The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

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SEC Proposes Rules to Implement FAIR Act; Member Call Scheduled for June 8 at 2 pm (ET) to Discuss

[31223]

May 30, 2018 TO: Accounting/Treasurers Committee
Advertising Compliance Advisory Committee
Broker/Dealer Advisory Committee
Chief Compliance Officer Committee
Closed-End Investment Company Committee
Compliance Advisory Committee
ETF (Exchange-Traded Funds) Committee
ETF Advisory Committee
Investment Advisers Committee
Operations Committee
Sales and Marketing Committee
SEC Rules Committee
Small Funds Committee RE: SEC Proposes Rules to Implement FAIR Act; Member Call Scheduled for June 8 at 2 pm (ET) to Discuss

Last week the SEC proposed rules and a rule amendment to fulfill its mandate under the FAIR Act, which became law in 2017.[1] The FAIR Act and related SEC proposal are designed to promote research by unaffiliated broker-dealers on mutual funds, exchange-traded funds, registered closed-end funds, business development companies, and other covered investment funds.

ICI intends to submit a comment letter, and will host a call on Friday, June 8 at 2:00 pm ET (Dial-in: 888-394-5484; Passcode: 11795) to discuss the proposal. Comments are due to the SEC 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 safe harbor currently 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."[3] The Act contains additional requirements regarding how the SEC should fulfill this statutory mandate.

Summary of the Proposed Rules and Amendments

Proposed Rule 139b's framework is modeled after and generally tracks Rule 139, with certain modifications. Generally speaking, it would establish a safe harbor for the publication or distribution of "covered investment fund research reports" by unaffiliated broker-dealers (including those participating in a securities offering) about "covered investment funds." Its key provisions are summarized below.

- "Covered investment fund research report" definition. The proposed rule incorporates the statute's definition of "covered investment fund research report" verbatim, including the statute's exclusions for research reports published or distributed by (i) the covered investment fund itself or any affiliate, or (ii) any broker or dealer that is an investment adviser (or an affiliated person of an investment adviser) for the covered investment fund.

- Safe harbor conditions. The proposed rule distinguishes between "issuer-specific research reports" and "industry reports," and each has its own set of conditions. With respect to issuer-specific research reports, the covered investment fund subject to the report (i) 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, and (ii) must satisfy a minimum public market value requirement.[4] And the safe harbor for these reports is further conditioned on a broker-dealer's publication or distribution of research reports "in the regular course of its business."[5]

  With respect to industry research reports, safe harbor protection requires (i) that each covered investment fund included in the report be subject to the reporting requirements of the Investment Company Act or Exchange Act (as applicable); (ii) compliance with certain content requirements;[6] (iii) that analysis of any covered investment 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; and (iv) the broker-dealer to satisfy the "regular-course-of-business" requirement, described above.

The Proposing Release also discusses the requirements that apply to advertisements under Securities Act Rule 482, noting the Rule's detailed performance disclosure requirements. By contrast, proposed Rule 139b would not require broker-dealers to present performance information in any particular fashion. The Proposing Release asks whether this is appropriate.

The SEC also is proposing new Rule 24b-4 under the Investment Company Act, which would exclude 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 rules related to research reports.[7]

Finally, the SEC is proposing a conforming amendment to Rule 101 of Regulation M. This

amendment would permit 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 proposed Rule 139b are satisfied.

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endnotes

[1] *Covered Investment Fund Research Reports*, SEC Release No. 33-10498 (May 23, 2018) ("Proposing Release"), *available at* www.sec.gov/rules/proposed/2018/33-10498.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 statute defines "covered investment fund" to include registered investment companies, business development companies, and certain commodity- or currency-based trusts or funds. The statute 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 an affiliated person of an investment adviser) for the covered investment fund." The statute defines "research report" as having the same meaning given under Section 2(a)(3) of the Securities Act, except that the term does not include an oral communication.

[4] 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 required by General Instruction I.B.1 to Form S-3, net of the value of shares held by affiliates. This amount is currently $75 million.

[5] This "regular-course-of-business" requirement is included in Rule 139 as well. The Proposing Release explains that "broker-dealers that publish or distribute research reports in the regular course of business are more likely to publish analysis that investors recognize as research." Rule 139 also specifies that such publication or distribution may not represent either the initiation of publication of research reports about the issuer or its securities or the reinitiation of such publication following a discontinuation thereof. Proposed Rule 139b does not include this "initiation or reinitiation" requirement for funds "in substantially continuous distribution."

[6] 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. Rule 139 contains similar requirements, designed to mitigate risks of "conditioning the market."

[7] Under the SEC's interpretation, covered investment fund research reports under proposed 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).
