

July 21, 2020

**VIA E-MAIL**

Ms. Vanessa Countryman  
Secretary  
U.S. Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-1090  
rule-comments@sec.gov

Re: *Good Faith Determinations of Fair Value* (File No. S7-07-20)

Dear Ms. Countryman:

This letter presents the comments of John Hancock Investment Management LLC and John Hancock Variable Trust Advisers LLC (collectively, “**John Hancock**”) with respect to the U.S. Securities and Exchange Commission’s (“**SEC**” or “**Commission**”) proposed new Rule 2a-5 (“**Proposed Rule**”) under the Investment Company Act of 1940, as amended (“**1940 Act**”). John Hancock is a premier asset manager representing one of America’s most trusted brands, with a heritage of financial stewardship dating back to 1862. We provide investment management services to the John Hancock Group of Funds, a family of 195 registered funds with approximately \$184.97 billion in assets.<sup>1</sup> These funds invest across a wide variety of asset classes and investment types. We have therefore had the opportunity to consider the impact of the Proposed Rule on a registered fund complex that assigns values to a large and diverse set of investments on a daily basis.

We appreciate the opportunity to comment on the Proposed Rule, and we support the SEC’s efforts to modernize the existing framework for valuation of fund investments and clarify the respective roles of a fund’s investment adviser and its board of directors with respect to valuation. However, we have concerns with certain aspects of the Proposed Rule. In particular, the Proposed Rule does not sufficiently distinguish between investments valued using prices obtained from a pricing service and investments valued by a fund’s investment adviser or its pricing committee, and we recommend revising certain unnecessary requirements with respect to pricing service-priced investments. In addition, we believe that a final Rule 2a-5 should be more principles-based and less prescriptive, particularly as it relates to valuation methodologies and board reporting. We also request that the Commission clarify that an investment adviser of the fund acting under an administration or similar agreement would be a permissible assignee, and further, that the Commission expand the scope of permissible assignees to include an administrator that is affiliated with a fund’s investment adviser. These comments are discussed in greater detail below.

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<sup>1</sup> Information regarding the John Hancock Group of Funds is as of June 30, 2020.

## I. Lack of Distinction between Pricing Service Prices and Adviser Valuations

We agree that funds should utilize information provided by pricing services or vendors only if appropriate due diligence and oversight of such pricing services have been performed. Accordingly, we support the Proposed Rule's requirement to establish a process for approval, monitoring and evaluation of any pricing service providers used as part of determining fair value in good faith. At the same time, we believe that the Commission should acknowledge the different processes and considerations with respect to prices obtained from pricing services and adviser-supplied valuations and distinguish between these types of valuations for purposes of certain rule requirements.

Pricing services are independent third parties that provide valuation information to a wide range of funds and advisers and, thus, are not subject to the same degree of potential conflicts of interest as a fund's investment adviser with respect to valuation. As noted in the release proposing the Proposed Rule, a fund's investment adviser may have an incentive to value a fund's assets improperly for various reasons, including to increase fees or improve reported performance.<sup>2</sup> The Proposing Release indicates that other service providers, such as pricing services, may have an incentive to provide valuation information favorable to a fund's investment adviser, for example to maintain an ongoing business relationship with the adviser.<sup>3</sup> However, we do not view this risk as significant. Pricing services maintain relationships with a wide variety of investment advisers, and generally are expected to provide the same valuation information with respect to a particular security to all funds, making it less likely that they will be unduly pressured to provide favorable information in a particular scenario or to a particular investment adviser. In addition, a pricing service's processes with respect to potential conflicts and the quality of its services can be evaluated as part of the due diligence process with respect to that pricing service and a pricing service simply does not have the level of involvement in a fund's valuation processes that an investment adviser does.

Within the John Hancock Group of Funds, the due diligence process is utilized to assess, among other things, the quality of pricing inputs and vendor prices, as well as any potential conflicts. John Hancock tests vendor prices by reviewing, for example, daily fund transactions, large price movements for securities that exceed day-over-day price tolerance levels and differences among vendor prices by comparing primary to secondary and tertiary pricing services. We also frequently meet with vendors and perform annual risk assessments. These actions allow us to assess the quality of pricing services in a more efficient and effective way than the proposed requirement to daily source, validate and maintain detailed inputs, assumptions and methodologies for thousands of securities. Accordingly, we believe that there is a policy basis for treating prices provided by pricing services differently from adviser-supplied fair valuations.

