SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 230, 242, 249, and 270

[Release Nos. 33–10580; 34–84710; IC–33311; File No. S7–11–18]

RIN 3235–AM24

Covered Investment Fund Research Reports

AGENCY: Securities and Exchange Commission.

ACTION: Final rules and technical amendment.

SUMMARY: The Commission is adopting a new rule under the Securities Act of 1933 to establish a safe harbor for an unaffiliated broker or dealer participating in a securities offering of a covered investment fund to publish or distribute a covered investment fund research report. If the conditions in the rule are satisfied, the publication or distribution of a covered investment fund research report would be deemed *not* to be an offer for sale or offer to sell the covered investment fund's securities for purposes of sections 2(a)(10) and 5(c) of the Securities Act of 1933. The Commission is also adopting a new rule under the Investment Company Act of 1940 to exclude a covered investment fund research report from the coverage of section 24(b) of the Investment Company Act, except to the extent the research report is otherwise not subject to the content standards in self-regulatory organization rules related to research reports. We are also adopting a conforming amendment to rule 101 of Regulation M, and a technical amendment to Form 12b–25.

DATES: This rule is effective January 14, 2019 except that amendatory instruction 4 amending § 230.139b(a)(1)(i)(A)(*1*) is effective May 1, 2020. Comments regarding the collection of information requirements within the meaning of the Paperwork Reduction Act of 1995 should be received on or before February 11, 2019.

FOR FURTHER INFORMATION CONTACT: Asaf Barouk, Attorney-Adviser, John Lee, Senior Counsel; Amanda Hollander Wagner, Branch Chief; Thoreau Bartmann, Senior Special Counsel; or Brian McLaughlin Johnson, Assistant Director, at (202) 551–6792, Investment Company Regulation Office, Division of Investment Management; Steven G. Hearne, Senior Special Counsel, at (202) 551–3430, Division of Corporation Finance; Laura Gold or Samuel Litz, Attorney-Advisers; or John Guidroz, Branch Chief, at (202) 551–5777, Office of Trading Practices, Division of Trading and Markets, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549–8549.

SUPPLEMENTARY INFORMATION: The Commission is adopting 17 CFR 230.139b (''new rule 139b'') under the Securities Act of 1933 [15 U.S.C. 77a *et seq.*]; 17 CFR 270.24b–4 (''new rule 24b–4'') under the Investment Company Act of 1940 [15 U.S.C. 80a–1 *et seq.*]; a conforming amendment to 17 CFR 242.101(a) (rule 101) of Regulation M [17 CFR 242.100–242.105]; and a technical amendment to Form 12b–25 under the Securities Exchange Act of 1934 [15 U.S.C. 78a *et seq.*].

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I. Introduction

As directed by the Fair Access to Investment Research Act of 2017,[1] we are adopting new rule 139b[2] under the Securities Act of 1933 (the ''Securities Act'') to extend the current safe harbor available under rule 139 to a ''covered investment fund research report.''[3] Rule 139 provides a safe harbor for the publication or distribution of research reports[4] concerning one or more issuers by a broker or dealer (a ''broker-dealer'') participating in a registered offering of one of the covered issuers' securities.[5] Rule 139's safe harbor currently is not available for a broker-dealer's publication or distribution of research reports pertaining to specific registered investment companies or business development companies (''BDCs'').[6] The

[1] Fair Access to Investment Research Act of 2017, Public Law 115–66, 131 Stat. 1196 (2017) (the ''FAIR Act'').

[2] *See* Covered Investment Fund Research Reports, Securities Act Release No. 10498 (May 23, 2018) [83 FR 26788 (June 8, 2018)] (''Proposing Release'').

[3] *See* section 2(a) of the FAIR Act; *see also* Proposing Release, *supra* note 2, at section I.B. The FAIR Act also includes an interim effectiveness provision that became effective as of July 3, 2018 and by its terms will terminate upon the adoption of new rule 139b. *See* section 2(d) of the FAIR Act.

[4] *See* Proposing Release, *supra* note 2, at 26789 n.11 and accompanying text. *See also infra* notes 5–6.

[5] Specifically, rule 139 provides that a broker-dealer's publication or distribution of research reports—whether about a particular issuer or multiple issuers, including within the same industry—that satisfy certain conditions under the rule are ''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.'' Rule 139(a) under the Securities Act [17 CFR 230.139(a)]. A broker-dealer's publication or distribution of a research report in reliance on rule 139 would therefore be deemed not to constitute an offer that otherwise could be a non-conforming prospectus in violation of section 5 of the Securities Act. Sections 5(a) and 5(c) of the Securities Act generally prohibit any person (including broker-dealers) from using the mails or interstate commerce as a means to sell or offer to sell, either directly or indirectly, any security unless a registration statement is in effect or has been filed with the Commission as to the offer and sale of such security, or an exemption from the registration provisions applies. *See* 15 U.S.C. 77e(a) and (c). Section 5(b)(1) of the Securities Act requires that any ''prospectus'' relating to a security to which a registration statement has been filed must comply with the requirements of section 10 of the Securities Act. *See* 15 U.S.C. 77e(b)(1). Section 5(b)(2) of the Securities Act requires that any sale of securities (or delivery after sale) must be accompanied or preceded by a prospectus meeting the requirements of section 10(a) of the Securities Act. *See* 15 U.S.C. 77e(b)(2).

[6] For example, rule 139 is available for research reports regarding issuers that meet the registrant requirements for securities offerings on Form S–3 or Form F–3. *See* rule 139(a)(1)(i)(A)(*1*). In contrast, registered investment companies register their securities offerings on forms such as Forms N–1A, N–2, N–3, N–4, and N–6. To the extent that commodity- or currency-based trusts or funds (as defined in section II.A.3 below) register their securities offering under the Securities Act and meet the eligibility requirements of Forms S–3 or F–3, as well as the other conditions of rule 139, the rule 139 safe harbor is currently available for a broker-dealer's publication or distribution of research reports pertaining to these issuers.

Section 2(a)(3) of the Securities Act provides a safe harbor for broker-dealers with respect to research reports about ''emerging growth

FAIR Act requires us to revise rule 139 to extend the safe harbor to broker-dealers' publication or distribution of covered investment funds upon such terms, conditions, or requirements, as we may determine necessary or appropriate in the public interest, for the protection of investors, and for the promotion of capital formation.[7]

In May of 2018 we proposed new rules and rule amendments designed to meet the requirements of the FAIR Act. We received seven comment letters on the proposal.[8] Commenters generally supported our proposed implementation of the FAIR Act. However, most commenters requested that we consider eliminating or modifying certain of the conditions in current rule 139, as applied to covered investment fund research reports (such as the minimum public float requirement and the requirement to publish research reports in the regular course of business).[9] Other commenters raised concerns about the potential conflicts of interest that may arise in the context of a broker-dealer's receipt of compensation from covered investment funds included in research reports, and commenters disagreed on the best ways of mitigating these conflicts.[10] Finally, commenters expressed varying views on our request for input on whether research reports that include performance information should be required to present that performance information consistently with the way fund performance must be presented in fund advertisements pursuant to rule 482 and related requirements.[11]

II. Discussion

Rule 139b's framework is modeled after and generally tracks rule 139. However, rule 139b differs from rule 139 in certain respects. Some of these differences are specifically directed or contemplated by the FAIR Act.[12] Others, while not specifically directed by the FAIR Act, clarify and tailor the provisions of rule 139 more directly or specifically to the context of broker-dealers' publication or distribution of covered investment fund research reports.[13] For the reasons described below, we believe that the provisions of rule 139b that differ from the provisions of rule 139, and that are not specifically contemplated in the FAIR Act, are necessary or appropriate in the public interest, for the protection of investors, and for the promotion of capital formation.[14] We believe that maintaining a similar approach in rule 139b to rule 139 with modifications to the extent necessary or appropriate is consistent with the FAIR Act's directive to revise rule 139 to extend the current safe harbor available under rule 139 to broker-dealer's publication or distribution of covered investment fund research reports. We do not believe that the FAIR Act intended for us to make a new or disparate regulatory regime for research reports on covered investment funds that subjects these funds to different conditions where it is not necessary or appropriate for differentiation from research reports on other issuers published under rule 139. Therefore, we have 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. In addition to rule 139b, we are also adopting rule 24b–4, a conforming amendment to rule 101 of Regulation M, and a technical amendment to Form 12b–25.[15]

A. Scope of Rule 139b

Rule 139b establishes a safe harbor for the publication or distribution of ''covered investment fund research reports'' by unaffiliated broker-dealers (as described below) participating in a securities offering of a ''covered investment fund.''[16] We define the term ''covered investment fund research report,'' as well as the ''covered investment fund'' and ''research report'' components of this definition.

1. Definition of ''Covered Investment Fund Research Report''

We are adopting the definition of ''covered investment fund research report'' as proposed.[17] The definition is consistent with the FAIR Act, which defined the term ''covered investment fund research report'' to mean a research report published or distributed by a broker-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[18] 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[19] of an investment adviser) for the covered investment fund (the ''affiliate exclusion'').[20]

The affiliate exclusion prohibits two separate categories of research reports from being deemed to be ''covered investment fund research reports'' under rule 139b's safe harbor. The first category covers research reports published or distributed by the covered investment fund or any affiliate of the covered investment fund. This exclusion prevents such persons from indirectly using the safe harbor to avoid the applicability of the Securities Act prospectus requirements and other provisions applicable to written offers by such persons. The second category covers research reports published or distributed by any broker-dealer that is an investment adviser (or an affiliated

companies,'' as defined in section 2(a)(19) of the Securities Act. Broker-dealers may therefore currently rely on this safe harbor with respect to research reports about BDCs that are emerging growth companies.

[7] *See* section 2(a) of the FAIR Act.

[8] Comment Letter of Morningstar, Inc. (July 5, 2018) (''Morningstar Comment Letter''); Comment Letter of BlackRock, Inc. (July 9, 2018) (''BlackRock Comment Letter''); Comment Letter of Eversheds Sutherland (US) LLP (July 9, 2018) (''Sutherland Comment Letter''); Comment Letter of Fidelity Investments (July 9, 2018) (''Fidelity Comment Letter''); Comment Letter of the Investment Company Institute (July 9, 2018) (''ICI Comment Letter''); Comment Letter of the Securities Industry and Financial Markets Association (July 9, 2018) (''SIFMA Comment Letter I''); Comment Letter of the Securities Industry and Financial Markets Association (Sept. 14, 2018) (''SIFMA Comment Letter II'').

[9] *See, e.g.,* SIFMA Comment Letter I; ICI Comment Letter; *see also* BlackRock Comment Letter.

[10] *See, e.g.,* Morningstar Comment Letter; Fidelity Comment Letter.

[11] *See, e.g.,* SIFMA Comment Letter I; ICI Comment Letter; *see also* BlackRock Comment Letter.

[12] *See, e.g., infra* section II.A.1 (discussing the ''affiliate exclusion'' (defined below)).

[13] *See, e.g., infra* section II.B.1.a (discussing reporting history and timeliness requirements for issuer-specific research reports).

[14] *See supra* note 7 and accompanying text.

[15] If any of the provisions of these rules, or the application thereof to any person or circumstance, is held to be invalid, such invalidity shall not affect other provisions or application of such provisions to other persons or circumstances that can be given effect without the invalid provision or application.

[16] Under the safe harbor, such publication or distribution is deemed not to constitute an offer for sale or offer to sell the covered investment fund's securities for purposes of sections 2(a)(10) and 5(c) of the Securities Act. The safe harbor is available even if the broker-dealer is participating or may participate in a registered offering of the covered investment fund's securities.

[17] *See* rule 139b(c)(3).

[18] ''Affiliate'' is defined in rule 405 under the Securities Act. *See* 17 CFR 230.405; Proposing Release, *supra* note 2, at 26790.

[19] ''Affiliated person'' is defined in section 2(a) of the Investment Company Act of 1940 (the ''Investment Company Act''). *See* 15 U.S.C. 80a–2(a); Proposing Release, *supra* note 2, at 26790; section 2(f)(1) of the FAIR Act and rule 139b(c)(1).

[20] *See* section 2(f)(3) of the FAIR Act.

person of an investment adviser) for the covered investment fund.[21]

As we noted in the Proposing Release, one factor to consider in evaluating whether a research report has been published or distributed by a person covered by the affiliate exclusion is the extent of such person's involvement in the preparation of the research report.[22] These determinations would necessarily be based on the extent to which a person covered by the affiliate exclusion, or any person acting on its behalf, has been involved in preparing the information or explicitly or implicitly endorsed or approved the information, also known as the entanglement theory and adoption theory, respectively.[23]

While we did not receive comments on the definition of ''covered investment fund research report,'' we received comments on the affiliate exclusion embedded in the definition.[24] One commenter raised concerns about the incorporation of the adoption and entanglement theories, which could prohibit broker-dealers from engaging in certain activities designed to ensure the accuracy of research reports.[25] Other commenters suggested that while the entanglement theory may have relevance to research reports under proposed rule 139b, the adoption theory may not.[26] Some commenters requested clarification on whether certain conduct—for example, a covered investment fund providing information or confirmation of certain factual matters such as performance data, holdings, or investment objectives or strategies—is prohibited by the affiliate exclusion.[27]

As we noted in the Proposing Release, the entanglement and adoption theories are helpful guideposts in establishing whether a research report about a covered investment fund was published or distributed by the fund.[28] However, those theories of liability have been set forth by courts in interpreting the federal securities laws, and how a court would apply such theories with respect to covered investment fund research reports would be based on the facts and circumstances presented.[29]

Under rule 139b, we believe it would be inappropriate for any person covered by the affiliate exclusion, or for any person acting on its behalf, to publish or distribute a research report indirectly that the person could not publish or distribute directly under the rule.[30] For example, if a broker-dealer distributes a research report including materials that a person covered by the affiliate exclusion authorized or approved for inclusion in the report, this could (depending on the facts and circumstances) inappropriately circumvent the affiliate exclusion in rule 139b.

Also in relation to the affiliate exclusion, one commenter suggested that the proposal did not adequately address conflicts of interest such as revenue sharing agreements.[31] Other commenters disagreed stating that self-regulatory organization (''SRO'') rules and federal securities laws addressing conflicts of interest would apply to covered investment fund research reports.[32] One commenter stated that additional restrictions are unnecessary because the proposed affiliate exclusion would be broad and effective.[33] One commenter recommended that the final rule should not have any specific revenue sharing agreement requirements, but suggested that if the Commission believes it should address such potential conflicts in the final rule, the final rule should require a general disclosure similar to mutual fund prospectus disclosure alerting investors of potential revenue sharing agreements.[34]

While we appreciate the concerns noted with respect to potential conflicts of interest, and specifically those arising from revenue sharing agreements, we are not adding additional explicit conflicts-of-interest-related restrictions in the final rule. The antifraud provisions of the federal securities laws and certain existing Commission and SRO rules continue to apply to covered investment fund research reports, some of which, depending on the facts and circumstances, may require disclosure of such conflicts.[35] For example, many covered investment fund research reports may be subject to FINRA's research report rules, which require disclosure in a research report if the member or its affiliates have received compensation from the subject company other than for investment banking services in the previous year.[36]

[21] Like the first category of exclusion, this second category of exclusion addresses the concern that a person covered by the affiliate exclusion may be able to circumvent the disclosure and prospectus delivery requirements of the Securities Act. For example, this second category helps to limit a person covered by the affiliate exclusion from publishing or distributing communications indirectly through the third-party broker-dealer that otherwise would have to be included in a statutory prospectus meeting the requirements of section 10 of the Securities Act. It also addresses the concern that a broker-dealer that is a covered investment fund's adviser or an affiliated person of a fund's adviser may have financial incentives that could give rise to a conflict of interest. For example, a broker-dealer that is an affiliated person of the fund's adviser may have an incentive to promote the covered investment fund's securities relative to other securities because sales of the covered investment fund's securities may benefit not only the fund but also the broker-dealer.

