Case Study Overview

You are an Independent Trustee on a board for a mutual fund. In addition to management's Pricing Committee, a separate Fair Value Committee consisting of Independent Trustees has been established. You are a member of the Fair Value Committee. The Committee meets quarterly on scheduled dates, but will meet more frequently, if deemed necessary.

The Fund's prospectus describes the investment objective as follows:

- *To achieve capital appreciation by investing in a variety of asset classes*

The Fund's Valuation Policies and Procedures are attached as an Exhibit. *(Please note that these policies and procedures are not intended to represent a complete set of valuation policies and procedures. You will likely note some valuation areas which are not sufficiently addressed. Consider and discuss what enhancements should be made to the policies and procedures as you review the case study.)*

PART 1

Facts:

Silvia Foster, the Chief Investment Officer of the Fund, announces at the Board meeting that the Fund will now invest in interest rate swap contracts, swaptions, and certain energy derivatives.

Questions:

1. What questions specific to valuation would you like to ask Silvia Foster relative to the new investment types? Do you believe that the Valuation Policies and Procedures are currently clear enough as to how the Fund should value these investment types or any other investment types that the Fund might hold? Is there a mechanism to amend the policies and procedures if warranted?

2. Do you believe that the Board's role in the valuation process is clearly outlined in the Valuation Policies and Procedures? Do you believe that management's role is clearly defined? Is it clear which valuation tasks the Board should be performing and which tasks should be performed by management?

PART 2

Facts:

A large mortgage lender, NY Bank, announces that an increasing percentage of its sub-prime loans will default. The Fund does not hold any NY Bank securitized products, but it does have significant sub-prime exposure within its portfolio of asset-backed securities, collateralized debt obligations, and commercial mortgage-backed securities. As a result of the announcement, management's Pricing Committee was asked to provide the Fair Value Committee with detailed information on the Fund's pricing sources and the methodology that the sources used to determine the price of the security.

The Fund's primary source for each security continues to provide a price for each of the asset-backed securities, collateralized debt obligations, and commercial mortgage-backed securities held in the portfolio subsequent to the announcement.

Questions:

Consider the expectations that the Fair Value Committee would have for management's Pricing Committee relative to the level of due diligence performed by management, the timing of communication of such items to the Fair Value Committee, and the documentation provided to the Fair Value Committee to support the decision to fair value or not to fair value one or more securities in the portfolio.

1. Consider the scenarios below and, for each one, determine if the Fund should continue to use the price from the primary source or, if not, what next steps should management's Pricing Committee take in order to determine the fair value of the securities.
    a. Primary source's price reflects an indication of the price supplied by a broker, but not an actual binding quote at which the broker would buy or sell
    b. Primary source's price is based on its model which reflects historical market information
    c. Primary source's price does not change for several days
    d. Primary source's price is significantly different (>5%) from the price provided by the secondary source
    e. Secondary pricing source does not exist or fails to provide a price

PART 3

Facts:

Assume that the following scenarios occur on April 1, 2008 and that the Fair Value Committee is asked at its next scheduled meeting on April 25, 2008 to review the fair value decisions that were reached by management's Pricing Committee and to ratify them.

Scenario A

A significant civilian conflict emerges in Russia. Management's Pricing Committee determined that the conflict would likely affect the value of the Russian securities held in the portfolio. Realizing that the fair value pricing service used by the Fund would not reflect such information in the adjustment factors it provided, management's Pricing Committee decided to reduce each Russian security price by 25% from its previous day's price in order to be conservative.

Scenario B

Faber Energy, a corporate bond holding of the Fund and the underlying security position for one of the credit default swap contracts held by the Fund, was delisted from its stock exchange. No broker was able/willing to supply a price on April 1. The counterparty to the credit default swap contract indicated that the Fund's position in the swap contract has appreciated significantly from the prior day swap price. Management's Pricing Committee considered using a model to estimate the value on April 1 but concluded instead that the fair value of the bond on April 1 should remain the same as the prior day's price, the last day that a broker supplied a price. Management's Pricing Committee continued to use the April 1 price until a broker provided a price for the security on April 15.

Scenario C

Management learned that Chile Consumer Products, an international common stock held by the Fund, spun off one of its divisions, CCP Electronics, on December 21. Although the Fund was entitled to the shares of CCP Electronics as of December 21, the shares were not delivered to the Fund's custodian until April 1, and there was no public trading of CCP Electronics until April 1. The Fund accountant did not record the spinoff, and, therefore, the

Fund did not value the shares of CCP Electronics. The Fund used the closing exchange price to value Chile Consumer Products every day.

Management has determined that the Fund should have been aware of the spinoff on December 21 and that the failure to value CCP Electronics represented a NAV error that exceeds $.01 and that the Fund needs to be made whole. Management has determined that the best estimate of fair value from December 21 to March 31 is the closing exchange price for CCP Electronics as of April 1.

Questions:

1. Do you agree with management's actions in the scenarios described above? Why or why not? What additional information would you like to see?

2. If management used a model to price the bond in Scenario B instead of using the previous day's price, what questions would you have regarding the use of the model? Consider the nature of the assumptions and the internal controls over the model in formulating your questions.

