The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

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ICI Submits Comment Letter on SEC's FAIR Act Rule Proposal

[31280]

July 9, 2018 TO: ICI Members SUBJECTS: Advertising
Closed-End Funds
Compliance
Disclosure
Distribution
Exchange-Traded Funds (ETFs)
Fund Accounting & Financial Reporting
Investment Advisers
Operations RE: ICI Submits Comment Letter on SEC's FAIR Act Rule Proposal

In May 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. Today, ICI submitted the comment letter linked below, generally supporting the proposal and offering recommendations to enhance broker-dealers' ability to issue fund research reports.

Background and Summary of Proposal

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. Proposed Rule 139b's framework is modeled after and generally tracks Rule 139, with certain modifications. It would establish a safe harbor for the publication or distribution of "covered investment fund research reports" by unaffiliated broker-dealers.

Summary of ICI's Comment Letter

Our comment letter generally supports this proposal, which, if carefully executed, will put operating company and fund research reports on more equal regulatory footing and provide investors with another useful source of information about funds.

However, we urge the SEC to tailor final Rule 139b to account for differences between these issuers. In three critical respects, proposed Rule 139b would impose conditions in ways that would severely undermine broker-dealers' ability to produce fund research reports. First, no broker-dealer would be permitted to publish research reports about small funds (i.e., those with less than $75 million in market value) or new funds (i.e., those that have not been subject to the SEC's filing requirements for at least 12 calendar months). Second, most broker-dealers would be hard-pressed to establish that they publish fund research reports "in the regular course" of their business, a necessary condition to rely on the safe harbor. Third, some of the conditions that the SEC would impose on fund industry reports are predicated on concerns about "market conditioning" (or "gun-jumping") that are inapt for funds.

In response, we recommend that final Rule 139b:

- Not exclude new and small funds from research report coverage;
- Not require that broker-dealers publish fund research reports "in the regular course" of their business—instead, broker-dealers should adopt and implement policies and procedures reasonably designed to achieve compliance with Rule 139b and any related rules; and
- Not impose overbroad market conditioning-influenced conditions—instead, any conditions should apply only to funds or their shares prior to effectiveness of their registration.

We conclude by addressing other key questions posed in the Proposing Release, expressing our support for:

- the sufficiency of the proposed rule's provisions for mitigating potential conflicts of interest; and
- requiring standardized presentation of fund-specific performance information in any research report relying on the safe harbor.

Matthew Thornton
Assistant General Counsel

Attachment

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. *See* Institute Memorandum No. 31223, dated May 30, 2018, for a detailed summary of the proposal.

[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."