[22] *See* Proposing Release, *supra* note 2, at 26791–92.

[23] *See* Securities Offering Reform, Securities Act Release No. 8591 (July 19, 2005) [70 FR 44722 (Aug. 3, 2005)] (''Securities Offering Reform Adopting Release'') (noting that ''[l]iability under the entanglement theory depends upon the level of pre-publication involvement in the preparation of the information''). *See* Use of Electronic Media, Securities Act Release No. 7856 (Apr. 28, 2000) [65 FR 25843 (May 4, 2000)] (''2000 Electronics Release'') (interpretive release on the use of electronic media); Asset-Backed Securities, Securities Act Release No. 8518 (Dec. 22, 2004) [70 FR 1506 (Jan. 5, 2005)] (''Asset-Backed Securities Adopting Release'') (adopting asset-backed securities regulations).

[24] *See* Morningstar Comment Letter; Fidelity Comment Letter; ICI Comment Letter; SIFMA Comment Letter I; *see also* BlackRock Comment Letter.

[25] *See* SIFMA Comment Letter I.

[26] *See* Fidelity Comment Letter; ICI Comment Letter; *see also* BlackRock Comment Letter.

[27] *See* ICI Comment Letter; SIFMA Comment Letter I; *see also* BlackRock Comment Letter.

[28] *See* Proposing Release, *supra* note 2, at 26792.

[29] *See* 2000 Electronics Release, *supra* note 23 (with respect to entanglement theory cases, citing *Elkind* v. *Liggett & Myers, Inc.,* 635 F.2d 156 (2d Cir. 1980); *In the Matter of Syntex Corp. Sec. Litig.,* 855 F.Supp. 1086 (N.D. Cal. 1993); *In the Matter of Caere Corp. Sec. Litig.,* 837 F. Supp. 1054 (N.D. Cal. 1993) and with respect to adoption theory cases, citing *In the Matter of Cypress Semiconductor Sec. Litig.,* 891 F. Supp. 1369, 1377 (N.D. Cal. 1995), *aff'd sub nom. Eisenstadt* v. *Allen,* 113 F.3d 1240 (9th Cir. 1997); *In the Matter of Presstek, Inc.,* Exchange Act Release No. 39472 (Dec. 22, 1997)). *See also* Asset-Back Securities Adopting Release, *supra* note 23.

[30] *See* Proposing Release, *supra* note 2, at 26791. *See also* section 5(a), 5(b), and 5(c) of the Securities Act [15 U.S.C. 77e(a), (b), and (c)] (prohibiting both direct and indirect violations of the prospectus requirements); section 48(a) of the Investment Company Act [15 U.S.C. 80a–47(a)] (It shall be unlawful for any person, directly or indirectly, to cause to be done any act or thing through or by means of any other person which it would be unlawful for such person to do under the provisions of this subchapter or any rule, regulation, or order thereunder.); section 208(d) of the Investment Advisers Act of 1940 [15 U.S.C. 80b–8(d)] (It shall be unlawful for any person indirectly, or through or by any other person, to do any act or thing which it would be unlawful for such person to do directly under the provisions of this subchapter or any rule or regulation thereunder.).

[31] Morningstar Comment Letter (stating that SRO rules would be inadequate in this respect and that the Commission should require elimination or mitigation of these conflicts).

[32] *See* Fidelity Comment Letter; ICI Comment Letter; SIFMA Comment Letter I; *see also* BlackRock Comment Letter.

[33] *See* ICI Comment Letter; *see also* BlackRock Comment Letter.

[34] *See* Fidelity Comment Letter.

[35] We note that the FAIR Act expressly stated that research reports published or distributed under its provisions would continue to be subject to the antifraud and anti-manipulation provisions of the federal securities laws, and rules adopted thereunder, including section 17 of the Securities Act, section 34(b) of the Investment Company Act, and sections 9 and 10 of the Exchange Act. *See* section 2(c)(1) of the FAIR Act.

[36] *See, e.g.,* FINRA rule 2241(c)(4)(D). *See also, e.g.,* FINRA rule 2210(d)(1)(A) (requiring all member communications with the public to be

Depending on the facts and circumstances, covered investment fund research reports may also need to include information about the compensation received by the broker-dealer from covered investment funds included in the report if such compensation is of the type covered by section 17(b) of the Securities Act.[37]

We understand that disclosure about conflicts of interest created by the receipt of compensation by the broker-dealer from covered investment funds is consistent with current industry practices in communications that are Securities Act section 10(b) prospectuses and are currently styled as ''research reports'' subject to the requirements of rule 482.[38] Considering current industry practice, and the protections offered by the other regulatory provisions discussed above, we do not believe that additional conflict-of-interest requirements are necessary in rule 139b. Accordingly, we are adopting the definition of covered investment fund research report as proposed.

2. Definition of ''Research Report''

We are defining, as proposed,[39] the term ''research report'' in rule 139b 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.[40] This definition is identical to the corresponding definition of ''research report'' in rule 139.[41] As discussed in the Proposing Release, while this definition is not identical to that in the FAIR Act, it is consistent with the FAIR Act because we interpret it to have the same meaning as the FAIR Act's definition of ''research report.''[42] We received one comment agreeing with this definition.[43]

3. Definition of ''Covered Investment Fund''

The FAIR Act defines the term ''covered investment fund'' to include registered investment companies, BDCs, and certain commodity- or currency-based trusts or funds.[44] We are adopting a definition of the term ''covered investment fund'' in rule 139b that is substantially the same as the one used in the FAIR Act, with the addition that the definition specifies that the term ''investment company'' includes ''a series or class thereof.''[45] We received no comments on this proposed definition. The final rule adopts the definition as proposed.

4. Non-Exclusivity of Safe Harbor

Broker-dealers publishing or distributing research reports for some covered investment funds, such as commodity- or currency-based trusts or funds that have a class of securities registered under the Securities Exchange Act of 1934 (the ''Exchange Act''), rather than relying on new rule 139b, instead may be able to rely on rule 139. Rule 139b does not preclude a broker-dealer from relying on existing rule 139 if applicable. In order to clarify that a broker-dealer may rely on existing research safe harbors, we proposed that rule 139b state that it does not affect the availability of any other exemption or exclusion from sections 2(a)(10) or 5(c) of the Securities Act that may be available to a broker-dealer.[46] We received no comments on this aspect of the proposed rule and are adopting it as proposed.[47]

B. Conditions for the Safe Harbor

As discussed in the Proposing Release, the Commission has previously acknowledged the value of research reports in providing the market and investors with information about reporting issuers.[48] To mitigate the risk of research reports being used to circumvent the prospectus requirements of the Securities Act,[49] the Commission

based on principles of fair dealing and good faith, be fair and balanced, and provide a sound basis for evaluating the facts in regards to any particular security; and barring members from omitting any material fact or qualification if the omission, in light of the context of the material presented, would cause the communication to be misleading).

[37] *See* 15 U.S.C. 77q(b) (making it unlawful for any person, by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails to publish, give publicity to, or circulate any notice, circular, advertisement, newspaper, article, letter, investment service, or communication which, though not purporting to offer a security for sale, describes such security for a consideration received or to be received, directly or indirectly, from an issuer, underwriter, or dealer, without fully disclosing the receipt, whether past or prospective, of such consideration and the amount thereof).

[38] 17 CFR 230.482. An investment company advertisement that complies with rule 482 is deemed to be a section 10(b) prospectus (also known as an ''advertising prospectus'' or ''omitting prospectus'') for purposes of section 5(b)(1) of the Securities Act. As a section 10(b) prospectus, an investment company advertisement is subject to liability under section 12(a)(2) of the Securities Act, as well as the antifraud provisions of the federal securities laws.

[39] *See* Proposing Release, *supra* note 2, at 26792–93.

[40] *See* rule 139b(c)(6). Rule 405 defines ''written communication'' to mean that ''[e]xcept as otherwise specifically provided or the context otherwise requires, a written communication is any communication that is written, printed, a radio or television broadcast, or a graphic communication as defined in [rule 405].'' 17 CFR 230.405.

[41] *See* rule 139(d) [17 CFR 230.139(d)]. Rule 139 defines ''research report'' to mean a written communication, as defined in Rule 405, 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. *See* rule 139(d) [17 CFR 230.139(d)]. A ''written communication,'' as defined in rule 405, includes a ''graphic communication.'' As further defined in rule 405, a ''graphic communication'' includes all forms of electronic media, including electronic communications except those, which at the time of the communication, originate in real-time to a live audience and does not originate in recorded form or otherwise as a graphic communication, although it is transmitted through graphic means. *See* rule 405 [17 CFR 230.405].

[42] *See* section 2(f)(6) of the FAIR Act; *see also* Proposing Release, *supra* note 2, at 26792–93 (explaining that the rule 139b definition tracks the FAIR Act definition except that it does not expressly reference ''electronic communications'' and that consistent with Commission rules on electronic communications, rule 139b definition's reference to a ''written communication,'' as defined in rule 405, includes a ''graphic communication,'' which in turn includes electronic communications (other than telephone and other live communications)).

[43] *See* SIFMA Comment Letter I (stating that it would reduce potential interpretive confusion for market participants who are familiar with the rule 139 definition).

[44] *See* section 2(f)(2)(B) of the FAIR Act. The term also includes other persons issuing securities in an offering registered under the Securities Act (i) whose securities are listed for trading on a national securities exchange, (ii) whose assets consist primarily of commodities, currencies, or derivative instruments that reference commodities or currencies or interests in the foregoing, and (iii) whose registration statement reflects that its securities are purchased or redeemed, subject to certain conditions or limitations, for a ratable share of its assets (such exchange-listed funds or trusts, ''commodity- or currency-based trusts or funds''). *See* section 2(f)(2)(B) of the FAIR Act. Based on the definition in section 2(f)(2) of the FAIR Act, the term ''covered investment fund'' would not include an investment company that is registered solely under the Investment Company Act, such as certain master funds in a master-feeder structure.

[45] *See* rule 139b(c)(2). This approach reflects the approach taken in other Commission rules that define the term ''fund'' to include a separate series of an investment company. *See, e.g.,* rule 22e–4(a)(4) under the Investment Company Act [17 CFR 270.22e–4(a)(4)]; rule 22c–1(a)(3)(v)(A) under the Investment Company Act [17 CFR 270.22c–1(a)(3)(v)(A)].

[46] *See* proposed rule 139b(a); *see also* addition to rule 139(a) (for purposes of the Fair Access to Investment Research Act of 2017 [Pub. L. 115–66, 131 Stat. 1196 (2017)], a safe harbor has been established for covered investment fund research reports, and the specific terms of that safe harbor are set forth in rule 139b (§ 230.139b)).

[47] *See* rule 139b(a).

[48] *See* Proposing Release, *supra* note 2, at 26794 (for example, the Commission has recognized that, for public operating entities that are well-followed, the research-report-related rules enhance the efficiency of the markets by allowing a greater number of research reports to provide a continuous flow of essential information about reporting entities into the marketplace).

[49] *See supra* note 5 and accompanying text (noting that the rule 139 safe harbor permits a broker-dealer to publish or distribute a research

Continued

has placed conditions on a broker-dealer's publication or distribution of research reports.[50] Under Rule 139, these conditions include restrictions on the issuers to which the research may relate, as well as requirements that such reports be published in the regular course of business. These conditions vary depending on whether a research report covers a specific issuer (''issuer-specific research reports'') or a substantial number of issuers in an industry or sub-industry (''industry research reports''). Rule 139b carries over these conditions for covered investment fund research reports and incorporates certain modifications intended to adapt these conditions to covered investment funds that we discuss below.

1. Issuer-Specific Research Reports

a. Reporting History and Timeliness Requirements

In order for a broker-dealer to include a covered investment fund in a research report published or distributed in reliance on the rule 139b safe harbor, the fund must meet certain reporting history and timeliness requirements. We are adopting as proposed that any such covered investment fund must have been subject to the 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 rule 139b and that these reports have been filed in a timely manner.[51] This requires covered investment funds that are registered investment companies to have been subject to the reporting requirements of the Investment Company Act for a period of at least 12 calendar months prior to a broker-dealer's reliance on the new rule and to have filed in a timely manner all required reports, as applicable, on Forms N–CSR,[52] N–Q,[53] N–PORT,[54] N–MFP,[55] and N–CEN [56] during the immediately preceding 12 calendar months.[57] If the covered investment fund is *not* a registered investment company, it must have been subject to the reporting requirements under section 13 or section 15(d) of the Exchange Act for a period of at least 12 calendar months and have filed all required reports in a timely manner on Forms 10–K [58] and 10–Q [59] and 20–F [60] during the immediately preceding 12 calendar months.[61]

Reporting History

Several commenters requested we eliminate the reporting history requirement for issuer-specific research reports under rule 139b.[62] One commenter suggested that the requirement is unnecessary because funds have ''detailed and comprehensive regulatory filing and disclosure obligations'' providing investors with ''a wealth of information about funds.'' [63] Another commenter argued that the reporting history requirement should be eliminated because ensuring compliance with the requirement would create ''operational hurdles'' for broker-dealers that provide investors with research on a large numbers of funds on a largely automated basis.[64] Commenters also argued that the reporting history requirement unduly restricts research on newer funds.[65]

As discussed in the Proposing Release, rule 139b tracks the reporting history requirement of rule 139.[66] We believe satisfying such a requirement indicates a likelihood that more current and timely information has been disseminated to and digested by the marketplace to inform investors of material information about the fund, including risks, and provides investors with SEC-filed information to compare against the contents of the research report.[67] We also continue to believe that maintaining a reporting history requirement is consistent with the FAIR Act, which permits a reporting history requirement so long as it does not exceed the period required in rule 139.[68]

We do not believe that funds should be treated differently from other issuers subject to the reporting requirement of rule 139. The Commission included a reporting history requirement in rule

report without this publication or distribution being deemed to constitute an offer that otherwise could be a non-conforming prospectus in violation of section 5 of the Securities Act). *See also* Securities Offering Reform Adopting Release, *supra* note 23 (discussing how the Sarbanes-Oxley Act, Regulation AC, and a global research analyst settlement required structural changes and increased disclosures in connection with certain abuses identified with analyst research); *supra* notes 35–36 and accompanying text (discussing certain rules and regulations under the federal securities laws, as well as certain SRO rules, that help address certain conflicts of interest and abuses identified with analyst research).

[50] Many research reports that broker-dealers publish or distribute in reliance on the rule 139 safe harbor may also be subject to other federal securities rules and regulations under the Exchange Act and SRO rules governing their content and use. *See supra* notes 35–36.

