

MEMO# 11389

November 5, 1999

DRAFT REQUEST FOR CLARIFICATION REGARDING ABILITY OF MUTUAL FUND BOARDS TO DELEGATE FAIR VALUATION RESPONSIBILITIES

[11389] November 5, 1999 TO: SEC RULES COMMITTEE No. 92-99 RE: DRAFT REQUEST FOR CLARIFICATION REGARDING ABILITY OF MUTUAL FUND BOARDS TO DELEGATE FAIR VALUATION RESPONSIBILITIES

_____ As discussed at recent meetings of the SEC Rules Committee, attached for your review is a draft letter to the SEC concerning the responsibilities of mutual fund boards of directors to make “fair value” determinations. The letter is summarized below. If you have comments on the attached draft letter, please contact me at (202) 326-5822 or frances@ici.org, or Barry Simmons at (202) 326-5923 or simmonbe@ici.org, by Wednesday, November 17th. The draft letter recommends that the SEC issue interpretive guidance clarifying that fund boards may delegate to the investment adviser or others their responsibilities under Section 2(a)(41) of the Investment Company Act to determine the fair value of fund assets for which market quotations are not readily available, provided that the following conditions are met: (1) the board, including a majority of the independent directors, establishes and periodically reviews written guidelines and procedures under which the delegate makes such determinations, and approves such changes thereto as the board deems reasonably necessary; (2) the board takes measures reasonably necessary to assure that the guidelines and procedures have been followed; (3) the board reviews at least quarterly a written report on all fair value determinations made during the preceding quarter; and (4) the fund maintains certain records related to fair value determinations. The draft letter notes that the need for clarification arises from the wording of Section 2(a)(41) and from related guidance that seems to contemplate an active role for fund directors in establishing fair values. It explains that fund directors (particularly independent directors) cannot reasonably be expected to have the expertise needed to evaluate each specific pricing formula or method used to establish fair value prices or to make fair value determinations themselves. The draft letter cites several instances in which the SEC or its staff has permitted board determinations to be delegated to the investment adviser or another appropriate delegate, in recognition that fund boards generally function most effectively in an oversight role and generally do not have the specialized expertise or resources needed to make certain types of determinations. Finally, the draft letter argues that the policy goal of Section 2(a)(41) (i.e., protecting funds and their shareholders against potential conflicts of interest when portfolio security prices are not based on “objective” market prices) can be

met through a delegation approach. Frances M. Stadler Deputy Senior Counsel Attachment

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