

MEMO# 31513

December 4, 2018

SEC Adopts Final FAIR Act Rule

[31513]

December 4, 2018 TO: ICI Members SUBJECTS: Advertising
Closed-End Funds
Compliance
Disclosure
Distribution
Exchange-Traded Funds (ETFs)
Fund Accounting & Financial Reporting
Investment Advisers
Operations RE: SEC Adopts Final FAIR Act Rule

Last week the SEC adopted rules and amendments to fulfill its mandate under 2017's FAIR Act.^[1] The FAIR Act and related SEC rulemaking are designed to promote research by unaffiliated broker-dealers on mutual funds, ETFs, registered closed-end funds, business development companies, and other covered investment funds. The rules and amendments will be effective 30 days after publication in the Federal Register.

Background

Rule 139 under the Securities Act of 1933 currently provides a safe harbor for the publication or distribution of research reports concerning one or more issuers by a broker-dealer.^[2] This rule's safe harbor is not available for a broker-dealer's publication or distribution of research reports pertaining to registered investment companies or business development companies, or their securities.

The Fair Access to Investment Research Act of 2017 ("FAIR Act") directs the SEC to propose and adopt rule amendments that would extend the current safe harbor available under Rule 139 to a "covered investment fund research report." The Act specifies how the SEC should fulfill this statutory mandate.

Summary of Rule 139b

New Rule 139b's framework is modeled after and generally tracks Rule 139, with certain modifications.^[3] The SEC adopted Rule 139b substantially as proposed in May, except for the provisions highlighted below. Its key provisions are as follows.

Scope of the rule and key terms. The rule establishes a safe harbor for the publication or distribution of "covered investment fund research reports"^[4] about "covered investment funds."^[5] Significantly, the rule limits the safe harbor to reports by unaffiliated broker-

dealers (including those participating in a securities offering).[\[6\]](#)

Safe harbor conditions. The rule distinguishes between “issuer-specific research reports” and “industry reports,” and each has its own set of conditions.

- *Common conditions.* Each research report requires that:
 - the broker-dealer publish or distribute the research report “in the regular course of its business;”[\[7\]](#) and
 - unlike the proposal, if fund performance information is included in a research report, it must be presented in accordance with certain standardized requirements.[\[8\]](#)
- *Issuer-specific research report conditions.* Funds subject to these reports must:
 - have been subject to relevant requirements under the Investment Company Act and/or the Exchange Act to file certain periodic reports for at least 12 calendar months prior to a broker-dealer’s reliance on the rule, and must have timely filed all required reports for the immediately preceding 12 months;[\[9\]](#) and
 - satisfy a minimum “market float” requirement.[\[10\]](#)
- *Industry report conditions.* Industry reports require:
 - that each fund included in an industry research report be subject to the reporting requirements of the Investment Company Act or Exchange Act (as applicable);
 - compliance with certain content requirements;[\[11\]](#) and
 - that analysis of any fund or its securities must not be given materially greater space or prominence in the publication than that given to any other fund or its securities.

Summary of Rule 24b-4 and Other Amendments

The SEC adopted without change Rule 24b-4 under the Investment Company Act, which excludes a covered investment fund research report from the Investment Company Act’s Section 24(b) filing requirements, except to the extent that such report is otherwise *not* subject to the content standards in self-regulatory organization (“SRO”) rules related to research reports.[\[12\]](#)

The SEC also adopted a conforming amendment to Rule 101 of Regulation M as proposed. This amendment permits distribution participants, such as brokers or dealers, to publish or disseminate any information, opinion, or recommendation relating to a covered security if the conditions of Rule 139b are satisfied.

Finally, the SEC adopted a technical amendment to Form 12b-25 to replace references to Form N-SAR with references to Form N-CEN and to remove the checkbox and accompanying text related to transition reports on Form N-SAR.

Matthew Thornton
Assistant General Counsel

endnotes

[\[1\]](#) *Covered Investment Fund Research Reports*, SEC Release No. 33-10580 (Nov. 30,

2018)(“Adopting Release”), available at www.sec.gov/rules/final/2018/33-10580.pdf.