[51] Rule 139b(a)(1)(i)(A). We believe that this condition also gives effect to FAIR Act section 2(e), which makes the safe harbor contemplated by the FAIR Act unavailable with respect to broker-dealers' publication or distribution of research reports about closed-end registered investment companies BDCs during these covered investment fund issuers' first year of operation. *See* section 2(e) of the FAIR Act (The safe harbor under subsection (a) of the FAIR Act shall not apply to the publication or distribution by a broker-dealer of a covered investment fund research report, the subject of which is a BDC or a registered closed-end investment company, during the time period described in 17 CFR 230.139(a)(1)(i)(A)*(1),* except where expressly permitted by the rules and regulations of the Commission under the federal securities laws.).

[52] 17 CFR 249.331 and 17 CFR 274.128.

[53] 17 CFR 249.332 and 17 CFR 274.130. Form N–Q will be rescinded May 1, 2020. Larger fund groups will begin submitting reports on Form N–PORT by April 30, 2019, and smaller fund groups by April 30, 2020. *See* Investment Company Reporting Modernization, Investment Company Act Release No. 32314 (Oct. 13, 2016) [81 FR 81870 (Nov. 18, 2016)] (''Reporting Modernization Release''); Investment Company Reporting Modernization, Investment Company Act Release No. 32936 (Dec. 8, 2017) [82 FR 58731 (Dec. 14, 2017)]. At the time of these compliance dates, covered investment funds would no longer be required to file reports on Form N–Q, and filing these reports would not be required as a condition to rely on the rule 139b safe harbor. Accordingly, rule 139b, as adopted, will be amended effective May 1, 2020 by removing the reference to Form N–Q. *See infra* section VI (instruction 4 under Text of Proposed Rules and Amendments).

[54] 17 CFR 274.150. Form N–PORT will be filed with the Commission on a monthly basis, but only information reported for the third month of each fund's fiscal quarter on Form N–PORT will be publicly available (and not until 60 days after the end of the fiscal quarter). *See* Reporting Modernization Release, *supra* note 53. Therefore, we would consider Form N–PORT to have been timely filed for purposes of the timeliness requirement if the public filing of Form N–PORT every third month is timely filed and publicly available.

[55] 17 CFR 274.201.

[56] 17 CFR 249.330 and 17 CFR 274.101.

[57] Rule 139b(a)(1)(i)(A)*(1).* As discussed in the Proposing Release, Form N–SAR was rescinded on June 1, 2018, which is the compliance date for Form N–CEN. As such, reliance on new rule 139b is not conditioned on covered investment funds reporting on Form N–SAR and the reference to Form N–SAR, as proposed, is not included in paragraph (a)(1)(i)(A)*(1)* of rule 139b. *See id.; see also* Proposing Release, *supra* note 2, at 26794.

[58] 17 CFR 249.310.

[59] 17 CFR 249.308a.

[60] 17 CFR 249.220f.

[61] Rule 139b(a)(1)(i)(A)*(2).*

[62] *See* Fidelity Comment Letter; ICI Comment Letter; SIFMA Comment Letter I; *see also* BlackRock Comment Letter.

[63] *See* ICI Comment Letter; *see also* BlackRock Comment Letter.

[64] *See* Fidelity Comment Letter.

[65] *See* ICI Comment Letter; SIFMA Comment Letter I; *see also* BlackRock Comment Letter.

[66] Rule 139 predicates issuer-specific research reports on an issuer's eligibility to use Form S–3 or F–3, which are short form or shelf registration statements that are available to register an issuer's securities offering only after it has been subject to and in compliance with the Exchange Act periodic reporting requirements for at least 12 months.

[67] *See* Proposing Release, *supra* note 2, at 26795 nn.75–78 and accompanying text. The safe harbor would be unavailable to broker-dealers' publication or distribution of research reports about closed-end registered investment companies or BDCs during these covered investment fund issuers' first year of operation. *See supra* note 51.

[68] *See* Proposing Release, *supra* note 2, at 26795 n.77 (explaining the reporting and timeliness requirements of rule 139).

139 because it helps to ensure that the market has information, beyond the research report, to allow investors to weigh how much value they will assign to the research report. The fund's reporting history should be particularly important when the broker-dealer publishing the research report is participating or may participate in the fund's offering, as is the case under rule 139b (similar to rule 139). As noted above, one commenter suggested that the reporting history requirement is unnecessary because funds' ''detailed and comprehensive regulatory filing and disclosure obligations'' provide investors ''a wealth of information about funds.'' [69] Eliminating the reporting history requirement would reduce the information available to investors when evaluating research reports published or distributed by broker-dealers when those broker-dealers are also participating in the offering of the fund's shares. The requirement also allows time for the market to absorb the previously released periodic reports and for investors to assess an issuer's track record.

Corporate issuers are subject to, under rule 139, filing and disclosure obligations similar to what is required of covered investment funds under rule 139b. Although funds differ from corporate issuers in many respects, investors would benefit similarly from having access to fund information to evaluate the research reports on which they may consider relying. Accordingly, for the same reasons the Commission determined to include this requirement in rule 139, we have determined to include this requirement in rule 139b.

We also believe that broker-dealers will be able to comply with the reporting history requirement in a manner similar to how they comply with the parallel requirement in rule 139 and that the effect of the requirement on new funds would be similar to the effect on new issuers under rule 139.[70] Other issuers also have ''detailed and comprehensive regulatory and disclosure obligations'' much like funds. In this regard, we are not persuaded that there is a material difference between covered investment funds and other issuers that would justify treating them in a disparate fashion. We continue to believe that the concerns underlying the reporting history requirement of rule 139 apply to research reports issued under rule 139b, and therefore are not persuaded that the reporting history requirement should be eliminated from rule 139b as suggested by some commenters.

One commenter also requested the reporting history requirement be shortened from 12 months to 25 days after a fund initially starts offerings shares. The commenter argued that this would align with broker-dealers' market practice of waiting 25 days after an initial public offering.[71]

Rule 139 is available only to broker-dealers that both publish or distribute a research report on an issuer and are participating or will participate in a registered offering of the issuer's securities. The 25-day standard referenced by the commenter relates to the issuance of a research report after the prospectus delivery obligation in an initial public offering ends, not while the offering is ongoing and the broker-dealer is participating in it. Accordingly, the prospectus delivery obligation described by the commenter is distinct from the delivery obligation that applies to continuous offerings. Thus, the commenter's suggested provision and rationale do not appropriately apply to a broker-dealer participating in a continuous offering. The 25-day standard referenced by the commenter is premised on statutory provisions addressing prospectus delivery, a different investor protection consideration from rules 139 and 139b. Accordingly, we believe the 25-day standard is inapposite to rule 139b, as rule 139b applies to broker dealers that are participating in the offering of the subject fund's securities, not after the offering has ended. For these reasons, we are adopting the reporting history provision as proposed.

Timeliness

Two commenters opposed the proposed timeliness requirement for issuer-specific research reports.[72] They argued that broker-dealers would face operational hurdles in confirming a covered investment fund's timely filing of periodic reports.[73] One commenter suggested that broker-dealer firms be allowed to accept compliance representations from covered investment funds for the reporting history and timeliness requirements.[74] The other commenter requested that the timeliness requirement apply only when a broker-dealer initiates research coverage on a fund, rather than for each research report.[75] Alternatively, the commenter also requested the Commission to permit broker-dealers to rely on the lack of any Form 12b–25 (indicating that a filing is late) filed by covered investment funds within the prior 12 months.[76]

Satisfaction of the timeliness requirement indicates a greater likelihood that a covered investment fund will make information available in a timely manner to inform investors of material information about the fund, including risks. We believe it is important for covered investment fund investors to have timely information from the fund when evaluating research reports, as it is for operating company investors. Rule 139 requires that an issuer satisfy the reporting history and timeliness requirements at the time the broker-dealer publishes or distributes a research report.[77] Modifying rule 139b to allow confirming the timeliness of a fund's reporting only upon initiation of coverage, or to accept the compliance representations of covered investment funds, would provide less protection to investors than the Commission determined to be appropriate in rule 139. We also do not believe providing disparate treatment between funds and other issuers with respect to reporting

[69] *See* ICI Comment Letter; *see also* BlackRock Comment Letter.

[70] We believe that a broker-dealer would be relying on rule 139 or rule 139b because it would be involved in distributing securities of the issuer covered in the report, and would therefore have information about the issuer to confirm it has been subject to filing obligations for the preceding 12 calendar months. For example, this information is accessible through the Commission's publicly available Electronic Data Gathering Analysis, and Retrieval (''EDGAR'') system. Moreover, we believe that broker-dealers that choose to automate publication of research reports may invest in technologies to implement this automation including by leveraging their existing technological infrastructures to verify the reporting history requirement for covered investment funds.

[71] *See* SIFMA Comment Letter I; SIFMA Comment Letter II. Additionally, this commenter presented an example of a new ETF based on a new industry classification standard that has garnered interest from the market and satisfies the minimum public market value requirement, but would be unable to satisfy a 12-month reporting history requirement. *See* SIFMA Comment Letter II. This situation and result equally occurs in the operating company context, where a well-followed operating company that has an initial public offering might satisfy the minimum public market value requirement, but not the reporting history requirement, and thus could not be covered as a rule 139 issuer-specific research report until the 12-month reporting history requirement is also satisfied.

[72] *See* Fidelity Comment Letter; SIFMA Comment Letter I; SIFMA Comment Letter II.

[73] *See* Fidelity Comment Letter; SIFMA Comment Letter I. In a subsequent letter, one commenter noted the difficulty broker-dealers would have in identifying reports filed by registered investment companies that are part of series companies, pointing to a lack of functionality in EDGAR's mutual-fund specific search page. *See* SIFMA Comment Letter II. All registered investment company filings are available on EDGAR, however, and there are multiple ways to search the EDGAR system in addition to the mutual-fund specific page the commenter identified—including using a fund's filing number, which can be found in a fund's prospectus, or by using a Central Index Key (''CIK'') number.

[74] *See* Fidelity Comment Letter.

[75] *See* SIFMA Comment Letter I.

[76] *See* SIFMA Comment Letter II.

[77] *See* rule 139(a)(1)(i)(A)(*1*)–(*2*).

history and timeliness conditions is necessitated by operational or structural differences between the issuer types. As with the 12-month reporting history requirement, we believe that confirming the timeliness of periodic filings for covered investment funds would be substantially similar to confirming the timeliness of periodic filings in the operating company context.[78] We do, however, agree with the commenter that a fund filing a Form 12b–25 (or lack thereof) would serve as a useful indication of the fund's timeliness. We believe that a broker-dealer may rely on the lack of a Form 12b–25 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. Accordingly, we are adopting the timeliness requirement as proposed.

b. Market Following Requirement

We are adopting a requirement that, in order for broker-dealers to use the rule 139b safe harbor to publish or distribute issuer-specific research reports, the covered investment fund that is the subject of a report must satisfy a minimum public market value threshold at the date of reliance on the new rule (the ''float requirement''). Specifically we are adopting a requirement that the aggregate market value of a covered investment fund, or the net asset value [79] in the case of a registered open-end investment company (other than an exchange-traded fund (''ETF'')) [80] *i.e.,* a mutual fund, must equal or exceed the aggregate market value required by General Instruction I.B.1 to Form S–3.[81] This amount is currently $75 million.[82] The FAIR Act permits us to set a float requirement for covered investment funds, as long as the minimum public float is not greater than what is required by rule 139.[83]

We are adopting the float requirement and level as proposed. However, as discussed below, the final rule includes two changes to the float calculation methodology for most covered investment funds. First, the final rule generally no longer requires that the fund issuer's aggregate market value or net asset value be calculated net of its affiliates' holdings.[84] Second, the minimum float requirement must be satisfied at the initiation (or reinitiation) of research coverage and then once a quarter thereafter. The proposal, on the other hand, would have required that the minimum float requirement be satisfied each time a broker or dealer relied on the safe harbor to publish or distribute a research report on a covered investment fund.

Float Level

Several commenters argued that a float requirement should be eliminated or reduced in the context of covered investment funds because such a requirement would limit the extent of research that could be produced.[85] Two commenters argued that for funds, NAV relates to the underlying value of the portfolio and therefore makes it an inapt proxy for market following.[86] Historically, the Commission has used public float as an approximate measure of a security's market following, through which the market absorbs information that is reflected in the price of the security.[87] We continue to view as significant the relationship between public float, information dissemination to the market, and following by investment institutions.[88] While market following for funds that price at or near NAV may not have the same degree of impact on the price of the fund shares that it may have for other issuers, market following serves other purposes as well, including ensuring that a mix of information about the fund's securities is available. We believe that providing a different calculation method for mutual funds is necessary to achieve the intent of the FAIR Act and is also consistent with the goals of the float requirement in rule 139. We also do not believe there is a reason to set the level of the minimum public float requirement based on a different set of considerations than for operating companies (*i.e.,* the level of the security's market following).

As noted by commenters, we recognize that the minimum public float requirement may impact the amount of research on covered investment funds. However, we continue to believe that this requirement is consistent with rule 139's framework and intent.[89] As discussed previously, we believe that the intent of the FAIR Act was to extend the rule 139 framework to covered investment funds in a manner consistent with the treatment of other issuers subject to rule 139, except where necessary or appropriate. We do not believe it is necessary or appropriate to treat covered investment funds and other issuers differently here, except with respect to the calculation method for mutual funds as discussed below. We also believe that concern about coverage for smaller issuers—and balancing that concern with investor protection concerns when the broker-dealer distributing the report is participating in the issuer's offering—is not unique to covered investment funds. As discussed in the Proposing Release, in the context of covered investment funds, we would expect market information to be most limited for new funds (which the reporting history and timeliness requirements could help to address) and for funds that are marketed to a limited segment of investors (which the float requirement could help to address).[90] The float requirement is designed to protect investors by excluding research reports on covered

[78] *See* Proposing Release, *supra* note 2, at 26794–95. A broker-dealer has diligence and investigative obligations under section 11 of the Securities Act in order to be able to claim a due diligence defense available thereunder. *See* Securities Offering Reform Adopting Release, *supra* note 23; rule 176 of the Securities Act [17 CFR 230.176]. Like the reporting history requirement, broker-dealers could confirm the timeliness of a covered investment fund's reports through a check of the Commission's EDGAR system, which is free and readily available. This may allow the leveraging of operating efficiencies for broker-dealers already familiar with the requirement.

[79] For mutual funds, net asset value would be computed using the investment company's current net asset value, as used in determining its share price. *See* rule 22c–1 under the Investment Company Act [17 CFR 270.22c–1] (requiring registered mutual funds, their principal underwriters, and dealers in the investment company's shares (and certain others) to sell and redeem the investment company's shares at a price determined at least daily based on the current net asset value next computed after receipt of an order to buy or redeem).

[80] *See* rule 139b(a)(1)(i)(B); rule 139b(c)(4) (defining ''exchange-traded fund'' for purposes of the new rule to have the meaning given the term in General Instruction A to Form N–1A).

[81] The new rule refers to General Instruction I.B.1 to Form S–3. Under this instruction, aggregate market value is ''computed by use of the price at which the common equity was last sold, or the average of the bid and asked prices of such common equity, in the principal market for such common equity as of a date within 60 days prior to the date of filing.'' General Instruction I.B.1 to Form S–3. The definition of ''market price'' in the General Instructions of Form N–1A contemplates valuing an ETF's shares similarly. *See* General Instruction A to Form N–1A.

