

BOARD OVERSIGHT OF VALUATION: THE SEC STAFF PERSPECTIVE

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Investment Company Act of 1940

- Section 2(a)(41)(B): “Value” means (i) with respect to securities for which market quotations are readily available, the market value of such securities; and (ii) with respect to other securities and assets, fair value as determined in good faith by the board of directors.
- Rule 2a-4: Defines “current net asset value” that funds use to calculate the price of fund shares. Portfolio securities with respect to which market quotations are readily available are valued at current market value. Other securities and assets are valued at fair value as determined in good faith by the fund’s board of directors.

Investment Company Act of 1940

- Rule 22c-1(a): Funds generally must sell and redeem their shares at a price based on the fund's current net asset value as next computed after the receipt of a redemption, purchase or sale order.
- Rule 22c-1(b): Funds generally must compute their net asset value at least once daily, Monday through Friday.
- Rule 38a-1: Funds must adopt and implement policies and procedures reasonably designed to prevent violations of the federal securities laws.

Valuation Guidance

- Accounting Series Release No. 113 and No. 118 (“ASR 113” and “ASR 118”).
- Other Commission releases and enforcement actions.
- Division of Investment Management staff guidance: letters to the industry, no-action letters and interpretations.
- Division of Investment Management staff valuation bibliography:
<http://www.sec.gov/divisions/investment/icvaluation.htm>

Fair Value Determinations

Under Section 2(a)(41)(B) of the Investment Company Act, fund boards of directors are required to determine in good faith the fair value of securities and other assets for which market quotations are not readily available. Fund directors may discharge their duty to determine fair value in more than one way.

Delegation

Section 2(a)(41)(B) of the Investment Company Act does not address whether fund boards may delegate their fair value obligations to others. It is the Commission's position, however, that fund boards may delegate some, but not all, fair value functions to others. *See ASR 118.*

ASR 118

“To the extent considered necessary, the [fund’s] board may appoint persons to assist them in the determination of [fair] value, and to make the actual calculations pursuant to the board’s direction.”

All Appropriate Factors

Fund boards must consider “all appropriate factors” relevant in determining the fair value of a security. *See* ASR 118. In some circumstances, a board may conclude that it needs supplemental information and, if so, the board should identify, request and review such information as part of its fair value determination.

Rule 38a-1 Required Policies and Procedures

“[R]ule 38a-1 requires funds to adopt policies and procedures that require the fund to monitor for circumstances that may necessitate the use of fair value prices; establish criteria for determining when market quotations are no longer reliable for a particular portfolio security; provide a methodology or methodologies by which the fund determines the current fair value of the portfolio security; and regularly review the appropriateness and accuracy of the method used in valuing securities, and make any necessary adjustments.” Investment Company Act Release No. 26299 (Dec. 17, 2003) (footnotes omitted).

Pricing Services

Are evaluated prices provided by pricing services market quotations or fair values for securities for which market quotations are not readily available? What information about pricing services should fund boards obtain to assess whether evaluated prices reflect the fair value of portfolio securities?

Ongoing Review

Fund boards must continuously review the appropriateness of any methodology used to fair value fund portfolio securities and other assets. *See ASR 113 and ASR 118.* Selecting or creating meaningful metrics involves a fundamental understanding of the valuation process and procedures in addition to risks associated with a fund's holdings, general market and economic conditions, and other relevant factors.

Documentation

Documenting fund valuation practices, policies and procedures and their implementation may reveal whether a fund's board of directors has fulfilled its obligation to determine in good faith the fair value of securities and assets for which market quotations are not readily available. *See ASR 118.*