Exhibit

VALUATION POLICIES and PROCEDURES

I. Management's Pricing Committee

Management's Pricing Committee is responsible for assisting the fund accountant with daily pricing questions and for determining the fair value of holdings as necessary. Members of the Pricing Committee include the following parties:

Silvia Foster – Chief Investment Officer

Brett Johnson – Lead Portfolio Manager

Oskar Lopez – Head Trader

Bridget Smith – Fund Treasurer

Wanda Rupert* – Chief Compliance Officer

Dennis Morgan – General Counsel

Monica Hubert* – Manager, Fund Accounting

** Represents a non-voting member of the Committee.*

Silvia Foster is the chair of the Pricing Committee.

The use of a valuation method that has not been previously approved by the Pricing Committee requires a simple majority vote. Similarly, a simple majority must approve all fair valuation determinations. A Pricing Committee member may send a replacement if he/she cannot attend a Pricing Committee meeting. The Pricing Committee's responsibilities are described in greater detail later in this document.

II. Valuation Methods for Investments

Shown below is a listing of valuation policies by investment type.

Common Stocks (Domestic and Foreign) – Equity securities that are traded on stock exchanges or the NASDAQ Global Market are valued at the last sale price or official close price on the exchange, as of the close of business on the day the securities are being valued or, lacking any sales, at the last available bid price. In cases where equity securities are traded on more than one exchange, the securities are valued on the exchange designated as the primary market by or under the authority of the Valuation Committee.

For foreign equities, the closing exchange price will be adjusted based on data provided by an approved third-party pricing vendor if the S&P 500 Index moves by more than .25% from the close on the previous day to the current day's close.

Corporate and Government Bonds – Debt securities are traded primarily in the over-the-counter ("OTC") markets and are valued at the last available bid price in the OTC market or on the basis of values obtained by a pricing service or broker-dealer. Pricing services use valuation matrices that incorporate both dealer-supplied valuations and valuation models.

Futures Contracts – Futures contracts are valued based on the closing exchange price.

Option Contracts – Each option security traded on a U.S. securities exchange is valued at the mid-point of the consolidated bid/ask quote for the option security.

III. Daily Monitoring Procedures

For each security, the fund accountant will compare the price obtained from the Fund's primary source to the prior day price used by the Fund. The fund accountant will alert management if any of the following scenarios occur:

- The price from the previous day fluctuated by more than 3% for fixed-income securities and by more than 8% for equity securities;
- A price does not change for 3 days (considered to be stale); or
- A price is unavailable from the primary pricing source.

Management will refer all such matters to management's Pricing Committee. Once the information has been validated, the fair value of the security must be determined in accordance with the General Fair Value Procedures set forth below.

Additionally, management's Pricing Committee is responsible for monitoring for significant events that may affect a single issuer or multiple issuers. Significant events may include, but are not limited to, the following:

- natural disasters;
- armed conflicts;
- government actions;
- significant fluctuations in domestic or in foreign markets;
- rating agency action;
- corporate action;
- bankruptcy;
- corporate announcement; and
- halt in trading or delisting of security.

If management's Pricing Committee determines that a significant event has occurred, then the fair value of the security must be determined in accordance with the General Fair Value Procedures set forth below.

IV. General Fair Value Procedures

Management's Pricing Committee will first consider the materiality of the positions. If the positions are not material to the fund individually or in aggregate, management will take no action. If the positions are material, management's Pricing Committee may determine the price based on a model developed internally or externally or based on another method if deemed more reliable. In determining the valuation, management's Pricing Committee should consider one or more of the following factors:

- Information provided by securities pricing services;
- Fundamental analytical data relating to the investment in the security;
- Nature and duration of any restriction on the disposition of the security;
- Evaluation of the forces that influence the market in which the security is purchased and sold;

- » Type of security or asset;
- » Financial statements of issuer;
- » Existence of merger proposals or tender offers affecting the security;
- » Price and extent of public trading in similar securities of the issuer or comparable companies and other relevant matters;
- » Most recent closing market prices;
- » The historical tendency of the security's price to track or respond to general and specific market movements (in terms of indices, sectors, or other market measurements);
- » Changes in interest rates; and
- » Other news events.

Management's Pricing Committee will maintain adequate documentation of the methodology it uses and the rationale for using it.

V. Role of the Fair Value Committee

The Fair Value Committee is comprised solely of Independent Trustees and will monitor and review pricing procedures and make determinations of "fair value" where the procedures call for judgment and analysis. The Fair Value Committee has delegated daily pricing and fair valuation decisions to management's Pricing Committee. The Fair Value Committee will meet quarterly and review the following:

1. a list of all securities that have been fair valued during the quarter by management's Pricing Committee, as well as those fair valued by management's Pricing Committee as of quarter end; and
2. any exceptions to the valuation policies and procedures occurring during the last quarter.

Annually, the Fair Value Committee will meet to evaluate the appropriateness of each primary valuation source.

The Fair Value Committee will meet more frequently as deemed necessary.

VI. NAV Pricing Errors

The Fund has established an internal policy for correction of NAV pricing errors. This policy provides general guidance for identification of a NAV pricing error and guidelines for determining materiality. All shareholder transactions will be reprocessed if the NAV is misstated by an amount that rounds to $.01 or greater. NAV pricing errors and the corrective action taken will be reported to the Board of Trustees and its Fair Value Committee.