[82] General Instruction I.B.1 to Form S–3.

[83] *See* section 2(b)(2)(B) of the FAIR Act.

[84] However, as discussed below, this change would not apply to the calculation of a commodity- or currency-based trust or fund's float.

[85] *See* SIFMA Comment Letter; ICI Comment Letter; Fidelity Comment Letter.

[86] *See* SIFMA Comment Letter; ICI Comment Letter.

[87] *See, e.g.,* Revisions To The Eligibility Requirements For Primary Securities Offerings On Forms S–3 and F–3, Securities Act Release No. 8878 (Dec. 19, 2007) [72 FR 73533 (Dec. 27, 2007)] (''S–3 Revisions Adopting Release''); *see also* Securities Offering Reform, Securities Act Release No. 8501 (Nov. 3, 2004) [69 FR 67391 (Nov. 17, 2004)] (discussing public float of a certain level as a factor indicating that an issuer has a demonstrated market following).

[88] *See, e.g.,* S–3 Revisions Adopting Release, *supra* note 87.

[89] *See* Proposing Release, *supra* note 2, at 26796.

[90] *See id.*

investment funds with a relatively small amount of total assets, which serves as a reasonable proxy for a limited market following.[91]

With respect to the level of the minimum public float, the float requirement is not intended to include or exclude a certain percentage of funds or other issuers from research coverage. The float requirement is intended to act as a proxy for market following. As we have previously analyzed in other contexts, analyst research coverage of an issuer is one indicia of market following. We have previously observed that analyst coverage drops off significantly with smaller issuers, and few if any issuers with less than $75 million in public float have significant analyst coverage.[92] Moreover, while certain data aggregators provide analyst research report coverage for a number of funds, most funds are not followed by dedicated research analysts akin to the analyst coverage that we have previously identified as being one indicia of market interest and following for operating companies.[93] As a consequence, we have observed that covered investment fund issuers with a public float of less than $75 million generally do not have a market following that would add to the mix of information in the marketplace. Some commenters suggested using a lower public float requirement for funds on the basis of seeking to equalize the percentage of funds that would be subject to coverage with the percentage of issuers similarly subject to coverage in rule 139.[94] Market following, however, appears to be a characteristic related to the size of a particular issuer, not to the statistical distribution of issuers in the market. In other words, there is no reason to believe that equalizing the percentage of issuers covered under rule 139 with the percentage of funds covered under rule 139b would result in a meaningful indication of market following because the result would depend on the distribution of issuers and funds by size. In addition, using a minimum public market value threshold that is the same as the parallel threshold in rule 139 may benefit market participants through regulatory consistency and reduce opportunities for investor confusion.[95]

While a broker-dealer publishing a research report about a fund that does not meet the minimum public float could not rely on rule 139b, other methods may be available to provide information about these funds by a broker-dealer participating in the offering, such as choosing to cover a smaller fund in a rule 482 communication.[96] In addition, the public market value requirement is limited to issuer-specific research reports, and does not apply to industry research reports.

Float Calculation

While we continue to believe that the float requirement serves a useful purpose, we recognize that the proposed float requirement could pose unique operational challenges for analysts covering certain covered investment funds. Accordingly, as discussed below, we are making certain changes to the timing and method of the float calculation that are designed to address these concerns for covered investment funds.

One commenter stated that calculating a covered investment fund's public float, and determining the specific amount of affiliate holdings to be excluded in calculating the public float as proposed, is a practical challenge for broker-dealers because it was not clear to the commenter that third-party vendors or filings on EDGAR contain data regarding the value of covered investment funds, net of value held by affiliates.[97] This commenter also noted that broker-dealers are unlikely to have information about beneficial owners of funds that are affiliates but hold the fund's shares through another record owner. Commenters also stated that the proposed float requirement more generally creates operational challenges given the need to track and test fluctuating market values to comply with it, given that many funds are continuously offered.[98]

We appreciate these concerns and are therefore adopting two modifications to the final rule. First, the final rule does not require that the fund's aggregate market value or net asset value be calculated net of affiliates' holdings for most covered investment funds.[99] However, the final rule, like the proposal, would require that a commodity- or currency-based trust or fund's public float be calculated net of affiliate holdings, as under rule 139. Broker-dealers today can rely on rule 139 to publish research reports regarding these covered investment funds and we believe it appropriate to maintain consistency for issuers that can be covered under both rules, where consistent with the FAIR Act. Otherwise, exactly the same activity could be subject to different standards based on the rule that a broker-dealer chose to use. One commenter argued that determining affiliate ownership for such funds based on Forms 10–K and S–1 may quickly become outdated.[100] We believe that for purposes of calculating affiliate ownership when determining a covered investment fund's public float, broker-dealers may rely on the covered investment fund's most recent ownership disclosures filed with the Commission for identifying the beneficial owners, despite the potential data limitations. As a consequence, we believe that a broker-dealer need not seek to identify unknown beneficial owners held through disclosed record owners, and also does not need to generally exclude record owners from the calculation of public float, except to the extent that they represent known beneficial owners. We believe this approach is reasonable and comparable to that used in the operating company context.

Unlike rule 139, rule 139b does not permit affiliates of covered investment funds to rely on the safe harbor,

[91] We believe that conditioning the availability of the safe harbor on the aforementioned reporting history and market valuation requirements will help restrict the availability of the safe harbor in situations where we expect the information environment to be most limited: For new funds and for funds with limited trading or interest. *See also infra* discussion in the Economic Analysis at notes 350–354.

[92] *See* Simplification of Registration Procedures for Primary Securities Offerings, Securities Act Release No. 6943 (July 16, 1992) [57 FR 32461 (July 22, 1992)] (stating that one indicia of market interest and following of a company is the number of research analysts covering the company and that approximately two-thirds of the newly eligible companies, based on the reduction of the float requirement to $75 million, are followed by at least three research analysts). *See also* Securities Offering Reform Adopting Release, *supra* note 23, at 44728 n.53 (stating that issuers with a market capitalization of between $75 million and $200 million, in most cases, have between zero to five analysts following them, with approximately 50% having zero to two analysts following them).

[93] The Commission and the staff intend to monitor changes in analyst research coverage of funds and the impact of the minimum public market value requirement on the availability of research on covered investment funds and may in the future reduce, change, or eliminate the requirement to the extent that empirical evidence demonstrates that a lower threshold or different metric would be consistent with investor protection.

[94] *See* Fidelity Comment Letter; SIFMA Comment Letter I.

[95] *See infra* discussion following note 319.

[96] *See* rule 482 [17 CFR 230.482]. Rule 482 sets forth certain filing and other investor protection requirements. *Id.*

[97] *See* SIFMA Comment Letter II. This commenter stated that broker-dealers satisfy the parallel minimum public float requirement under rule 139 by relying upon third-party data vendors, such as Bloomberg. We understand that third-party service providers do not currently calculate this number for covered investment funds, although they may do so in the future.

[98] *See* Fidelity Comment Letter; SIFMA Comment Letter I.

[99] *See* rule 139b(a)(1)(i)(B).

[100] *See* SIFMA II Comment Letter.

mitigating the risk that a fund with significant affiliate holdings would be the subject of market moving research by those same affiliates. We also appreciate that there is more limited information currently available regarding the holdings of affiliates of covered investment funds relative to operating companies, as noted by commenters.[101] That many covered investment fund are continuously offered also adds operational challenges. A covered investment fund's investor base, and thus potential affiliates, may change day to day, making it more difficult to identify affiliate holdings. In addition, covered investment funds are subject to unique legal provisions that generally restrict affiliate ownership and provide additional legal protections when affiliate ownership is permitted.[102] Accordingly, not requiring a broker-dealer to identify and exclude affiliate holdings is designed to address these challenges and appropriately tailors this requirement for covered investment funds.[103]

Second, the final rule will permit a broker-dealer to satisfy the minimum float requirement when it initiates (or reinitiates) coverage and then once a quarter thereafter (so long as it continues issuing or distributing research on that fund), rather than each time the broker-dealer publishes or distributes a research report, as proposed.[104] We recognize that in the operating company context where most issuers are not engaged in a continuous distribution, broker-dealers can rely on other research report rules that do not include a public float requirement. The requirement in proposed rule 139b that a covered investment fund have the requisite public float each time the broker-dealer publishes a research report could therefore have involved greater operational challenges than those associated with the corresponding requirement in rule 139. A broker-dealer would generally only need to comply with the requirement in rule 139 for a discrete period of time while the issuer is in distribution, but would have been required to comply with the corresponding requirement in rule proposed 139b every time the broker-dealer published a research report about a covered investment fund that was in continuous distribution where the broker-dealer is participating in the offering. We believe that requiring a broker-dealer to determine the float upon initiation or reinitiation of coverage will ensure that the float requirement is met at the outset of research coverage. We are requiring a quarterly re-assessment of the float requirement to mitigate the risk that a covered investment fund's float declines over time and no longer meets the float requirement. We believe a quarterly assessment is appropriate as it aligns with the quarterly reporting schedule of most funds, and balances the risks of only periodically verifying a fund's float with the costs of more frequent or continuous assessments.

We believe these adjustments appropriately tailor rule 139 to covered investment funds. For the reasons discussed below, we believe that the changes to the calculation and time of testing of the minimum public float requirement for covered investment funds under rule 139b are necessary or appropriate in the public interest, and for the protection of investors, and for the promotion of capital formation as they allow appropriately tailoring of rule 139 in applying it to covered investment funds while considering their unique structure and operational aspects.

We proposed that the float threshold be calculated in terms of NAV rather than aggregate market value for mutual funds in order to reflect the market structure differences between mutual funds and all other covered investment funds.[105] Absent this modification, the float requirement would categorically exclude broker-dealers from relying on rule 139b in their publication or distribution of mutual fund issuer-specific research reports, which would appear inconsistent with the FAIR Act's directives. Mutual funds redeem their shares each day and therefore must compute their net asset value each day, providing a timely and reliable measure of the fund's size, akin to other issuers' public float; and investors' ability to purchase and redeem fund shares at net asset value provides timely share prices akin to the price discovery that occurs in a public trading market. As discussed further below, for other types of covered investment funds, such as closed-end funds and BDCs, which may or may not have public float, we believe it is appropriate, and consistent with the FAIR Act, to provide the same public float requirements—the manner of calculation and amount—as applies to issuer-specific research reports under rule 139. Accordingly, we are adopting this NAV calculation method as proposed.

Non-Traded Funds

Finally, one commenter suggested that we revise rule 139b to permit an issuer-specific research report to cover a non-traded closed-end fund or BDC that does not have a ''public float,'' and thus which, under proposed rule 139b, could not be included in an issuer-specific research report.[106] This commenter noted that the proposed rule did not extend the NAV calculation method beyond open-end funds, but pointed to a footnote in the proposal that discussed the potential for non-traded BDCs or CEFs to be able to use a variant of the NAV approach, and asked that we amend the final rule to allow them to do so.[107]

Although under the proposed rule the NAV calculation method was only available to mutual funds, we acknowledge that the Proposing Release discussion was inconsistent with the proposed rule text in that the Proposing Release discussed the possibility of non-traded BDCs and CEFs calculating a NAV based on their last publicly disclosed share price for purposes of proposed rule 139b.[108]

We decline to amend the rule text to allow the NAV calculation method for non-traded BDCs and closed-end funds. We believe that it is inappropriate for non-traded BDCs and closed-end funds to satisfy the float requirement using a

[101] *See* SIFMA Comment Letter II (noting that third party vendors do not currently provide float information net of affiliates for funds, and that for certain funds whose ownership is held in street name, affiliate ownership may be ''unknowable'').

[102] *See, e.g.,* Investment Company Act sections 12, 17, and 57 and rules thereunder.

[103] The instructions to Form S–3 discuss methodologies for calculating float net of affiliates. When calculating float for purposes of rule 139b, those instructions related to the exclusion of affiliate ownership must be disregarded.

[104] *See* rule 139b(a)(1)(i)(B). If a broker-dealer were to cease publication or distribution of a covered fund research report and then initiate coverage again, this provision would require the fund's float to be above the minimum at the time that the broker or dealer begins relying on the safe harbor provided by rule 139b once more.

[105] *Id.* at 26796 n.86.

[106] *See* Sutherland Comment Letter.

[107] *Id.* The commenter argued that all non-traded covered investment funds that have a net asset value (less the value of shares held by affiliates) that equals or exceeds the aggregate market value required in General Instruction I.B.1. to Form S–3 should be covered by new rule 139b.

[108] *Compare* Proposing Release, *supra* note 2, at 26796 n.83 (''For covered investment funds that are not actively traded (such as non-traded closed-end funds and non-traded business development companies), we anticipate that, for purposes of proposed rule 139b, net asset value and aggregate market value would be calculated based on the fund's last publicly-disclosed share price (for non-traded business development companies, this would be the common equity share price).'') *with* proposed rule 139b(a)(1)(i)(B): ''The aggregate market value of voting and non-voting common equity held by non-affiliates of the covered investment fund, or, in the case of a *registered open-end investment company* (*emphasis added)* (other than an exchange-traded fund) its net asset value (subtracting the value of shares held by affiliates), equals or exceeds the aggregate market value specified in General Instruction I.B.1 of Form S–3.''

NAV calculation because doing so would undermine the purpose of the requirement. As discussed previously, historically, the Commission has used public float as a proxy for a security's market following.[109] We believe that the NAV method for mutual funds acts as an effective proxy for market following for mutual funds because mutual funds redeem their shares daily and therefore must compute their net asset value each day, providing a timely and reliable measure of the fund's size, akin to other issuers' public float; and investors' ability to purchase and redeem fund shares at net asset value provides timely share prices akin to the price discovery that occurs in a public trading market. Non-traded BDCs and CEFs do not have an equivalent daily metric available, and often compute NAV on a significantly more infrequent basis, such as quarterly.

In addition, we do not believe that providing a different calculation method for non-traded closed-end funds and non-traded BDCs is appropriate, because such funds do not have the same kind of structural differences that necessitate different treatment provided to open-end funds. For example, unlike mutual funds, non-traded closed-end funds and BDCs could meet the float requirement if they chose to be listed and would not have to undertake any structural changes. By 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.

Finally, we do not believe that our approach is inconsistent with the statute or congressional intent. Specifically, we note that the FAIR Act includes an interim effectiveness provision, whereby if the Commission has not adopted a covered investment fund research report rule within 270 days of the Act's enactment, broker-dealers could begin publishing or distributing covered investment fund research reports provided that certain rule 139 conditions are satisfied.[110] One such specified condition is that an issuer-specific research report about a covered investment fund must satisfy the existing public float requirement of rule 139 during this interim effectiveness. As such, even during the interim effectiveness period provided under the FAIR Act and as a result of the conditions in rule 139, non-traded BDCs and CEFs would not be able to satisfy the public float requirement and thus by congressional design would not receive the benefit of the FAIR Act's safe harbor. In light of the reasons discussed above, we have determined not to amend the proposed rule text as the commenter recommended to expressly include non-traded BDCs and CEFs within the safe harbor.

c. Regular-Course-of-Business Requirement

We are adopting as proposed a condition to rule 139b that a broker-dealer's publication or distribution of research reports be ''in the regular course of its business'' [111] (the ''regular-course-of-business'' requirement). Although the regular-course-of-business requirement is generally similar to the existing provisions of rule 139, it differs in one respect as required by the FAIR Act. Rule 139 provides, in addition to the requirement that a broker-dealer ''publish or distribute research reports in the regular course of its business,'' 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 (the ''initiation or reinitiation'' requirement).[112]

The FAIR Act, however, provides that the safe harbor shall not apply the ''initiation or reinitiation'' requirement to a report concerning a covered investment fund with a class of securities ''in substantially continuous distribution.'' [113] Accordingly, rule 139b incorporates the ''initiation or reinitiation'' requirement from rule 139 and specifies that it applies only to research reports regarding a covered investment fund that does not have a class of securities in substantially continuous distribution.[114] Determining whether a class of securities is in substantially continuous distribution would be based on an analysis of the relevant facts and circumstances.

