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July 21, 2020

Vanessa Countryman,
Secretary,
Securities and Exchange Commission,
100 F Street N.E.,
Washington, D.C. 20549–1090

Re: Proposed Rule on Good Faith Determinations of Fair Value
(Release No. IC-33845; File No. S7-07-20 RIN 3235-AM71)

Dear Ms. Countryman:

The Board of Trustees of the Vanguard Funds[1] (the "*Board*") is appreciative of the efforts of the Securities and Exchange Commission (the "*Commission*") in proposing new Rule 2a-5 (the "*Proposed Rule*") under the Investment Company Act of 1940, as amended (the "*Investment Company Act*")[2] to clarify how fund boards of directors and trustees can fulfill their statutory valuation responsibilities in light of market and other developments in the fund industry. We recognize that VGI is submitting a comment letter addressing many aspects of the Proposed Rule; however, given that the Proposed Rule defines how a board *must* fulfill its statutory obligation to determine fair value in good faith, the Board believes it is important to submit this letter to highlight four key areas of focus for the Board.

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[1] The Vanguard Funds are the investment companies registered and regulated under the Investment Company Act of 1940, as amended, other pooled investment vehicles, and institutional accounts that are sponsored, managed or advised by The Vanguard Group, Inc. ("*VGI*"), a Pennsylvania corporation, or its subsidiaries and affiliates. The same individuals that serve on the Vanguard Funds' boards of trustees also serve as VGI's board of directors; other than the Chief Executive Officer of VGI, the other nine individuals are independent trustees and directors. The trustees are submitting this letter in their capacity as trustees of the Vanguard Funds.

[2] Good Faith Determinations of Fair Value, Rel. No. IC–33845, 85 Fed. Reg. 28734 (May 13, 2020) (the "*Proposing Release*").

I. Importance of a Principles-Based Approach

The Board strongly believes that, in many respects, the Proposed Rule is overly detailed and prescriptive in defining the minimum conditions for a board of directors to determine fair value in good faith under Section 2(a)(41) of the Investment Company Act ("*Section 2(a)(41)*"). Although the Commission indicates in the Proposing Release that complying with certain aspects of the Proposed Rule will depend on the particular facts and circumstances, consistent with a more principles-based approach, the overall structure of the Proposed Rule, the numerous express requirements within the rule text, and the extensive guidance in the Proposing Release stating the Commission's expectations for complying with—and in many cases expanding upon—the prescriptive requirements of the Proposed Rule all risk transforming a thoughtful, reasonably designed valuation process into a "check-the-box" exercise that does not meaningfully enhance board oversight, but imposes substantial costs and burdens on fund boards, funds and their investors.

Although consistency and enhanced compliance certainty are important goals, particularly in light of the increased complexity regarding valuing fund investments, a more principles-based approach has worked well for the Board and for the Vanguard Funds. Indeed, the Board believes that it is best positioned to determine the specific processes for determining fair value in good faith for the funds that it oversees. If adopted as proposed, the Board believes that the Proposed Rule would not provide sufficient flexibility for the Board to use its experience and expertise to determine how best to fulfill its statutory obligations under Section 2(a)(41) based on the Vanguard Funds' particular circumstances.

As part of its economic analysis, the Commission considered a more principles-based approach as a "reasonable alternative" to the Proposed Rule.[3] As described in the Proposing Release, such an approach would not specify the types of fair value functions that must be performed, but instead would only state that funds should have in place policies and procedures, reporting and recordkeeping that would allow fair values to be determined in good faith by the board or the investment adviser.[4] Although the economic analysis raises several questions and concerns related to this approach—including with respect to compliance certainty, oversight and consistency,[5] we believe those concerns are not unique to valuation matters, and in any case do not outweigh the clear benefits of a more principles-based approach.

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[3] Proposing Release at 28761.

[4] *Id.*

[5] *Id.*

Indeed, the more principles-based approach is one that the Commission has historically taken with regard to addressing fund compliance requirements, including matters related to valuation. Rule 38a-1 under the Investment Company Act, which addresses fund compliance programs, including valuation, requires funds to adopt policies and procedures that are "reasonably designed" to ensure compliance.[6] This approach has worked well for the Board, the Vanguard Funds and our investors, most significantly because it provides flexibility for the Board to tailor its valuations policies and procedures appropriately.

