggested valuation factors, namely “reliance on service providers that have more limited expertise in relevant asset classes.” See our answer to RFCQ 1 above where we have above recommended that this valuation risk factor be revised in a way that would encourage more competition for pricing services.

##### 5. Performance of Fair Value Determinations

*18. For boards that elect to conduct fair value determinations themselves, should we provide any guidance on the level of assistance they can receive*

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<sup>6</sup> Proposal at 28,753.

*from service providers, while fulfilling their obligations under section 2(a)(41)? Do we need to provide any guidance on how a board should obtain and oversee such assistance if needed? If so, what guidance should we provide?*

As a pricing service provider, we would welcome guidance on the level of assistance that they can receive from service providers as this would assist firms like us in tailoring our products and services to boards that elect to conduct fair value determinations themselves. This would have the effect of reducing costs for funds and ultimately their investors.

#### 6. Board Reporting

*34. In light of their importance, should the rule impose specific requirements beyond reporting regarding pricing services? For example, should any pricing services used be explicitly approved by the board? Should there be a required finding or report by the adviser as to pricing services' adequacy and effectiveness?*

Based on our work with 40 Act fund customers, the best practice appears to be board or pricing committee approval of pricing service providers and regular and at least annual review of pricing service providers' performance based on back testing and other relevant considerations.

#### 7. Assignment of Responsibilities to Service Providers Other Than Investment Advisers

*71. Would it be preferable to allow the board to assign the fair value determinations to service providers other than the investment adviser, such as a pricing service provider? If yes, why?*

We agree with the Proposal that the responsibility to determine fair valuations in good faith should apply to fiduciaries of the fund, i.e. its board or an advisor of the fund. We would urge strict compliance with the rules and requirements applicable to advisors of funds subject to the duty to determine fair valuations in good faith.

On a related issue, we request that the Commission clarify whether pricing service providers would be able to substantively act as fiduciaries and "advisors" for 40 Act funds for the purpose of determining fair values. We believe that pricing service providers, even if they are otherwise registered as investment advisors, cannot substantively meet the requirements of a fiduciary under the Investment Company Act of 1940 and other securities laws. If the Commission disagrees, we (and likely other non-RIA pricing service providers) would appreciate clarification on this point in the final rulemaking. The notice that such clarification would provide will have significant competitive consequences and therefore would be consequential for the

purpose of the Commission's considerations of costs and benefits.

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IHS Markit appreciates the opportunity to provide these comments to the Commission. We would be happy to elaborate on or further discuss any of the points addressed above. If you would like to follow up on our comment letter, please contact B. Salman Banaei, Executive Director, [REDACTED] or [REDACTED].