One commenter asked for clarification that the scope and meaning of ''substantially continuous distribution'' includes traded registered closed-end investment companies and BDCs engaged in at-the-market (''ATM'') offering programs over consecutive quarters pursuant to rule 415(a)(4) under the Securities Act.[115] Determining whether a class of securities is in ''substantially continuous distribution'' is an analysis based on the relevant facts and circumstances. With respect to traded funds that offer ATM programs over consecutive quarters pursuant to rule 415(a)(4) under the Securities Act, we believe that a covered investment fund that engages in ongoing distributions of its shares on a frequency consistent with open-end investment companies is in substantially continuous distribution, but one that does so on a less frequent basis may not be.

One commenter asked that we clarify whether broker-dealers that have published and distributed communications styled as ''research reports'' in compliance with rule 482 would meet the regular-course-of-business requirement.[116] This commenter also mentioned that some broker-dealers have published and distributed research reports on other issuers (such as non-covered investment funds, or on operating companies) in reliance on the rule 139 safe harbor. We believe that a broker-dealer can satisfy the regular-course-of-business requirement through either of the methods discussed by this commenter.[117] A broker-dealer publishing or distributing an issuer-specific research report can satisfy the regular-course-of-business requirement if at the time of reliance on rule 139b it has distributed or published at least one research report about the issuer or its securities, or has distributed or published at least one such report following a period of discontinued coverage. In addition, the condition may be satisfied by publishing or distributing research reports on a covered investment fund when a broker-dealer is

[109] *See supra* note 87 and accompanying text.

[110] *See supra* note 3; section 2(d) of the FAIR Act. The FAIR Act's interim effectiveness provision became effective as of July 3, 2018 and by its terms will terminate upon the adoption of a covered investment fund research report rule. Currently, at least one broker-dealer is issuing covered investment fund research reports in reliance on the interim effectiveness provision. *See, e.g.,* Rachel Evans, *In a Passive World, Bank of America's New ETF Team Picks Stocks* (Oct. 17, 2018), *available at https://www.bloomberg.com/news/articles/2018-10-17/in-a-passive-world-bank-of-america-s-new-etf-team-picks-stocks?srnd=etfs.*

[111] Rule 139b(a)(1)(ii).

[112] Rule 139(a)(1)(iii) [17 CFR 230.139(a)(1)(iii)].

[113] Section 2(b)(1) of the FAIR Act.

[114] *See* rule 139b(a)(1)(ii).

[115] *See* Sutherland Comment Letter. This commenter also asked for clarification regarding non-traded registered closed-end investment companies and non-traded BDCs offering shares on a continuous basis under Securities Act rule 415(a)(1)(ix). Although these funds would not be covered in issuer-specific research reports because they would not have the requisite public float, we believe that a ''continuous'' offering under rule 415(a)(1)(ix) would include a ''substantially continuous offering'' for purposes of rule 139b. *See infra* section II.B.2.b.

[116] *See* Fidelity Comment Letter.

[117] *See also* Securities Offering Reform Adopting Release, *supra* note 23, at 44763–64. There is no minimum time period for the broker or dealer to have distributed or published research reports, only that the particular broker or dealer has initiated or reinitiated coverage. *Id.*

not participating in the offering of that fund.[118]

One commenter indicated that broker-dealers should not be required to have a traditional research department in order to rely on the rule.[119] A traditional research department is not a requirement to meet the condition, but would be a factor in indicating compliance with the regular-course-of-business requirement. We discussed a number of other factors that may evidence compliance with this condition in the Proposing Release.[120]

Several commenters expressed concerns that the regular-course-of-business requirement was too restrictive.[121] For example, one commenter stated that requiring broker-dealers to satisfy the regular-course-of-business requirement by having a history of publishing or distributing research on the same types of securities as covered in the research report is inconsistent with the FAIR Act and congressional intent, and may preclude coverage by new broker-dealer entrants.[122] We do not believe that the regular-course-of-business requirement is inconsistent with the FAIR Act, congressional intent, or would preclude new broker-dealer entrants from relying on the rule 139b safe harbor, as suggested by the commenter. We believe the FAIR Act and congressional intent are clear in their directive to extend the rule 139 safe harbor to covered investment fund research reports. Rule 139 includes a regular-course-of-business requirement, and we believe it is appropriate for rule 139b to also include the same type of requirement. Commenters did not identify, and we are not aware of, any distinguishable differences in the operation of covered fund issuers that would necessitate different treatment from other issuers subject to rule 139 with respect to a regular-course-of-business requirement.

Moreover, broker-dealers that wish to newly begin publishing or distributing research reports on funds could meet this condition through any of the methods discussed above.[123] Once a broker-dealer has established a history of issuing such research reports pursuant to any of these (or potentially other) methods in the regular course of business, it could satisfy the condition and begin relying on rule 139b.

Similarly, another commenter stated that in place of the regular-course-of-business requirement, we should require broker-dealers' policies and procedures to include rule 139b compliance.[124] We are not incorporating this suggested change. Maintaining policies and procedures to comply with rule 139b is one of several factors we would assess in determining whether the broker-dealer has engaged in research report publication and distribution in the regular course of business, but such a factor alone does not establish that the regular-course-of-business requirement has been met.

Since rule 139 was first adopted, the regular-course-of-business requirement has been a condition for a broker-dealer's publication or distribution of research reports in reliance on the rule.[125] We continue to believe requiring that research reports be published or distributed in the regular course of a broker-dealer's business under rule 139b, consistent with the requirements of rule 139, could reduce the potential that covered investment fund research reports could be used to circumvent the prospectus requirements of the Securities Act.[126] For the reasons discussed in this section, we are adopting the regular-course-of-business requirement as proposed.

2. Industry Research Reports

Rule 139b sets forth conditions for industry research reports that parallel the corresponding conditions under rule 139 and are intended to provide appropriate parameters to address the risk of circumvention of the prospectus requirements of the Securities Act.[127]

a. Reporting Requirement

Under the rule 139b safe harbor, each covered investment fund included in an industry research report must be subject to the reporting requirements of section 30 of the Investment Company Act (or, for covered investment funds that are not registered investment companies under the Investment Company Act, the reporting requirements of section 13 or section 15(d) of the Exchange Act). This reporting requirement generally tracks an existing requirement for industry research reports under rule 139 but has been modified so that it would be applicable to industry research reports that include covered investment fund issuers.[128] Like the parallel provision of rule 139, the reporting requirement under rule 139b helps ensure that there is publicly available information about the relevant issuers and that investors are able to use such information in making their investment decisions. Commenters did not present any concerns regarding the reporting requirement for purposes of industry research reports, and we are adopting it as proposed.

b. Regular-Course-of-Business Requirement

Under rule 139b, as proposed, a broker-dealer must publish or distribute research reports in the regular course of its business in order to rely on the new rule's safe harbor.[129] The regular-course-of-business requirement for industry research reports similarly applies to issuer-specific research reports,[130] and it also tracks an existing requirement for industry research reports under rule 139.[131]

Like the parallel provision in rule 139, rule 139b's regular-course-of-business requirement for industry research reports includes the requirement that, at the time of publication or distribution of the

[118] This would also include other types of research or rule 482 stylized ''research reports,'' discussed below.

[119] *See* SIFMA Comment Letter I (also asking the Commission to clarify that the regular-course-of-business requirement would definitively be satisfied where the research is produced by traditional research analysts within a traditional research department—regardless of whether it previously produced research on a particular type of security).

[120] *See* Proposing Release, *supra* note 2, at 26796–99 (These factors included whether the broker-dealer: Has a compliance structure in place with relevant policies and procedures governing their publication of research and their distribution of registered investment company advertisements; has a research department with research analysts covering particular issuers or industries; maintains policies and procedures governing its research protocols; and regularly publishes or distributes research on any other type of company or business other than covered investment funds.).

[121] *See* SIFMA Comment Letter I; ICI Comment Letter; Fidelity Comment Letter; *see also* BlackRock Comment Letter.

[122] *See* SIFMA Comment Letter I.

[123] *See supra* notes 116–118 and accompanying text.

[124] *See* ICI Comment Letter; *see also* BlackRock Comment Letter.

[125] *See* Adoption of Rules Relating to Publication of Information and Delivery of Prospectus by Broker-Dealers Prior to or After the Filing of a Registration Statement Under the Securities Act of 1933, Securities Act Release No. 5105 (Nov. 19, 1970) [35 FR 18456 (Dec. 4, 1970)].

[126] *See* Proposing Release, *supra* note 2, at 26797; *see also* Securities Offering Reform Adopting Release, *supra* note 23.

[127] *See supra* notes 49–50 and accompanying text; *see also supra* paragraph accompanying notes 12–15.

[128] *See* rule 139(a)(2)(i) [17 CFR 230.139(a)(2)(i)] (The issuer is required to file reports pursuant to section 13 or section 15(d) of the Securities Exchange Act of 1934 or satisfies the conditions in paragraph (a)(1)(i)(B) of this section.).

[129] Rule 139b(a)(2)(iv) (the broker-dealer publishes or distributes research reports in the regular course of its business and, at the time of the publication or distribution of the research report (in the case of a research report regarding a covered investment fund that does not have a class of securities in substantially continuous distribution) is including similar information about the issuer or its securities in similar reports).

[130] *See supra* section II.B.1.c.

[131] *See* rule 139(a)(2)(v) [17 CFR 230.139(a)(2)(v)].

industry research report, the broker-dealer is including similar information about the issuer or its securities in similar reports.[132] However, unlike rule 139, the ''similar information'' requirement under rule 139b applies only to circumstances in which a broker-dealer is publishing or distributing a research report regarding a covered investment fund that does not have a class of securities in substantially continuous distribution. As discussed above, the FAIR Act provides that the safe harbor shall not apply the ''initiation or reinitiation'' requirement to a research report concerning a covered investment fund with a class of securities ''in substantially continuous distribution.'' [133] We believe that the ''similar information'' requirement is akin to the ''initiation or reinitiation'' requirement, in that both would have the effect of limiting a broker-dealer's ability to rely on the rule 139b safe harbor to publish or distribute a research report about a particular covered investment fund if the broker-dealer had not previously published research on that issuer. Therefore, as in the ''initiation or reinitiation'' requirement, we are also excluding covered investment funds from the ''similar information'' requirement if they have a class of securities in substantially continuous distribution.

We provided guidance in section II.B.1.c above on how a broker-dealer can meet the regular-course-of-business requirement in the context of issuer-specific research reports, and such guidance would be equally applicable in meeting the requirement in the context of industry research reports. We are adopting the requirement as proposed for the reasons discussed in this section and in the similar section for issuer-specific research reports.

c. Content Requirements for Industry Research Reports

Rule 139b's safe harbor for publication or distribution of industry research reports is also conditioned on certain content requirements. We are adopting these requirements as proposed.

Specifically, under rule 139b, industry research reports either must include similar information about a substantial number of covered investment fund issuers of the same type or investment focus (the ''industry representation requirement''),[134] or alternatively contain a comprehensive list of covered investment fund securities currently recommended by the broker-dealer (the ''comprehensive list requirement'').[135] These requirements are designed to result in industry research reports that cover a broad range of investment companies or securities.[136] At the same time, the comprehensive list requirement would permit a different presentation of research about multiple covered investment funds than the industry representation requirement would permit.[137] Because the affiliate exclusion applies to all covered investment fund research reports—*i.e.,* both issuer-specific research reports and industry research reports—a broker-dealer seeking to rely on rule 139b by satisfying either the industry representation requirement or the comprehensive list requirement cannot include any covered investment fund issuer that is an affiliate of the broker-dealer, or for which the broker-dealer serves as an investment adviser (or is an affiliated person of the investment adviser) in a covered investment fund research report, including industry research reports.[138]

Several commenters argued that a broker-dealer should be able to include affiliated funds in industry research reports about covered investment funds.[139] Another commenter argued that industry research reports with a substantial number of funds should satisfy the purposes of the affiliate exclusion if they contain similar information about each fund and no particular fund is afforded materially greater space or prominence.[140] Another commenter suggested that, in some instances, because affiliated funds may be as or more suitable than non-affiliated funds, broker-dealers should be allowed to include affiliated funds in industry research reports.[141] Several commenters also argued that we should permit broker-dealers to include both affiliated and non-affiliated funds in industry research reports, but only provide the rule 139b safe harbor for the non-affiliated funds included in the report. They suggested that any information about affiliated funds included in such a report not benefit from the safe harbor, and thus any discussions of those funds be subject to the requirements of rule 482.[142]

We believe extending the rule 139b safe harbor to affiliated funds in industry research reports (whether industry representation or comprehensive list reports) would not be consistent with the intent and plain language of section 2(f)(3) of the FAIR Act.[143] We also believe that allowing for a mix of affiliated funds and non-affiliated funds to appear together in a single research report, as suggested by commenters, in reliance on two separate and distinct characterizations of that communication (*i.e.,* under rule 139b such a research report would be deemed not an offer under the Securities Act, and under rule 482 such a research report would be deemed to be a 10(b) omitting prospectus) would be an untenable regulatory framework. Not only would there be differing presentation, liability, and filing standards for the different portions of the report, but we believe that it could create challenges for regulators and others and confusion for investors because the information presented for each type of fund would likely differ.[144]

[132] Rule 139b(a)(2)(iv).

[133] *See supra* notes 113–114 and accompanying text.

[134] Rule 139b(a)(2)(ii)(A).

[135] Rule 139b(a)(2)(ii)(B).

[136] *See* Research Reports, Securities Act Release No. 6492 (Oct. 6, 1983) [48 FR 46801 (Oct. 14, 1983)].

[137] Under rule 139b, a ''comprehensive list'' research report would have to include a list of all of the broker's currently-recommended covered investment fund securities, whereas an ''industry representation'' report would not be required to list each currently-recommended security but instead could cover a more limited number of issuers as long as a ''substantial number'' of covered investment fund issuers of the same type or investment focus were included.

[138] *See* rule 139b(a)(2)(ii)(B) (excluding from the comprehensive list securities of a covered investment fund that is an affiliate of the broker-dealer, or for which the broker-dealer serves as investment adviser (or for which the broker-dealer is an affiliated person of the investment adviser)); *see also supra* section II.A.1. In the final rule, we also made a change to rule 139b(a)(2)(ii) to clarify that the industry research report provisions are with respect to covered investment fund research reports and the affiliate exclusion set forth therein. Thus, a broker-dealer cannot include a covered investment fund issuer in any industry specific report (*i.e.,* industry representation requirement or the comprehensive list requirement) if the broker-dealer's relationship to the issuer meets any of the affiliations designated in the affiliated exclusion.

