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January 14, 2021

The Honorable Mike Crapo
Chairman
The Honorable Sherrod Brown
Ranking Member
Committee on Banking, Housing, and Urban Affairs
United States Senate

The Honorable Maxine Waters
Chairwoman
The Honorable Patrick McHenry
Ranking Member
Committee on Financial Services
House of Representatives

Subject: *Securities and Exchange Commission: Good Faith Determinations of Fair Value*

Pursuant to section 801(a)(2)(A) of title 5, United States Code, this is our report on a major rule promulgated by the Securities and Exchange Commission (Commission) entitled “Good Faith Determinations of Fair Value” (RIN: 3235-AM71). We received the rule on December 3, 2020. It was published in the *Federal Register* as a final rule on January 6, 2021. 86 Fed. Reg. 748. The stated effective date of the rule is March 8, 2021.

According to the Commission, this final rule is being adopted under the Investment Company Act of 1940 to address valuation practices and the role of the board of directors with respect to the fair value of the investments of a registered investment company or business development company (fund). 15 U.S.C. §§ 80a-1–80a-64. The Commission states the rule will provide requirements for determining fair value in good faith for purposes of the Investment Company Act. According to the Commission, this determination will involve assessing and managing material risks associated with fair value determinations; selecting, applying, and testing fair value methodologies; and overseeing and evaluating any pricing services used. The Commission also states the rule will permit a fund’s board of directors to designate certain parties to perform the fair value determinations, who will then carry out these functions for some or all of the fund’s investments. This designation will be subject to board oversight and certain reporting and other requirements designed to facilitate the board’s ability effectively to oversee this party’s fair value determinations. The Commission states the rule will include a specific provision related to the determination of the fair value of investments held by unit investment trusts, which do not have boards of directors. According to the Commission, the rule will also define when market quotations are readily available under the Investment Company Act. The Commission states it is also adopting a separate rule providing the recordkeeping requirements that will be associated with fair value determinations and is rescinding previously issued guidance on the role of the board of directors in determining fair value and the accounting and auditing of fund investments.

Enclosed is our assessment of the Commission's compliance with the procedural steps required by section 801(a)(1)(B)(i) through (iv) of title 5 with respect to the rule. If you have any questions about this report or wish to contact GAO officials responsible for the evaluation work relating to the subject matter of the rule, please contact Shari Brewster, Assistant General Counsel, at (202) 512-6398.

A handwritten signature in black ink that reads "Shirley A. Jones". The signature is written in a cursive, flowing style.

Shirley A. Jones
Managing Associate General Counsel

Enclosure

cc: Vanessa A. Countryman
Secretary
Securities and Exchange Commission

REPORT UNDER 5 U.S.C. § 801(a)(2)(A) ON A MAJOR RULE
ISSUED BY THE
SECURITIES AND EXCHANGE COMMISSION
ENTITLED
“GOOD FAITH DETERMINATIONS OF FAIR VALUE”
(RIN: 3235-AM71)

(i) Cost-benefit analysis

The Securities Exchange Commission (Commission) conducted an economic analysis of this final rule. In the analysis, the Commission discussed benefits and expenses, both quantifiable and unquantifiable, against a baseline established by comparing the requirements of the rules to the current regulatory framework and current industry practices.

The Commission estimated that the one-time incremental costs to comply with the rules would range from \$100,000 to \$600,000 per registered investment company or business development company (fund), depending on the current practices of the fund. According to the Commission, these estimated costs are attributable to: (1) reviewing the requirements of the rules; (2) developing new or modifying existing policies and procedures, reporting, recordkeeping, valuation risk assessment, fair value methodology, testing, and pricing service oversight practices and to align with the requirements of the rules; (3) implementing those policies and procedures, reporting, recordkeeping, valuation risk assessment, fair value methodology, testing, and pricing service oversight practices and integrating them into the rest of the fund's activities; (4) preparing new training materials and administering training sessions for staff in affected areas; and (5) independent board members consulting their independent counsel on whether the fund's adviser should be designated to perform fair value determinations and how to set up appropriate policies and procedures, reporting, and recordkeeping requirements. The Commission stated it expects the one-time cost would depend on the fund's current practices and the amount and valuation complexity of fund investments. The Commission estimated that 9,804 funds will be affected by the rules and incur this one-time compliance cost. Hence, the Commission estimated the aggregate one-time costs of the final rule to range between \$980.4 million and \$5.9 billion.

The economic analysis also discussed benefits of the rule that would provide a framework for appropriate oversight of determinations of fair value in good faith. For example, according to the Commission, the rule helps the board oversee the fund and promote the mitigation of conflicts of interest of those involved in the fair value process and in the management of investments and the fund for the benefit of the fund's shareholders. The Commission stated other benefits arise from appropriate oversight of the fair value process, such as a fair market determination that is more likely to reflect arm's length prices with less bias. Such benefits, according to the Commission, would yield further benefits, such as promoting the purchase and sale of fund shares at fair prices, helping to avoid dilution of shareholder interests, and making investors' decisions better informed.

(ii) Agency actions relevant to the Regulatory Flexibility Act (RFA), 5 U.S.C. §§ 603-605, 607, and 609

The Commission prepared a Final Regulatory Flexibility Analysis. The analysis included (1) a statement of the need for the rule, (2) a description of significant issues raised by public comments; (3) a description of the small entities subject to the rule; (4) projected reporting, recordkeeping, and other compliance requirements; and (5) a description of agency actions to minimize effects on small entities.

(iii) Agency actions relevant to sections 202-205 of the Unfunded Mandates Reform Act of 1995, 2 U.S.C. §§ 1532-1535

As an independent regulatory agency, the Commission is not subject to the Act.

(iv) Other relevant information or requirements under acts and executive orders

Administrative Procedure Act, 5 U.S.C. §§ 551 *et seq.*

On May 13, 2020, the Commission published a proposed rule. 85 Fed. Reg. 28734. The Commission received more than 60 comments and addressed the comments in the final rule.

Paperwork Reduction Act (PRA), 44 U.S.C. §§ 3501-3520

The Commission determined that this final rule contains information collection requirements (ICRs) subject to the PRA and stated that it is submitting the ICRs to the Office of Management and Budget (OMB) for review. The rule contains additional requirements for an existing ICR entitled "Investment Companies Act Rule 38a-1, 17 C.F.R. 270.38a-1, Compliance procedures and practices of registered investment companies" (OMB Control Number 3235-0586) with estimated 451,408 internal annual burden hours and \$19.6 million annual external cost burden. The Commission is also submitting new ICRs entitled "Rule 2a-5 under the Investment Company Act of 1940, Fair Value," with estimated 317,390 internal annual burden hours and \$29.7 million annual external cost burden, and "Rule 31a-4 under the Investment Company Act of 1940, Records of Fair Value Determinations," with estimated 529,416 internal annual burden hours and \$0 annual external cost burden.

Statutory authorization for the rule

The Commission promulgated this final rule pursuant to sections 80a-2(a), 80a-6(c), 80a-30(a), 80a-31(c), 80a-37(a), 80a-58, and 80a-63(a) of title 15, United States Code.

Executive Order No. 12866 (Regulatory Planning and Review)

As an independent regulatory agency, the Commission is not subject to the Order.

Executive Order No. 13132 (Federalism)

As an independent regulatory agency, the Commission is not subject to the Order.