

MEMO# 28546

December 2, 2014

Valuation Guidance Included in SEC Money Market Fund Release

[28546]

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TO: ACCOUNTING/TREASURERS COMMITTEE No. 30-14
CHIEF COMPLIANCE OFFICER COMMITTEE No. 10-14
END OF DAY PRICING FORUM No. 6-14
SEC RULES COMMITTEE No. 40-14 RE: VALUATION GUIDANCE INCLUDED IN SEC'S MONEY MARKET FUND RELEASE

Earlier this year, the SEC adopted amendments to the rules that govern money market funds (the "Release"). [\[1\]](#) Among many other things, the Release provided guidance regarding the fair value of thinly traded securities, the use of pricing services, and the use of amortized cost valuation. [\[2\]](#) Although discussed primarily in the context of money market funds, this valuation guidance is generally applicable to all registered investment companies and business development companies—not just money market funds.

ICI recently expressed concerns over both the process by which this guidance was issued and its substance. The valuation guidance in the Release and ICI's letter to SEC Chair Mary Jo White [\[3\]](#) are briefly summarized below.

Context for the Valuation Guidance

Government and retail money market funds are permitted to maintain a stable net asset value (NAV) by using amortized cost valuation and/or the penny rounding method of pricing. In addition, all other registered investment companies (including floating NAV money market funds) may, in accordance with SEC guidance, continue to use amortized cost to value debt securities with remaining maturities of 60 days or less if fund directors, in good faith, determine that the fair value of the debt securities is their amortized cost value, unless the particular circumstances warrant otherwise.

In commenting on the money market fund reform proposals, a number of commenters, including ICI, addressed the use of amortized cost valuation by money market funds. In response, the SEC not only provided expanded valuation guidance on the use of amortized cost valuation for money market funds, but went further and provided more generally applicable guidance on other valuation issues as well.

Use of Amortized Cost Valuation

According to the Release, “a fund may only use the amortized cost method to value a portfolio security with a remaining maturity of 60 days or less when it can reasonably conclude, at each time it makes a valuation determination, that the amortized cost value of the portfolio security is approximately the same as the fair value of the security as determined without the use of amortized cost valuation. Existing credit, liquidity, or interest rate conditions in the relevant markets and issuer specific circumstances at each such time should be taken into account in making such an evaluation.”

Further, the Release states the SEC’s belief that because each money market fund will be required to value, on a daily basis, the fund’s portfolio securities using market-based factors and disclose the fund’s share price using basis point rounding, each money market fund should have readily available market-based data to assist it in monitoring any potential deviation between a security’s amortized cost and fair value determined using market-based factors. In certain circumstances (e.g., intraday), the Release notes that a fund may rely on the last obtained market-based data to assist it when valuing its portfolio securities using amortized cost. To address this, a fund’s policies and procedures could be designed to ensure that the fund’s adviser is actively monitoring both market and issuer-specific developments that may indicate that the market-based fair value of a portfolio security has changed during the day indicating the use of amortized cost valuation for that security may no longer be appropriate.

Thinly Traded Securities

The Release acknowledges that many debt securities, such as commercial paper, are often valued based upon “mark-to-model” or “matrix pricing” estimates because these securities are not actively traded in the secondary markets. The Release states that funds holding debt securities generally should not fair value these securities at par or amortized cost based on the expectation that the funds will hold those securities until maturity, if the funds could not reasonably expect to receive approximately that value upon the current sale of those securities under current market conditions.

Pricing Services

The Release notes that many funds use evaluated prices provided by third-party pricing services to assist them in determining fair values of their portfolio securities. The SEC states that evaluated prices provided by pricing services are not, by themselves, “readily available” market quotations or fair values “as determined in good faith by the board of directors” as required under the Investment Company Act. It further states, with respect to the board’s responsibilities in connection with pricing services (citations omitted):

We note that a fund’s board of directors has a non-delegable responsibility to determine whether an evaluated price provided by a pricing service, or some other price, constitutes a fair value for a fund’s portfolio security. In addition, we have stated that “it is incumbent upon the [fund’s] Board of Directors to satisfy themselves that all appropriate factors relevant to the value of securities for which market quotations are not readily available have been considered,” and that fund directors “must . . . continuously review the appropriateness of the method used in valuing each issue of security in the [fund’s] portfolio.” Although a fund’s directors cannot delegate their statutory duty to determine the fair

value of fund portfolio securities for which market quotations are not readily available, the board may appoint others, such as the fund's investment adviser or a valuation committee, to assist them in determining fair value, and to make the actual calculations pursuant to the fair valuation methodologies previously approved by the directors.

Before deciding to use evaluated prices from a pricing service to assist it in determining the fair values of a fund's portfolio securities, the fund's board of directors may want to consider the inputs, methods, models, and assumptions used by the pricing service to determine its evaluated prices, and how those inputs, methods, models, and assumptions are affected (if at all) as market conditions change. In choosing a particular pricing service, a fund's board may want to assess, among other things, the quality of the evaluated prices provided by the service and the extent to which the service determines its evaluated prices as close as possible to the time as of which the fund calculates its net asset value. In addition, the fund's board should generally consider the appropriateness of using evaluated prices provided by pricing services as the fair values of the fund's portfolio securities where, for example, the fund's board of directors does not have a good faith basis for believing that the pricing service's pricing methodologies produce evaluated prices that reflect what the fund could reasonably expect to obtain for the securities in a current sale under current market conditions.

ICI Response

ICI has long taken the position that any significant valuation guidance should be subject to public comment. Consistent with that view, ICI submitted a letter to SEC Chair Mary Jo White that expressed serious concerns about the process followed here, in which valuation guidance of general applicability was deeply embedded in a detailed and complex release on money market fund reform. The letter notes that by publishing this guidance without notice and comment, the SEC denied itself the opportunity to benefit from public perspectives, to understand whether the guidance would be understood to change long-standing legal obligations, and potentially to improve the guidance based on input from the industry and public at large.

The letter also raises substantive concerns. In 2013, ICI had strongly recommended that, if and when any valuation guidance was proposed, it should be prospective in application and crafted to make it crystal clear that the appropriate role for a fund board is one of oversight and not the day-to-day administration of the fund's valuation policies and procedures. The letter expresses our view that the guidance in the Release disregards both of these recommendations.

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[Attachment](#)

endnotes

[1] Money Market Fund Reform; Amendments to Form PF, SEC Release No. IC-31166 (July 23, 2014), available at <http://www.sec.gov/rules/final/2014/33-9616.pdf>. For a detailed description of the Release, see ICI [Memorandum](#) No. 28290 (July 31, 2014).

[2] Release at pages 270-281.

[3] Letter from Paul Schott Stevens, President and CEO, Investment Company Institute to The Honorable Mary Jo White, Chair, U.S. Securities and Exchange Commission (October 15, 2014) (attached).

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