[139] *See* ICI Comment Letter; Fidelity Comment Letter; SIFMA Comment Letter I; *see also* BlackRock Comment Letter.

[140] *See* SIFMA Comment Letter I.

[141] *See* Fidelity Comment Letter.

[142] *See* SIFMA Comment Letter I; Fidelity Comment Letter.

[143] This section excludes from the definition of covered investment fund research report any 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-dealer that is an investment adviser (or an affiliated person of an investment adviser) for the covered investment fund.

[144] For example, communications subject to rule 482 must be filed with the Commission pursuant to section 24(b) of the Investment Company Act. 15 U.S.C. 80a–24(b). Rule 24b–3 under the Investment Company Act deems these materials to have been filed with the Commission if filed with FINRA. 17 CFR 270.24b–3. Unless the entirety of the research report was filed, reviewing isolated and selective portions of a research report related to affiliated

Continued

Accordingly, we clarify that broker-dealers may not selectively apply the rule 139b safe harbor to certain aspects of a research report. The safe harbor must apply to the entirety of the report or it does not apply at all. Broker-dealers may, however, instead choose to issue a rule 482 communication that is styled as an industry research report about affiliated funds or about affiliated and non-affiliated funds; in either case, such a communication would be subject to the requirements of rule 482 and not gain the benefit of the rule 139b safe harbor.

One commenter raised the concern that excluding affiliated funds from an industry research report subject to the comprehensive list requirement may create a false impression that an affiliated fund is excluded because it does not meet an investor's criteria.[145] We acknowledge this possibility. If a broker-dealer is concerned that a research report purporting to include a comprehensive list of funds may confuse investors, the broker-dealer could include an explanation of why affiliated funds are excluded from the research report. For example, a broker-dealer could include a statement in the report indicating that it does not include information about affiliated funds due to relevant securities regulations.

One commenter argued that rule 139b should not include industry report content requirements because covered investment funds do not have the same market conditioning or ''gun-jumping'' concerns as securities covered in research reports published or distributed in reliance on rule 139.[146] Since many covered investment funds continuously distribute their securities, conditioning the market concerns can remain throughout the offering for issuers covered under rule 139b. Market conditioning is a concern that information about a fund or its securities might supersede the information provided in their offering prospectus. With respect to research reports, this concern is heightened for issuer-specific research reports and therefore they are subject to more stringent conditions than industry research reports. Market conditioning, however, remains a concern for industry research reports, as well. The content requirements for industry reports are designed to help ensure that industry reports become a part of the mix of information in the marketplace, rather than circumventing the prospectus requirements of the Securities Act or the issuer-specific conditions.

The language from rule 139's industry representation requirement is replicated in rule 139b, with modifications designed to apply the language to the covered investment fund context. Under rule 139's corresponding requirement, an industry research report must include ''similar information with respect to a substantial number of issuers in the issuer's industry or sub-industry.''[147] As discussed in the Proposing Release, while operating companies are typically grouped based on their business category, entities that are included in the definition of ''covered investment fund'' are typically grouped based either on their type or investment focus.[148] Therefore, the industry representation requirement would require an industry research report to include similar information about a substantial number of issuers either of the same type (*e.g.,* ETFs or mutual funds that are large cap funds, bond funds, balanced funds, money market funds, etc.) or investment focus (*e.g.,* primarily invested in the same industry or sub-industry, or the same country or geographic region).[149] We believe that this requirement tracks rule 139 to the extent practicable and appropriate, and we did not receive comments on this aspect of the proposal. For the reasons discussed above, we are adopting the industry research report content requirements as proposed.

d. Presentation Requirement for Industry Research Reports

As proposed, the rule 139b safe harbor for industry research reports is conditioned on a presentation requirement. Under the new rule, analysis of any covered investment fund issuer or its securities included in an industry research report cannot be given materially greater space or prominence in the publication than that given to any other covered investment fund issuer or its securities.[150]

We believe that the concerns underlying the rule 139 presentation requirements apply equally in the context of covered investment fund research reports.[151] The industry should already be familiar with this long-established and well-understood condition, and therefore we believe implementing a similar presentation condition for industry research reports on covered investment funds would be straightforward.

One commenter argued that rule 139b should not include industry report presentation requirements because covered investment funds do not have the same market conditioning or ''gun-jumping'' concerns as those securities covered in research reports published or distributed in reliance of rule 139.[152] As discussed above, market conditioning remains a concern for industry research reports.[153] The presentation requirements for industry reports are designed to help ensure that industry reports become a part of the mix of information in the marketplace, rather than circumventing the prospectus requirements of the Securities Act or the issuer-specific conditions. For the same reasons discussed above, we disagree with this commenter.[154] Accordingly, we are adopting this requirement as proposed.

C. Presentation of Performance Information in Research Reports About Registered Investment Companies

The proposed rule would not have required standardized performance presentation for covered investment fund research reports. However, the Commission requested comment on whether the final rule should require research reports about registered investment companies to be subject to standardized performance presentation requirements. The Commission expressed its concern that not including standardized performance measures in research reports could lead to investor confusion. The Commission also noted its longtime recognition that investors tend to consider investment performance to be a particularly significant factor in evaluating or comparing investment companies and had previously identified a number of circumstances in which performance could be disclosed in a misleading manner.[155]

funds may not allow for effective review of such materials.

[145] *See* Fidelity Comment Letter.

[146] *See* ICI Comment Letter (citing an SEC staff report issued in 1969 noting that ''gun-jumping'' concerns primarily arise during the pre-filing stage of a securities offering and casting doubt on the doctrine's applicability to non-participants in a securities offering). This commenter made the same argument regarding industry report presentation requirements. *See infra* note 152. *See also* BlackRock Comment Letter. Rule 139b is not limited to non-participants. Broker-dealers participating in the distribution of the covered investment fund's securities may rely on the rule provided the applicable conditions are satisfied.

[147] Rule 139(a)(2)(iii) [17 CFR 230.139(a)(2)(iii)].

[148] *See* Proposing Release, *supra* note 2, at 26800.

[149] Rule 139b(a)(2)(ii)(A).

[150] Rule 139b(a)(2)(iii).

[151] *See* Proposing Release, *supra* note 2, at 26801.

[152] *See* ICI Comment Letter; *see also* BlackRock Comment Letter.

[153] *See supra* note 146 and accompanying paragraph.

[154] *See id.*

[155] *See* Proposing Release, *supra* note 2, at 26802. Additionally, the Commission noted its concern that rule 482 or rule 34b–1 could be circumvented by recasting registered investment company

In a change from the proposal, we are adopting a condition in rule 139b that if fund performance information is included in a research report, it must be presented in accordance with certain standardized presentation requirements dependent on the type of covered investment fund covered.[156] For research reports that include registered open-end fund performance, we are requiring that fund performance be presented according to the presentment and timeliness requirements of rule 482.[157] For research reports that include closed-end fund performance, one commenter argued for standardized presentation requirements for all covered investment funds and recommended that closed-end funds comply with the requirements of Form N–2 instead of rule 482, which does not offer any standardized performance requirements for closed-end funds.[158] We agree with the commenter, and are therefore requiring that closed-end fund performance be presented in a manner that is in accordance with the instructions to item 4.1(g) of Form N–2, although other historical measures of performance may also be included if any other measurement is set out with no greater prominence.

Specific statutory provisions and rules apply to advertising the performance of registered investment companies.[159] An advertisement about a covered investment fund that is a registered investment company is deemed a section 10(b) prospectus (also known as an ''advertising prospectus'' or ''omitting prospectus'') for purposes of section 5(b)(1) of the Securities Act so long as it complies with rule 482.[160] Therefore, a broker-dealer's publication or distribution of a research report that complies with the requirements of rule 482 would not be deemed a non-conforming prospectus in violation of section 5 of the Securities Act.[161] As discussed in the Proposing Release, given the breadth of the definition of ''research report'' under the FAIR Act (and the definition of ''research report'' under rule 139b), certain communications by broker-dealers that historically have been treated as advertisements for registered investment companies under rule 482 now could be considered covered investment fund research reports subject to the rule 139b safe harbor.[162] Among other things, rule 482 requires standardized presentation of performance data included in registered open-end investment company advertisements.[163] Alternatively, if other performance measures are presented, they must be accompanied by certain standardized performance data.[164]

Because a broker-dealer's publication or distribution of a covered investment fund research report under rule 139b is deemed not to constitute an offer for purposes of sections 2(a)(10) and 5(c) of the Securities Act, a covered investment fund research report would no longer need to be deemed to be a section 10(b) prospectus (such as an advertising prospectus under rule 482) for purposes of section 5(b)(1) of the Securities Act. In addition, some communications that previously were considered supplemental sales literature under rule 34b–1 under the Investment Company Act that must be accompanied or preceded by a statutory prospectus now could be considered covered investment fund research reports (which need not be preceded or accompanied by a statutory prospectus).[165] Rule 34b–1 incorporates many of the rule 482 requirements relating to performance disclosure and makes these requirements applicable to supplemental sales literature.[166] As discussed in the Proposing Release, we are concerned that this shift in regulatory treatment of research reports about registered investment companies could result in investor confusion if a communication were not easily recognizable as research as opposed to an advertising prospectus or supplemental sales literature. Although there are multiple provisions in proposed rule 139b that aim to limit the risk that broker-dealers could use the proposed safe harbor to circumvent the prospectus requirements of the Securities Act,[167] there could be circumstances where, under rule 139b, broker-dealers publish or distribute communications that historically have been viewed as registered investment company advertisements or selling materials.

We received two comment letters addressing this issue.[168] One commenter suggested that the presentation of performance information in research reports about registered investment companies should not be subject to the standardized performance requirements of rule 482.[169] This commenter stated that because rule 482 is intended to apply to advertisements, such presentation requirements might undermine analysis or insights that a

advertisements or selling materials as research reports. *Id.*

[156] Rule 139b(a)(3).

[157] *See id.* (requiring that a research report discussing fund performance of a registered open-end management investment company must present it in accordance with the performance requirements of paragraphs (d) and (e) of rule 482 [17 CFR 230.482] and must also comply with the timeliness requirement of performance data in paragraph (g) of rule 482).

[158] *See* ICI Comment Letter; *see also* BlackRock Comment Letter.

[159] *See, e.g.,* section 24(g) of the Investment Company Act [15 U.S.C. 80a–24(g)] (directing the Commission to adopt rules or regulations that permit registered investment companies to use prospectuses that (i) include information the substance of which is not included in the statutory prospectus, and (ii) are deemed to be permitted by section 10(b) of the Securities Act); rule 34b–1 under the Investment Company Act [17 CFR 270.34b–1] (requiring that, in order not to be misleading, investment company sales literature must include certain information, including with respect to performance information by incorporating certain related provisions of rule 482 of the Securities Act); rule 156 of the Securities Act [17 CFR 230.156] (providing guidance on what statements or omissions of material fact may be misleading in investment company sales literature); rule 482 of the Securities Act [17 CFR 230.482] (setting forth that for an investment company advertisement to be deemed a prospectus under section 10(b) of the Securities Act, it must meet certain requirements thereunder, including with respect to standardized performance information presentation).

[160] *See* rule 482 under the Securities Act [17 CFR 230.482].

[161] *See id.* FINRA content standards also would generally require a member's publication or distribution of such a communication (to the extent it presents performance data as permitted by rule 482) to include certain of the standardized performance information specified under rule 482. *See* FINRA rule 2210(d)(5)(A).

[162] *See* Proposing Release, *supra* note 2, at 26801.

[163] *See* rule 482(d)(1)–(4) under the Securities Act (for open-end investment companies other than money market funds) [17 CFR 230.482(d)(1)–(4)]; rule 482(e) under the Securities Act (for money market funds) [17 CFR 230.482(e)].

[164] *See* rule 482(d)(5) [17 CFR 230.482(d)(5)]. These other performance measures are not subject to any prescribed method of computation, but must reflect all elements of return and be accompanied by quotations of standardized measures of total return as provided for in paragraphs (d)(3) and (d)(4) of the rule. Rule 482(d)(5) also includes other requirements for the inclusion of non-standardized performance data, such as presentation and prominence requirements. *See id.*

[165] *See* section 2(a)(10)(a) of the Securities Act; rule 139b(a). *See also* rule 34b–1 under the Investment Company Act [17 CFR 270.34b–1]. Rule 34b–1 provides that any advertisement, pamphlet, circular, form letter, or other sales literature addressed to or intended for distribution to prospective investors that is required to be filed with the Commission by section 24(b) of the Investment Company Act will have omitted to state a fact necessary in order to make the statements made therein not materially misleading unless it includes certain specified information.

[166] *See* rule 34b–1(b)(1)–(2) [17 CFR 270.34b–1(b)(1)–(2)].

[167] *See, e.g., supra* sections II.A.1 (affiliate exclusion) and II.B.1.c and II.B.2.b (regular-course-of-business requirements). Certain covered investment fund research reports that meet the definition of ''research report'' in Regulation AC would be subject to the requirements of Regulation AC. Similarly, covered investment fund research reports that meet the definition of ''research report'' in FINRA rule 2241 or the definition of ''debt research report'' in FINRA rule 2242 would be subject to the content requirements in those rules as applicable. *See infra* section II.D.1.

[168] *See* SIFMA Comment Letter I; ICI Comment Letter; *see also* BlackRock Comment Letter.

[169] SIFMA Comment Letter I.

research analyst may seek to convey about one or more covered investment funds by highlighting a particular aspect of performance information. This commenter also stated that SRO rules would address the investor confusion concern raised by the Commission. We disagree that applying standardized performance presentation requirements would undermine a research analyst's analysis or insights because rule 482 does not preclude non-standardized performance information. Rather, it requires standardized performance information to be presented if non-standardized performance information is presented. We believe SRO rules may address some investor confusion concerns, but we believe requiring presentation performance requirements would more fully address these concerns.

Another commenter stated that the Commission should require that fund-specific performance information in covered investment fund research reports be presented in accordance with the applicable standardization requirements.[170] This commenter stated that investors tend to consider fund performance a significant factor in evaluating or comparing funds and that standardized fund performance reporting requirements have served investors well. Furthermore, this commenter noted that discrepancies in performance between a broker-dealer's research report and what a fund may report or disclose in regulatory filings or advertisements would risk confusing investors. We agree with both of the commenter's points. This commenter also noted that if the final rule does not require standardized presentation requirements for fund performance information, the Commission should require a clear and prominent disclosure whenever fund-specific performance is not in accordance with these standards.

The final rule thus requires that a research report that includes open-end fund performance information must present this information in accordance with rule 482 presentment and timeliness requirements. A research report must present closed-end fund performance information in accordance with the instructions to item 4.1(g) set forth in Form N–2 (although other historical measures of performance may also be included if the other measurement is set out with no greater prominence than the measurement that is in accordance with the instructions to item 4.1(g) of Form N–2).