II. Preference for a Safe Harbor Rule

If the Commission determines to maintain the prescriptive approach of the Proposed Rule in adopting a final rule, the Board recommends that the Commission clarify that the final rule operates as a safe harbor. In the event the Commission does not adopt a safe harbor, the Commission could issue Commission-level interpretive guidance for determining fair value in "good faith." We believe that each of these approaches can have the same beneficial effects on fund and fund board practices consistent with a board's oversight responsibilities. Each of these approaches would provide boards with the benefits of enhanced compliance certainty yet preserve flexibility for each board to determine the approach it deems appropriate to oversee the investment adviser's fair value processes. And, each of these approaches gives appropriate effect to board fair valuation practices developed over decades and enables evolutionary developments separately applicable to different funds and different fund boards.

The Board strongly encourages the Commission to structure the final rule to operate as a safe harbor. Utilizing a safe harbor is an approach commonly taken by the Commission,[7] and would achieve the Commission's goals of enhanced compliance certainty, oversight and consistency, while also recognizing, as discussed in more detail in Section I above and Section IV below, the potential harm in adopting a prescriptive rule that is the exclusive means for compliance.

As an alternative, Commission-level guidance addressing good faith fair value determinations could provide examples to help facilitate fund boards' compliance with their valuation responsibilities, but would not function as the only way by which a fund board could comply with the requirement to determine fair value in good faith under Section 2(a)(41). This approach has been adopted recently by the Commission in areas

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6 17 CFR § 270.38a-1.

7 The Commission has adopted a number of rules that operate as a safe harbor, including: Rules 3a-2, 3a-4 and 15a-2 under the Investment Company Act; Rules 144, 147, 163A and 506(b) under the Securities Act of 1933; and Rule 10b-18 under the Securities Exchange Act of 1934.

that, similar to making a "good faith" determination, necessarily depend on the facts and circumstances and are not conducive to a "one-size-fits-all" rule.[8]

III. Unintended Consequences of Not Treating Evaluated Prices as Readily Available Market Quotations

The Proposing Release acknowledges that neither the Investment Company Act nor the rules promulgated thereunder define when market quotations are "readily available," despite the wide use of pricing services.[9] The Proposed Rule would provide that a market quotation is readily available for purposes of Section 2(a)(41) only when that quotation is an unadjusted, quoted price in active markets for identical investments that the fund can access at the measurement date, and the quotation is reliable. In addition, the Proposing Release states that evaluated prices by themselves are not readily available market quotations.[10] Thus, the implication is that boards are required to determine in good faith the fair value of all instruments that are priced using evaluated prices and accordingly to apply the far more extensive requirements of the Proposed Rule to that process. In the Board's experience, many fixed-income securities are typically priced using evaluated prices by pricing services, and thus would be considered securities for which market quotations are not readily available and subject to fair valuation requirements. The Board believes that this treatment alters in an overly prescriptive manner the profound evolution of industry practices and acceptance of critical fund service providers without apparent benefit.

The Board agrees with the principles set forth in the Proposing Release indicating that pricing methodologies should be understood, conflicts of interest should be identified and addressed, and price challenge processes within the adviser should be monitored, understood and appropriately reported to a board. However, subjecting all instruments with evaluated prices, such as fixed-income securities, to fair value determinations risks resulting in the unintended consequence of entirely duplicating the

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8 *See, e.g.*, Commission Interpretation and Guidance Regarding the Applicability of the Proxy Rules to Proxy Voting Advice, Rel. No. 34–86721, 84 Fed. Reg. 47416 (Sept. 10, 2019); Commission Interpretation Regarding Standard of Conduct for Investment Advisers, Rel. No. IA–5248, 84 Fed. Reg. 33669 (July 12, 2019) ("*Standard of Conduct Release*").

9 Proposing Release at 28748.

10 Proposing Release at 28748-49. The Proposing Release also states that "indications of interest" and "accommodation quotes" are not readily available market quotations. *Id*.

costs of pricing the instrument, which will be borne by funds and their investors, without any meaningful corresponding benefit.[11]

IV. Board Oversight and Reporting

The requirements in section 2a-5(b)(1) of the Proposed Rule relating to board oversight and reporting, and the accompanying guidance in the Proposing Release, are among the most prescriptive and, in the Board's view, problematic, provisions of the Proposed Rule. In particular, the Board respectfully submits that the prescriptive reporting requirements required to satisfy the Proposed Rule's conditions, and the minimum frequency of those reports, are inconsistent with reasonable oversight of the valuation process. We believe that the amount and frequency of reports and other information that boards are expected to receive and review under the Proposed Rule would actually inhibit, rather than enhance, the Board's ability to meaningfully oversee the investment adviser's fair valuation determinations.