In light of the different degree of conflicts presented, we believe that the costs and additional resources associated with applying all of the Proposed Rule's requirements to pricing service-priced investments significantly outweigh any benefits. The John Hancock Group of Funds has over 12,000 securities valued using pricing vendor evaluated prices each day. Given the significant volume of investments priced daily utilizing information supplied by pricing services, the procedural and recordkeeping requirements involved would be substantial for many funds, particularly those that invest extensively in fixed-income investments. In addition, the procedural and recordkeeping requirements could add significant time to the process for calculating a fund's net asset value at the end of each business day by requiring a considerable volume of data elements to be validated, which could result in delays in disseminating a fund's daily net asset value

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<sup>2</sup> *Good Faith Determinations of Fair Value*, SEC Release No. IC-33845, 85 Fed. Reg. 28734 (May 13, 2020) at 28743, available at <https://www.govinfo.gov/content/pkg/FR-2020-05-13/pdf/2020-08854.pdf> (“**Proposing Release**”).

<sup>3</sup> *Id.*

information. In our view, the time and resources associated with the proposed reporting and recordkeeping requirements for pricing service-priced investments would require significantly more hours to implement and result in higher costs than the estimates presented in the Proposing Release.

For these reasons, we believe that the requirements below should not apply with respect to pricing service-priced investments. Instead, we believe that these are more appropriately addressed through initial and ongoing due diligence with respect to the pricing services used by a fund, consistent with the current regulatory framework and funds' practices today.<sup>4</sup>

#### **A. Selecting, Applying and Reviewing Fair Value Methodologies**

Proposed Rule 2a-5(a)(2) would require a fund to “[e]stablish and apply fair value methodologies,” which would include, among other things, (i) the selection and application of “an appropriate methodology or methodologies for determining (and calculating) the fair value of fund investments, including specifying...the key inputs and assumptions specific to each asset class or portfolio holding” and (ii) a periodic review of the “appropriateness and accuracy of the methodologies selected” and implementation of “any necessary adjustments thereto.”

Where a fund utilizes information provided by a pricing service, the fund does not establish the specific methodology and/or the key inputs and assumptions. Rather, the pricing service performs these functions, and the fund undertakes due diligence to understand and assess the pricing service's methodologies, processes and inputs, including its processes for reviewing its methodologies and making adjustments on an ongoing basis and testing of the provided valuations against other sources of market data. As a practical matter, it may be challenging – and unnecessarily costly – for a fund or adviser to obtain the level of detail as to methodologies and inputs contemplated by the text of the Proposed Rule for inclusion in its procedures. In addition, this level of detail would provide limited benefit given the separate requirements as to due diligence and ongoing oversight of pricing services. Given that the pricing service, rather than the fund, selects and applies an appropriate methodology, the proposed requirement to “[e]stablish and apply fair value methodologies” should not apply to pricing service-priced investments.

#### **B. Recordkeeping**

Proposed Rule 2a-5(a)(6) would require the maintenance of “[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, for at least five years from the time the determination was made, the first two years in an easily accessible place.” The Proposing Release indicates that the requirement to maintain appropriate documentation to support fair value determinations would include documentation sufficient for third-party verification of fair value determinations.<sup>5</sup> We believe that the SEC should clarify that, for pricing service-priced investments, a fund need only identify the source of the price (*i.e.*, name of the pricing service), and not the specific methodology and inputs for each individual investment. Given the volume of investments for which pricing services provide prices, it would be costly and require additional resources to retain the underlying methodology for thousands of pricing service-priced investments, and in

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<sup>4</sup> See *Money Market Fund Reform; Amendments to Form PF*, SEC Release No. IC-31166, 79 Fed. Reg. 47735 (Aug. 14, 2014) at 47814-15, available at <https://www.govinfo.gov/content/pkg/FR-2014-08-14/pdf/2014-17747.pdf> (describing factors a board may want to consider before determining to use evaluated prices from a pricing service to assist in fair valuation determinations).

<sup>5</sup> Proposing Release at 28741.

our view would provide little additional benefit given the pricing vendor due diligence we perform. Although the Proposing Release states that the estimated burden of compliance would be four hours per year,<sup>6</sup> we expect that the actual time burden and the related costs could be significantly higher if funds were required to maintain detailed data and records on methodologies and inputs associated with pricing service valuations.

## **II. Specificity of the Proposed Rule's Requirements**

We acknowledge the critical importance of valuation under the 1940 Act and agree that it is appropriate for the Commission to establish a “minimum, consistent framework” for fair valuation of investments.<sup>7</sup> Nonetheless, we believe that certain aspects of the Proposed Rule are too prescriptive in nature, particularly with respect to the specificity required in valuation procedures and the level and frequency of board reporting. Funds and investment advisers have extensive experience valuing fund investments and over time have developed appropriate processes and procedures based on their particular facts and circumstances. In addition, procedures need to be flexible enough to respond to changing and unforeseen events impacting the markets generally or specific issuers or securities. We believe that the specificity of the Proposed Rule's requirements discussed below could limit such flexibility and evolution over time.