Rule 139b(a)(3) requirements would not preclude research report analysts from presenting performance information in their preferred manner; rather, it requires that standardized performance information also be included if non-standardized performance information is presented. To satisfy this requirement, analysts may choose to present non-standardized performance information in a way they believe highlights a particular insight or analysis, so long as it is presented alongside the standardized performance information consistent with rule 482 requirements or Form N–2, if applicable.[171]

As noted in the proposal, covered investment fund research reports relying on the rule 139b safe harbor are subject to the antifraud provisions of the federal securities laws.[172] The Commission has previously articulated guidance on factors to be weighed in considering whether statements involving a material fact in registered investment company advertisements and sales literature, which are also subject to the antifraud provisions of the federal securities laws, could be misleading.[173] This guidance provided factors to be weighed when determining whether fund performance in sales literature is adequately disclosed. The guidance factors in rule 156[174] are informative in evaluating whether any presentations of registered investment company performance in these research reports could be misleading because they reflect principles that would help guide this analysis (such as providing information to investors that is informative and that does not create unrealistic investor expectations[175]). We believe that incorporating these rule 482 and Form N–2 presentation standards in rule 139b reduces the potential for confusion between (i) registered open-end management investment company advertisements and selling materials covered by rule 482 and registered closed-end investment company selling materials covered by Form N–2 and (ii) rule 139b research reports. Moreover, we believe it would reduce the potential for investor confusion resulting from divergent standards in the presentation of performance data.

D. Role of Self-Regulatory Organizations

1. SRO Content Standards and Filing Requirements for Covered Investment Fund Research Reports

SRO Content Standards

The FAIR Act contemplates that SRO content standards applicable to research reports would apply to covered investment fund research reports.[176] Specifically, the FAIR Act provides that, unless covered investment fund research reports are subject to the content standards in the rules of any SRO related to research reports, these research reports may still be subject to the filing requirements of section 24(b) of the Investment Company Act for the review of investment company sales literature.[177] As discussed in more detail below, we are adopting rule 24b–4 to implement this provision of the FAIR Act. New rule 24b–4 provides that a covered investment fund research report about a registered investment company will not be subject to section 24(b) of the Investment Company Act (or the rules and regulations thereunder), except to the extent the

[170] ICI Comment Letter. This commenter also suggested the disclosure of Form N–2 performance data for closed-end funds. *See also* BlackRock Comment Letter.

[171] *See* rule 139b(a)(3).

[172] *See* section 2(c)(1) of the FAIR Act (stating that nothing in the FAIR Act shall be construed as in any way limiting the applicability of the antifraud or anti-manipulation provisions of the federal securities laws and rules adopted thereunder to a covered investment fund research report, including section 17 of the Securities Act, section 34(b) of the Investment Company Act, and sections 9 and 10 of the Exchange Act).

[173] *See* Amendments to Investment Company Advertising Rules, Securities Act Release No. 8294 (Sept. 29, 2003) [68 FR 57759 (Oct. 6, 2003)]; *see also* rule 156 under the Securities Act [17 CFR 230.156].

[174] Rule 156(b) under the Securities Act provides guidance factors concerning misleading statements in investment company sales literature including: (i) Statements and omissions generally (including in light of general economic or financial conditions or circumstances), (ii) representations about past or future investment performance, and (iii) statements involving a material fact about an investment company's characteristics or attributes.

[175] *See* Amendments to Investment Company Advertising Rules, Securities Act Release No. 8101 (May 17, 2002) [67 FR 36712 (May 24, 2002)].

[176] *See* section 2(b)(4) of the FAIR Act (A covered investment fund research report shall not be subject to section 24(b) of the Investment Company Act or the rules and regulations thereunder, except that such report may still be subject to such section and the rules and regulations thereunder to the extent that it is otherwise not subject to the content standards in the rules of any self-regulatory organization related to research reports, including those contained in the rules governing communications with the public regarding investment companies or substantially similar standards.). This provision is relevant only to research reports on covered investment funds that are investment companies subject to section 24(b) of the Investment Company Act. For example, registered closed-end investment companies, BDCs, and commodity- or currency-based trusts or funds are covered investment funds that are not subject to section 24(b) of the Investment Company Act. A covered investment fund research report that is not subject to section 24(b) of the Investment Company Act would not be subject to filing requirements under that section even if research reports concerning the covered investment fund were not subject to the content standards in the rules of any self-regulatory organization related to research reports.

[177] *See id.*

research report is otherwise not subject to the content standards in SRO rules related to research reports, including those contained in the rules governing communications with the public regarding investment companies or substantially similar standards.[178]

Currently, the SRO content standards relevant to communications that would be considered covered investment fund research reports under rule 139b include the applicable content standards of FINRA rules 2210, 2241, and 2242.[179] FINRA's rule governing communications with the public (FINRA rule 2210) contains general content standards that apply broadly to member communications,[180] including broker-dealer research reports. These general content standards require, among other things, that all member communications ''must be based on principles of fair dealing and good faith, must be fair and balanced, and must provide a sound basis for evaluating the facts in regard to any particular security or type of security, industry or service.'' [181]

The FAIR Act does not explicitly refer to specific content standards in SRO rules. It refers more generally to ''the content standards in the rules of any self-regulatory organization related to research reports, including those contained in the rules governing communications with the public regarding investment companies or substantially similar standards.'' [182] In order to provide clarity and facilitate consistent and predictable application of rule 24b–4, we interpret section 2(b)(4) of the FAIR Act as excluding covered investment fund research reports from section 24(b) of the Investment Company Act so long as they continue to be subject to the general content standards in FINRA rule 2210(d)(1) (or substantially similar SRO rules). Accordingly, by operation of rule 24b–4, 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).[183] This interpretation is consistent with our belief that it is important for SRO content standards to continue to apply to covered investment fund research reports, especially if, as discussed below, research reports about registered investment companies would no longer be required to be filed pursuant to section 24(b) of the Investment Company Act or rule 497 under the Securities Act,[184] and therefore would no longer be subject to routine review.[185] We received no comments on SRO content standards specifically, but some commenters suggested that FINRA rules (particularly with respect to definitions and filing requirements thereunder) be modified or harmonized with rule 139b, which we discuss below.[186]

Filing Requirements for Covered Investment Fund Research Reports

Rule 24b–4, as adopted, modifies the filing requirements that currently apply to certain broker-dealer communications regarding registered investment companies. Today, registered investment company sales literature, including rule 482 omitting prospectus advertisements, are required to be filed with the Commission under section 24(b) of the Investment Company Act [187] and rule 497 under the Securities Act.[188] Rule 24b–3 under the Investment Company Act and rule 497(i) deem these materials to have been filed with the Commission if filed with FINRA.[189]

As discussed in the Economic Analysis below, we anticipate that certain communications that historically have been treated as investment company sales literature, including rule 482 ''omitting prospectus'' advertisements, would be published or distributed by a broker-dealer as covered investment fund research reports pursuant to the rule 139b safe harbor.[190] Such communications styled

[178] *See* rule 24b–4.

[179] *See infra* note 183 (discussing the scope of these rules in more detail, including noting that the scope of certain provisions of FINRA rule 2210, and the scope of FINRA rules 2241(c)(1) and 2242(c)(2) generally, apply only to a certain subset of communications that would be considered covered investment fund research reports under rule 139b).

[180] *See* FINRA rule 2210(d)(1).

[181] *See* FINRA rule 2210(d)(1)(A). FINRA rule 2210's general content standards also provide, among other things, that FINRA members may not ''make any false, exaggerated, unwarranted, promissory or misleading statement or claim in any communication'' nor ''publish, circulate or distribute any communication that the member knows or has reason to know contains any untrue statement of a material fact or is otherwise false or misleading.'' *See* FINRA rule 2210(d)(1)(B).

[182] Section 2(b)(4) of the FAIR Act.

[183] A subset of communications that would fall within the definition of ''covered investment fund research report'' under rule 139b also would be subject to additional content-related requirements under FINRA rules that are applicable to certain research reports, but that are more narrowly applicable than the general content standards of FINRA rule 2210(d)(1). However, under our interpretation, whether or not these additional content standards apply to any given covered investment fund research report would not determine the applicability of section 24(b) to that research report under proposed rule 24b–4. A different interpretation could lead to results that we believe could be inconsistent with section 2(b)(4) of the FAIR Act (*i.e.,* if only communications that are subject to additional FINRA content standards discussed in this footnote (*e.g.,* those applicable to retail communications) were excluded from section 24(b) filing requirements).

Additional FINRA content-related requirements include the content standards of FINRA rule 2210 that apply only to retail communications (or retail communications and correspondence, as those terms are defined in FINRA rule 2210(a)). *See, e.g.,* FINRA rules 2210(d)(2) (Comparisons), 2210(d)(3) (Disclosure of Member's Name). Accordingly, covered investment fund research reports that would meet the definition of institutional communications would not be subject to some of the content standards of FINRA rule 2210.

These additional requirements also include the content standards incorporated in FINRA rules 2241 and 2242, which apply to certain research reports defined in these FINRA rules. The scope of FINRA rules 2241 and 2242 only includes research reports or debt research reports as defined in these rules, and the definitions of ''research report'' and ''debt research report'' in these rules are different than the definitions of ''research report'' set forth in rule 139 and new rule 139b. Under FINRA rule 2241, ''research report'' is defined as any written (including electronic) communication that includes an analysis of equity securities of individual companies or industries (other than an open-end registered investment company that is not listed or traded on an exchange) and that provides information reasonably sufficient upon which to base an investment decision; similarly, under FINRA rule 2242, ''debt research report'' is defined as any written (including electronic) communication that includes an analysis of a debt security or an issuer of a debt security and that provides information reasonably sufficient upon which to base an investment decision, excluding communications that solely constitute an equity research report as defined in FINRA rule 2241(a)(11). *See* FINRA rules 2241(a)(11), 2242(a)(3).

[184] *See infra* notes 187–189 and accompanying text.

[185] Broker-dealer communications that are excluded from, or otherwise not subject to FINRA's filing requirements may still be reviewed by FINRA, for example, through examinations, targeted sweeps or spot-checks. FAIR Act section 2(c)(2) provides that nothing in the Act shall be construed as in any way limiting ''the authority of any self-regulatory organization to examine or supervise a member's practices in connection with such member's publication or distribution of a covered investment fund research report for compliance with applicable provisions of the Federal securities laws or self-regulatory organization rules related to research reports, including those contained in rules governing communications with the public.'' *See also, e.g.,* FINRA rule 2210(c)(6) (''In addition to the foregoing requirements, each member's written (including electronic) communications may be subject to a spot-check procedure. Upon written request from [FINRA's Advertising Regulation] Department, each member must submit the material requested in a spot-check procedure within the time frame specified by the Department.'').

[186] *See, e.g.,* Fidelity Comment Letter; SIFMA Comment Letter I.

[187] *See supra* note 144.

[188] *See* rule 497 of the Securities Act [17 CFR 230.497]. Rule 497, which generally requires investment company prospectuses, including investment company advertisements deemed to be a section 10(b) prospectus pursuant to rule 482, to be filed with the Commission.

[189] *See supra* note 144; *see also* 17 CFR 230.497(i).

[190] *See infra* section III.C.3.

as ''research reports'' that previously had been subject to the filing requirements of section 24(b) of the Investment Company Act no longer would be subject to these requirements by operation of rule 24b–4, as adopted, because they would be subject to the general content standards of FINRA rule 2210(d)(1).[191]

FINRA rule 2210 requires the filing of certain communications, including retail communications that promote or recommend a specific registered investment company or family of registered investment companies.[192] However, FINRA provides a number of exclusions from the filing requirements.[193] For example, with respect to research reports (as that term is defined in FINRA rule 2241), FINRA currently excludes from filing those that concern only securities that are listed on a national securities exchange, other than research reports required to be filed with the Commission pursuant to section 24(b) of the Investment Company Act.[194] Because covered investment fund research reports are not required to be filed with the Commission pursuant to section 24(b), as directed by the FAIR Act, rule 24b–4 could have the effect of narrowing the types of communications that would be filed with FINRA (under current FINRA rule 2210) regarding registered investment companies.

However, 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.'' [195] Therefore, even if the exclusion of covered investment fund research reports from the provisions of section 24(b) affects the applicability of the filing requirements or exclusions under FINRA rule 2210 with respect to covered investment fund research reports, it would not affect FINRA's authority to require the filing of a communication that is included in the FAIR Act's definition of ''covered investment fund research report'' but whose purpose is not to provide research and analysis.[196] In addition, a covered investment fund research report would continue to be subject to FINRA recordkeeping requirements applicable to communications with the public, even if the broker-dealer would not be required to file the research report with FINRA or the Commission.[197]

Two commenters requested that FINRA's filing requirements be modified in light of the FAIR Act.[198] One commenter recommended that the Commission work with FINRA to harmonize FINRA's research rules with rule 139b and that broker-dealers relying on rule 139b be exempted from FINRA's filing requirements with respect to covered investment fund research reports.[199] Another commenter suggested that the relevant statutory language of the FAIR Act [200] should be interpreted to be limited to covered investment fund research reports made in reliance of the 139b safe harbor that only provide ''information'' that a user would not be able to use for research and analysis.[201] This commenter asserted that only covered investment fund research reports that solely provide information would fall within the scope of what an SRO could require to be filed under its authority. Moreover, one commenter argued that because the definition of ''research report'' under the FAIR Act was broader than FINRA's definition of research report, that this may cause confusion and conflicting interpretive views on what communications are deemed research for purposes of the safe harbor and filing exclusion.[202]

As we discussed above, section 2(c)(2) of the FAIR Act states that nothing in the FAIR Act shall be construed as in any way limiting the authority of an SRO, which includes FINRA, to require the filing of communications with the public, including covered investment fund research reports, the purpose of which is not to provide research and analysis of covered investment funds. To the extent FINRA would seek to amend its rules, any such proposed rule changes would be filed with the Commission pursuant to section 19(b)(1) of the Exchange Act and rule 19b–4 thereunder.

2. SRO Limitations

The FAIR Act also directs us to provide that SROs may not maintain or enforce any rule that would (i) prohibit the ability of a member to publish or distribute a covered investment fund research report solely because the member is also participating in a registered offering or other distribution of any securities of such covered investment fund; or (ii) prohibit the ability of a member to participate in a registered offering or other distribution of securities of a covered investment fund solely because the member has published or distributed a covered investment fund research report about such covered investment fund or its securities.[203] Proposed rule 139b incorporated this provision of the FAIR Act, and we received no comments on this aspect of the proposal. We note that these limitations on an SRO and any rules relating to research reports that an SRO might adopt would not affect the safe harbor provided by rule 139b. To provide additional context for the safe harbor, however, and in light of Congress's direction that we provide these limitations in implementing the rulemaking required by the FAIR Act, we have set forth these SRO limitations in rule 139b as proposed.[204]

E. Conforming and Technical Amendments

Rule 101 of Regulation M under the Exchange Act [205] prohibits any person who participates in a distribution from attempting to induce others to purchase securities covered by the rule during a specified period. It provides an exception for certain research activities—namely, the publication or dissemination of any information, opinion, or recommendation—if the conditions of Securities Act rule 138 or rule 139 are satisfied. We proposed, in connection with our adoption of Securities Act rule 139b, a conforming

[191] A communication that previously had been subject to the filing requirements of rule 497 also would no longer be subject to the rule 497 filing requirements if it were published or distributed by a broker-dealer as a covered investment fund research report, because it would no longer be considered to be a section 10(b) prospectus. *See supra* paragraph accompanying notes 165–167.