While the Board agrees that "effective information flow is a critical part of a board's oversight of an adviser to whom it has assigned fair value determinations,"[12] the reporting requirements are at the same time extremely prescriptive and open-ended. For example, the Proposed Rule requires five specific types of reports to be provided at least quarterly and the Proposing Release lists examples of nine other types of reports that a fund board may consider reviewing.[13] The Proposed Rule then includes a "catch all" requiring reporting of "any other materials requested by the board related to the adviser's process for determining the fair value of fund investments" and the Proposing Release states that the board must "request and review such information as may be necessary to be *fully* informed of the adviser's process for determining the fair value of fund investments."[14]

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[11] In addition, we believe that the confusion which might arise from the apparent carry forward of the 2014 adopting release for the Commission's money market fund reform (while at the same time rescinding the related staff guidance published shortly thereafter) and the current guidance in the Proposing Release should be eliminated by making clear in the comprehensive and thorough re-examination and rationalization of fair valuation represented by the Proposing Release what the Commission's views on the treatment of pricing services and evaluated prices are. *See* Division of Investment Management, Valuation Guidance Frequently Asked Questions, *available at* https://www.sec.gov/divisions/investment/guidance/valuation-guidance-frequently-asked-questions.shtml; *see also* Money Market Fund Reform; Amendments to Form PF, Rel. No. IC–31166, 79 Fed. Reg. 47736 (August 14, 2014).

[12] Proposing Release at 28744.

[13] *Id*. at 28745-46.

[14] *Id*. 28745, 28743 (emphasis added).

In proposing this approach, the Commission has eschewed its more customary principles-based approach for situations where the specific requirements that apply should be informed by what is reasonable under the circumstances, such as how a fund board should effectively carry out its oversight responsibilities.[15] We have significant concerns that this prescriptive and open-ended approach will incentivize investment advisers and their compliance personnel to be over-inclusive in providing boards with any and all information regarding valuation regardless of its materiality—rather than allowing boards and investment advisers to develop a thoughtful, reasonable approach to determining what information the board truly needs to receive to effectively oversee the valuation process. As a result, it will be more difficult for boards to carefully review and identify relevant and material information that deserves board attention and follow up, thereby undermining an apparent goal of the Proposed Rule.

In addition, we recommend that the Commission clarify that differences in fair value methodologies may be appropriate for different contextual characteristics of a fund's structure including the nature of its assets, and share purchase and redemption procedures, based on each structure's attendant valuation risks, and that a single fund board overseeing different types of funds may adopt fair value methodologies that result in different valuations of the same security held by those different types of funds. For the reasons discussed in VGI's comment letter on the Proposed Rule, we do not believe that this approach is inconsistent with the Proposed Rule, but we believe it should be confirmed in light of the proposal to rescind prior staff guidance.

V. Conclusion

The Board is appreciative and supportive of the Commission's initiative to modernize the framework for fund valuation practices and clarify how fund boards can

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[15] *See, e.g.*, Compliance Programs of Investment Companies and Investment Advisers, Rel. No. IC–26299, 68 Fed. Reg. 74714, 74715-16 (Dec. 24, 2003) ("The rule requires only that the policies and procedures be reasonably designed to prevent violation of the Advisers Act, and thus need only encompass compliance considerations relevant to the operations of the adviser . . . Commenters agreed with our assessment that funds and advisers are too varied in their operations for the rules to impose of a single set of universally applicable required elements."); Standard of Conduct Release at 33673 ("[A]n adviser must have a reasonable understanding of the client's objectives. . . How an adviser develops a reasonable understanding will vary based on the specific facts and circumstances, including the nature of the client, the scope of the adviser-client relationship, and the nature and complexity of the anticipated investment advice."); Regulation Best Interest: The Broker-Dealer Standard of Conduct, Rel. No. 34–86031, 84 Fed. Reg. 33318, 33386 (July 12, 2019) (providing that in developing reasonably designed policies and procedures, "broker-dealers should have flexibility to tailor their policies and procedures to their particular business model, focusing on specific areas of their business that pose the greatest risk of noncompliance and greatest risk of potential harm to retail customers as opposed to a detailed review of each recommendation").

satisfy their valuation obligations in light of market developments. The Board recognizes the benefits that consistency and enhanced compliance certainty can bring to fund boards, funds and their investors. We believe our recommendations will allow the Commission to benefit from its experience in issuing the Proposed Rule and the feedback provided by commenters when taking final action in this area, while ensuring that the regime is flexible enough to accommodate a wide variety of funds.

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Sincerely,

/s/ Mark Loughridge

Mark Loughridge

Lead Independent Director,
Board of Trustees of the
Vanguard Funds

cc: John E. Baumgardner Jr.
Whitney A. Chatterjee