In addition, under the requirements below, the board would be asked to approve and oversee valuation procedures reflecting detailed information about methodologies (as part of either the fund's or the adviser's compliance program). Where the board assigns fair valuation responsibilities to the fund's investment adviser, the board would also be asked to receive and review detailed reports on a range of valuation matters, including prompt reports regarding matters that materially affect fair value determinations. These requirements could lead to day-to-day board involvement in the valuation process. We thus urge the Commission to clarify that the board's role is one of oversight and that the board can rely on the expertise of the adviser to perform the day-to-day valuation functions, subject to the board understanding the valuation process and receiving periodic reporting on the valuation outcomes.

### **A. Selecting and Applying Methodologies in a Consistent Manner**

Under Proposed Rule 2a-5(a)(2), establishment of fair value methodologies would include “[s]electing and applying in a consistent manner an appropriate methodology or methodologies for determining (and calculating) the fair value of fund investments.” The Proposing Release indicates that the Proposed Rule “would require that the fair value methodologies be consistently applied to the asset classes for which they are relevant.”<sup>8</sup> The Proposed Rule also would require an investment adviser or board to monitor for circumstances that may necessitate the use of fair value and to establish criteria for determining when market quotations are no longer reliable.

While we do not, in general, oppose a requirement to apply methodologies in a consistent manner, we believe there should be a recognition that investments within one asset class may appropriately be valued using different methodologies based on the relevant facts and circumstances. Given that fair value depends upon the facts and circumstances of each individual case, a final Rule 2a-5 should not require a rigid application of ex-ante consistency in determining fair value in an environment of changing market conditions. Instead, a final Rule 2a-5 should require a consistent approach to governance of the valuation

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<sup>6</sup> *Id.* at 28765.

<sup>7</sup> *Id.* at 28737.

<sup>8</sup> *Id.* at 28739.

determinations. Likewise, we believe that it is not possible to identify in advance all of the circumstances that may require the use of fair value and/or criteria that may indicate that market quotations are no longer reliable. We encourage the Commission to clarify that a fund's or adviser's valuation procedures can be drafted to allow for flexibility to take into account the relevant facts and circumstances as they exist at the time to determine the valuation of a fund's investments.

## **B. Price Challenges**

In addition, Proposed Rule 2a-5(a)(4) would require an investment adviser and/or board to establish "criteria for initiating price challenges." In our experience, price challenges are initiated on a case-by-case basis based on the particular facts and circumstances, which can vary day-to-day. Requiring specific criteria for such a determination would be difficult to administer and, in our view, would undoubtedly result in unintended consequences by reducing the ability of investment advisers and/or boards to respond to the specific facts and circumstances as they exist at the time. Accordingly, we believe that initiating price challenges should be principles based, subject to the discretion of the investment adviser and/or board, rather than rigid requirements set forth in policies and procedures.

Currently, for example, we issue price challenges to pricing vendors when we have information that differs from the vendor price, which could be based on a fund transaction, comparisons among information provided by pricing services, or other sources. We do not, however, have rigid guidelines outlining the specific criteria pursuant to which price challenges must be initiated. We believe that this process works effectively by allowing us to issue price challenges when appropriate, while at the same time allowing us to adjust as needed based on the circumstances. The imposition of rigid requirements, on the other hand, could lead to mechanical price challenges with unintended consequences, such as unnecessarily frequent price challenges. Unnecessarily frequent challenges would be particularly likely in periods of market volatility, as experienced earlier this year when prices were changing frequently, but where such changes were expected given the market environment. In addition, unnecessarily frequent challenges could impair the quality of the prices and services provided by pricing vendors, as pricing vendors may need to address these challenges on a significant scale.

## **C. Periodic Board Reporting**

The Proposed Rule requires an investment adviser that has been assigned fair valuation responsibilities to provide periodic reports, at least quarterly, to the board. As proposed, Rule 2a-5 would require that such periodic reports cover: the material valuation risks applicable to a fund, including material conflicts of interest of the investment adviser and any other service provider; material changes to or deviations from the fair value methodologies; testing results of the fair value methodologies; an assessment of the resources allocated to the fair value process; material changes to the adviser's process for selection and oversight of third-party pricing services, including changes to the pricing services used and a report on all price overrides; and other information requested by the board.

Although we acknowledge the importance of certain of this information, we believe that the list of information to be provided to the board on a periodic basis is overly prescriptive and that greater deference should be afforded to the board to work with the investment adviser to determine the appropriate frequency and scope of reporting based on a fund's particular facts and circumstances. To the extent more specific requirements are maintained in a final Rule 2a-5, we agree that quarterly valuation reports presented to the board should focus on material matters such as material changes to the valuation risks applicable to a fund, material revisions to the fair valuation procedures, and material changes to the investment adviser's oversight of third-party pricing services. Unless there are material changes or updates, the items specified in the Proposed Rule generally should be required on an annual basis, instead of quarterly or periodically.