[2] Rule 139 includes conditions that, if satisfied, provide that a broker-dealer’s publication or distribution of a research report about an issuer will be deemed for purposes of Sections 2(a)(10) and 5(c) of the Securities Act not to constitute an offer for sale or offer to sell a security that is the subject of an offering pursuant to a registration statement, even if the broker-dealer is participating or may participate in the registered offering of the issuer’s securities. A broker-dealer’s publication or distribution of a research report in reliance on Rule 139 therefore would not be deemed to constitute an offer that otherwise could be a non-conforming prospectus in violation of Section 5 of the Securities Act.

[3] The FAIR Act required certain deviations. Otherwise, the Adopting Release states that the SEC “sought to maintain similar treatment and conditions for funds under rule 139b and other issuers subject to rule 139 unless we believed that a deviation was necessary or appropriate for the particular operational or structural characteristics of a type of covered investment fund.” Adopting Release at 7.

[4] The rule defines “covered investment fund research report” as “a research report published or distributed by a broker or dealer about a covered investment fund or any securities issued by the covered investment fund, but does not include a research report to the extent that the research report is published or distributed by the covered investment fund or any affiliate of the covered investment fund, or any research report published or distributed by any broker or dealer that is an investment adviser (or any affiliated person of an investment adviser) for the covered investment fund.” The rule defines “research report” as a “written communication [as defined in Rule 405 under the Securities Act] that includes information, opinions, or recommendations with respect to securities of an issuer or an analysis of a security or an issuer, whether or not it provides information reasonably sufficient upon which to base an investment decision.”

[5] The rule defines “covered investment fund” to include registered investment companies, business development companies, and certain commodity- or currency-based trusts or funds.

[6] See Adopting Release at 8-13 for guidance on the affiliate exclusion.

[7] See Adopting Release at 38-41 for guidance on how a broker-dealer may satisfy this condition.

[8] Specifically, for a research report about a registered open-end management investment company or a trust account, any performance quotation must follow Rule 482(d), (e), and (g) under the Securities Act; for a research report about a registered closed-end investment company, any performance quotation must follow instructions to item 4.1(g) of Form N-2, provided that other historical measures of performance may also be included if any other measurement is set out with no greater prominence than the Form N-2 measurement. ICI recommended these changes in its comment letter.

[9] In satisfying the “timeliness” requirement, the Adopting Release states, “We believe that a broker-dealer may rely on the lack of a Form 12b-25 filing [*i.e.*, a filing that provides the SEC with notice of a late filing] as confirmation that a fund’s filings are timely under the rule unless the broker-dealer is actually aware through other means that the issuer has not in fact made timely filings.” Adopting Release at 24.

[10] Specifically, the aggregate market value of a covered investment fund, or the net asset value in the case of a registered open-end investment company (other than an ETF), must equal or exceed the aggregate market value specified in General Instruction I.B.1 to Form S-3. This amount is currently \$75 million. The final rule differs from the proposed rule in that (i) the final rule generally does not require the fund's value to be calculated net of its affiliates' holdings, and (ii) the minimum float requirement must be satisfied at the initiation (or reinitiation) of research coverage, and quarterly thereafter. The Adopting Release also notes that "[b]y opting not to list, non-traded BDCs and closed-end funds are similar to non-listed operating company issuers that, by choosing not to list, cannot meet the public float requirement of rule 139." Adopting Release at 36.

[11] Specifically, industry research reports either must include similar information about a substantial number of covered investment fund issuers of the same type (e.g., money market fund, bond fund, balanced fund, etc.) or investment focus (e.g., primarily invested in the same industry or sub-industry, or the same country or geographic region), or contain a comprehensive list of covered investment fund securities currently recommended by the broker-dealer.

[12] Under the SEC's interpretation, covered investment fund research reports under Rule 139b that otherwise would be subject to Section 24(b) of the Investment Company Act would *not* be subject to that section so long as they remain subject to the general content standards of FINRA Rule 2210(d)(1) (the FINRA rule that imposes content standards on broker-dealer communications with the public). The Adopting Release also notes that "the FAIR Act's rules of construction provide that the Act shall not be construed as limiting the authority of an SRO to require the filing of communications with the public if the purpose of such communications 'is not to provide research and analysis of covered investment funds.'" Adopting Release at 63.