

THE REVIEW OF  
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## SEC PROPOSES NEW FRAMEWORK FOR FUND VALUATION PRACTICES

*The SEC has issued a proposed 1940 Act rule setting forth a new framework for funds' fair value determinations when a market value for a portfolio holding is not readily available. The authors discuss the proposed rule, focusing on six requirements for fair value determinations. They then turn to the definition of "readily available" market quotations and delegation of fair value determinations to fund advisers. They close with notes on rescission of prior SEC and staff guidance and the one-year transition period for the new rule.*

By Amy Doberman, Phillip Gillespie, and Seth Davis \*

On April 21, 2020, the Securities and Exchange Commission proposed new Rule 2a-5 (the "Proposed Rule") under the Investment Company Act of 1940 setting forth a new framework for funds' fair value determinations when a market value for a portfolio holding is not readily available.<sup>1</sup> The Proposed Rule would define "readily available" market quotations, and, for the first time, provides a framework for how fund boards may delegate certain aspects of their statutory responsibility to value fund shares.

The SEC last comprehensively addressed fund valuation practices when it issued Accounting Series Release 113 ("ASR 113") and Accounting Series Release 118 ("ASR 118") in 1969 and 1970, respectively, so an update is long overdue. If adopted, the Proposed Rule would apply to all registered investment companies and business development

companies ("BDCs") regardless of their classification or sub-classification (e.g., both open-end mutual funds, ETFs, and closed-end funds).

### EXISTING REGULATORY FRAMEWORK FOR FAIR VALUE DETERMINATIONS

In defining the "value" of a registered fund's securities for purposes of calculating its net asset value, Section 2(a)(41)(B) of the 1940 Act directs that a "fair value" be used when "market quotations are not readily available." This provision also expressly places the responsibility for determining a security's fair value on a fund's board of directors, "acting in good faith."<sup>2</sup> Rule 2a-4 under the 1940 Act defines the term "current net asset value" of a redeemable security issued by a

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<sup>1</sup> The SEC release can be found at <https://www.sec.gov/rules/proposed/2020/ic-33845.pdf> (the "Proposing Release").

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<sup>2</sup> With respect to unit investment trusts, because such entities do not have a board of directors or an investment adviser, the Proposed Rule would permit the trustee of a unit investment trust ("UIT") to conduct fair value determinations.

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