We note that this approach would be more consistent with the board reporting requirements of Rule 22e-4 and Rule 38a-1 under the 1940 Act.

#### **D. Prompt Board Reporting**

Proposed Rule 2a-5(b)(1)(ii) would require an investment adviser to promptly report to the board on “matters associated with the adviser’s process that materially affect or could have materially affected the fair value of the assigned portfolio of 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.” Proposed Rule 2a-5 would require such reports to be provided in writing and no later than three business days after the adviser becomes aware of the issue. While we agree that significant issues should be reported to the board, we believe that this standard is vague and overbroad, and is therefore likely to result in unnecessarily frequent reporting on items that are not ultimately significant. Moreover, a final Rule 2a-5 should not specify a three-business day requirement for such reporting, but rather should require reporting within a reasonable time period. In our experience, an investment adviser’s ability to report such matters to the board is subject to its receipt of the relevant information from the various service providers involved and its review and consideration of the matter, which may take longer than three business days. We note that this is particularly true with respect to a manager of managers, such as John Hancock, which may need to consult with the applicable sub-adviser(s) regarding the matter.

In addition, we believe that a final Rule 2a-5 should provide flexibility as to the format of the report provided to the board (either written or oral). An investment adviser may be able to provide an oral report to the board sooner than a written report. The investment adviser could then provide a more formal written discussion of the matter in a subsequent quarterly report to the board.

#### **III. Permissible Assignees**

Proposed Rule 2a-5(b) permits a board to “assign the fair value determination relating to any or all fund investments to an investment adviser of the fund,” subject to certain conditions. We strongly agree that boards should be permitted to assign fair valuation responsibilities to an investment adviser as contemplated by the Proposed Rule. However, we believe that the Commission should clarify and expand the scope of permissible assignees to reflect the variety of organizational structures and entities that assist funds with valuation matters today. Specifically, we request that the following be permissible assignees under a final Rule 2a-5: (i) an investment adviser of the fund (whether acting pursuant to the advisory agreement or an administration or similar agreement); and (ii) an administrator that is an affiliated person (as defined in Section 2(a)(3) of the 1940 Act) of the fund’s investment adviser (an “**Affiliated Administrator**”).

Valuation-related services can be provided by a fund’s adviser in its role as an adviser, fund administrator, or in a similar capacity. While we believe that such an approach would be permitted under the text of the Proposed Rule (given that such entity is the investment adviser of the fund), we would welcome clarity on this point. Furthermore, we believe that allowing assignment of responsibilities to an Affiliated Administrator is consistent with permitting assignment to the investment adviser itself. The Commission observed that assignment to an entity other than the investment adviser “potentially could limit a board’s ability to effectively oversee the service provider that performs the fair value determinations” and that other service providers “may not owe a fiduciary duty to the fund, and thus their obligation to serve the fund’s and its shareholders’ best interests is limited.”<sup>9</sup> However, these concerns do not exist to the same degree where the entity is an Affiliated Administrator, over which a board can exercise oversight through its

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<sup>9</sup> Proposing Release at 28761.

relationship with the investment adviser. In addition, SEC staff guidance relating to affiliated service provider relationships imposes further protections for funds and their shareholders.<sup>10</sup> Accordingly, we believe this clarification and expansion in the scope of permissible assignees would be appropriate.

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John Hancock appreciates the opportunity to comment on the Proposed Rule and hopes that the Commission finds these comments helpful and constructive. Please contact us if you wish to discuss these comments further or if we can provide any additional assistance.

Sincerely,



Andrew G. Arnott  
President and Chief Executive Officer  
John Hancock Investment Management LLC  
John Hancock Variable Trust Advisers LLC

cc: The Honorable Jay Clayton  
The Honorable Allison Herren Lee  
The Honorable Hester M. Peirce  
The Honorable Elad L. Roisman  
Dalia Blass, Director, Division of Investment Management

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<sup>10</sup> The SEC staff takes the position that service arrangements between a fund and an affiliated person may be subject to the prohibitions of Section 17(d) and Rule 17d-1 thereunder (relating to joint transactions) unless the affiliate receives only compensation that is “fair and reasonable,” and “adequate safeguards” are present to prevent overreaching. *See, e.g., Norwest Bank Minnesota, N.A.*, SEC No-Action Letter (May 25, 1995); *Washington Square Cash Fund, Inc.*, SEC No-Action Letter (July 9, 1990).