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- 17 CFR Part 271
- File No. S7-33-11
- **Use of Derivatives by Investment Companies under the Investment Company Act of 1940**

Dear Sir,

Thank you for giving us the opportunity to contribute to your Concept Release and request for comments on: Use of Derivatives by Investment Companies under the Investment Company Act of 1940.

The Securities and Exchange Commission (SEC) is reviewing the use of derivatives by investment companies registered under the Investment Company Act of 1940 (Act). To assist in this review, the SEC is issuing this concept release and request for comments on a wide range of issues relevant to the use of derivatives by funds, including the implications for fund leverage, diversification, exposure to securities-related issuers, portfolio concentration, valuation and related matters.

I would like to comment on the valuation of derivatives. Generally accepted accounting principles (GAAP)<sup>1</sup> define fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.<sup>2</sup> They require the use of market data to measure fair value, and also provide guidance on the correct use of observable and unobservable inputs. This fair value hierarchy prioritises the input levels to the valuation methodology underlying fair value as follows:

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<sup>1</sup> E.g. US GAAP or IFRS.

<sup>2</sup> Compare with your definition in paragraph VI.A: "the fair value of a security or other asset held by a fund would be the amount that the fund might reasonably expect to receive for the security or other asset upon its current sale".

<b>Hierarchy</b>	<b>Input Type</b>	<b>Valuation Methodology</b>
Level 1	Unadjusted quoted prices in active markets for identical assets or liabilities	Mark-to-market
Level 2	Quoted priced for similar instruments or other observables	Mark-to-matrix (interpolation)
Level 3	Unobservable inputs reflecting estimates and assumptions that market participants would use	Mark-to-model

The current fair valuation methodology under GAAP is sufficient and complete in order to value derivatives as required under the Act, and would be an improvement on the existing requirement for “fair value at the end of such quarter, as determined in good faith by the board of directors”. For example, market participant assumptions include the effect of contractual restrictions on transferability and restrictions on the ability to close out the transactions. Therefore, in answer to your specific question in paragraph VI.C, I would recommend that the SEC should issue guidance on the fair valuation of derivatives required under the Act. I would further recommend that such fair valuation of derivatives should comply with GAAP, in this case FAS 157 Fair Value Measurements, issued by the FASB in September 2006.

Yours faithfully

Chris Barnard