[192] *See* FINRA rule 2210(c)(3) (broker-dealers must file, within 10 business days of first use or publication, retail communications that promote or recommend a specific registered investment company or family of registered investment companies). *See generally* FINRA rule 2210(c)(1)–(3). In addition to these FINRA filing requirements, as discussed above, such communications would be required to be filed with the Commission (and are deemed to have been filed with the Commission if filed with FINRA). *See supra* notes 187–189 and accompanying text.

[193] *See generally* FINRA rule 2210(c)(7).

[194] *See* FINRA rule 2210(c)(7)(O).

[195] *See* section 2(c)(2) of the FAIR Act.

[196] *Id. See also* 15 U.S.C. 80a–24(b); FINRA rule 2210.

[197] *See* FINRA rule 2210(b)(4)(A) (requiring members to maintain all retail communications and institutional communications for the retention period required by Exchange Act rule 17a–4(b) and in a format and media that comply with Exchange Act rule 17a–4).

[198] *See* SIFMA Comment Letter I; Fidelity Comment Letter.

[199] *See* Fidelity Comment Letter.

[200] The FAIR Act provides that the Act does not limit the authority of any self-regulatory organization to require the filing of communications with the public the purpose of which is not to provide research and analysis of covered investment funds. *See* section 2(c)(2) of the FAIR Act.

[201] SIFMA Comment Letter I.

[202] *See* Fidelity Comment Letter.

[203] Section 2(b)(3) of the FAIR Act.

[204] *See* rule 139b(b).

[205] 17 CFR 242.101(a).

change to the exception contained within rule 101(b)(1) of Regulation M to permit the publication or dissemination of any information, opinion, or recommendation so long as the conditions of rule 139b are satisfied.

The conforming amendment is intended to align the treatment of research under rule 139b with the treatment of research under rules 138 and 139 for purposes of Regulation M. In the absence of the conforming amendment, rule 101 could prevent the publication or dissemination of a covered investment fund research report under the rule 139b safe harbor by a broker-dealer that is participating in a distribution that is covered by Regulation M. We believe that such a result would be contrary to the mandate of the FAIR Act. The conforming amendment is intended to harmonize treatment of research under the Securities Act and Exchange Act rules. We received no comments on this aspect of the proposal. We are adopting the conforming amendment as proposed.

In October 2016, the Commission adopted new rules and forms and amended other rules and forms under the Investment Company Act to modernize the reporting and disclosure of information by registered investment companies.[206] The Commission, among other things, adopted Form N–CEN, a new form for registered investment companies to report census-type information to the Commission, and rescinded Form N–SAR, a form on which the Commission had previously collected census-type information on management investment companies and unit investment trusts. To implement these changes, the Commission revised references to rules and forms to remove references to Form N–SAR and replace them with references to Form N–CEN, but inadvertently did not revise Form 12b–25. We are making 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.[207]

III. Economic Analysis

A. Introduction

We are mindful of the costs and benefits of our rules. Section 2(b) of the Securities Act, section 3(f) of the Exchange Act, and section 2(c) of the Investment Company Act state that when the Commission is engaging in rulemaking under such titles and is required to consider or determine whether an action is necessary or appropriate in (or, with respect to the Investment Company Act, consistent with) the public interest, the Commission shall consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.[208] Additionally, Exchange Act section 23(a)(2) requires us, when making rules or regulations under the Exchange Act, to consider, among other matters, the impact that any such rule or regulation would have on competition and states that the Commission shall not adopt any such rule or regulation which would impose a burden on competition that is not necessary or appropriate in furtherance of the Exchange Act.[209]

The economic analysis proceeds as follows. We begin with a discussion of the baseline used in the analysis. We then discuss the costs and benefits of the rules we are adopting, as well as the effects of these rules on efficiency, competition, and capital formation compared to the baseline. Where possible, we attempt to quantify the economic effects we discuss, although in many cases we are unable to do so and instead rely on qualitative characterizations. In the Proposing Release, we requested comment on our analysis of these effects.[210] We did not receive comments that provided any additional quantification of these effects, nor did commenters provide data that could facilitate a more quantitative analysis. We therefore continue to be unable to produce reasonable quantitative estimates for most of the economic effects, and—as in the Proposing Release—rely on qualitative economic assessments instead.[211]

B. Baseline

The Commission's economic analysis evaluates the costs and benefits of the rules being adopted relative to a baseline that represents the best assessment of relevant markets and market participants in the absence of these rules. In this section, we begin by characterizing the relevant market structure and participants.[212] We then proceed to describe the relevant regulatory structure.

1. Market Structure and Market Participants

The rules we are adopting directly affect broker-dealers, but their indirect effects extend to covered investment funds, other producers of research on covered investment funds, and consumers of information about covered investment funds.[213]

a. Covered Investment Funds

The ''covered investment fund'' definition in the FAIR Act and rule 139b has the effect of capturing five common types of investment vehicles: Mutual funds, ETFs, certain currency and commodity exchanged traded products (''ETPs''),[214] closed-end funds, and BDCs.[215] As shown in Figure 1, the universe of covered investment funds is large. At the end of 2017, there were 11,924 such entities, including 9,564 mutual funds, 1,629 ETFs and ETPs, 596 closed-end funds, and 135 BDCs.[216] The total public market value of covered investment funds exceeds $20 trillion. Of this total, $17 trillion is held through shares issued by open-end mutual funds, $3 trillion through shares of ETFs and ETPs, $317 billion through shares of closed-end funds, and $27 billion through shares of BDCs.[217]

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[206] *See* Reporting Modernization Release, *supra* note 53.

[207] Transition reports on Form N–SAR were covered by rule 30b1–3 under the Investment Company Act, which was rescinded by the Reporting Modernization Adopting Release. See Reporting Modernization Adopting Release, *supra* note 53, at 81929 n.781 and accompanying and following text.

[208] 15 U.S.C. 77b(b); 15 U.S.C. 78c(f); 15 U.S.C. 80a–2(c); 15 U.S.C. 80b–2(c).

[209] 15 U.S.C. 78w(a)(2).

[210] *See* Proposing Release, *supra* note 2.

[211] *See id.*

[212] To characterize the baseline, we rely on data from year-end 2017 where possible; however, in some cases, timing issues related to data availability require us to rely on data from prior periods.

[213] The rules we are adopting, through their effects on capital formation, may also affect securities issuers more broadly. *See infra* section III.C.5.

[214] Exchange-traded trusts with assets consisting primarily of commodities, currencies, or derivative instruments that reference commodities or currencies (commonly referred to as currency ETPs and commodity ETPs) and which are not registered under the Investment Company Act; *see* rule 139b(c)(2)(ii).

[215] *See supra* section II.A.3.

[216] Mutual fund, ETF, and ETP statistics are based on data from CRSP mutual fund database (2017Q4). Closed-end fund statistics are based on data from CRSP monthly stock file (Dec. 2017). BDC statistics are based on the Commission's listing of registered BDCs. Securities and Exchange Commission, Business Development Company Report: January 2012–July 2018 (Sept. 28, 2018), *available at https://www.sec.gov/open/datasets-bdc.html.*

[217] *See supra* note 216. Market value of BDC shares are based on information obtained from CRSP, Compustat, and Audit Analytics.

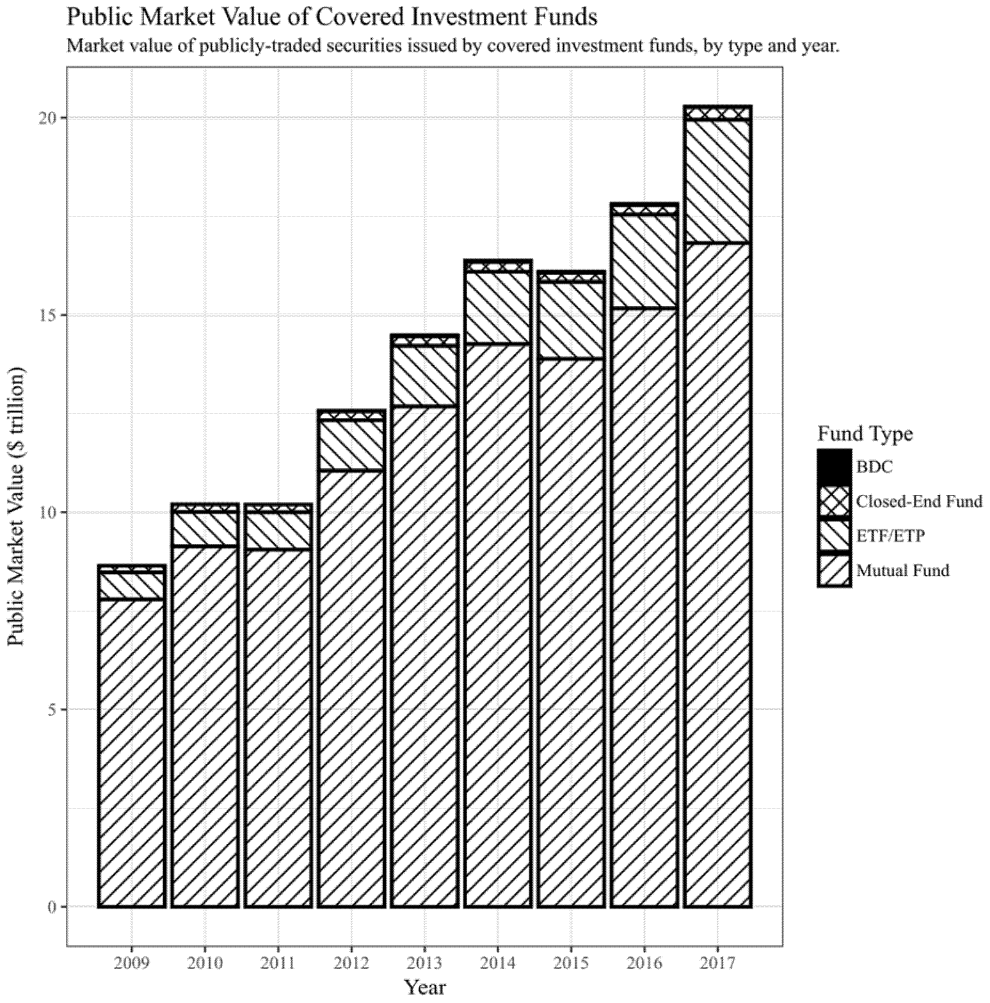

Figure 1: Numbers of publicly traded covered investment funds, by type and year. Counts based on CRSP mutual fund database, CRSP monthly stock file, and Commission's listing of BDC registrants; see supra note 216. BDC data begins in 2013.

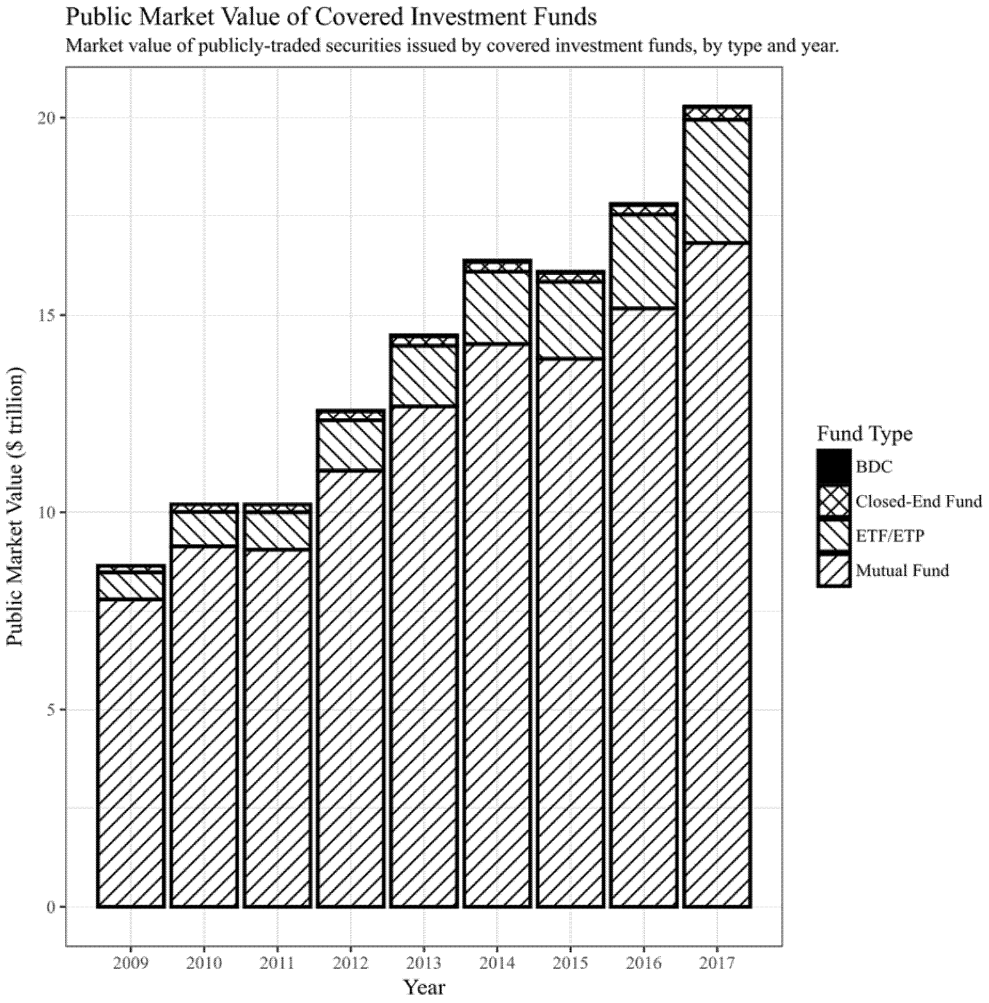

Figure 2: Market value of publicly traded securities issued by covered investment funds. Valuation estimates based on data from CRSP mutual fund database, CRSP monthly stock file, Compustat, and Audit Analytics; *see supra* note 217.

Covered investment fund shares represent a significant fraction of investment assets held by U.S. residents. Approximately one-third of U.S. corporate equity issues, one-quarter of U.S. municipal securities, one-fifth of corporate debt, one-fifth of U.S. commercial paper, and one-tenth of U.S. treasury and agency securities are held through covered investment funds.[218] Mutual funds comprise the bulk (84%) of covered investment funds.[219] Nearly half of U.S. households hold mutual fund shares [220] and the vast majority (89%) of mutual fund shares are held through retail accounts (*i.e.,* accounts of retail investors, or households).[221] Consequently, at least 75% of the public market value of all covered investment funds is held through retail accounts. By analyzing institutional holdings from year-end 2017 Form 13F filings we estimate that across ETF and ETPs, the mean institutional holding [222] was 45%.[223] For BDCs, we estimate the mean institutional holding was 30%, while for closed-end funds, we estimate the mean institutional holding was 21%. Based on these figures, we further estimate that shares representing 86% of the public market value of all covered investment funds are held through retail accounts.[224]

[218] *See* Investment Company Institute, 2017 Investment Company Fact Book (2017), *available at http://www.icifactbook.org/* (''ICI Fact Book'').

[219] *See supra* note 217.

[220] *See* Investment Company Institute, *Ownership of Mutual Funds, Shareholder Sentiment, and Use of the internet* (2017), *available at https://www.ici.org/pdf/per23-07.pdf.*

[221] Percentage by value. *See* ICI Fact Book, *supra* note 218, at 30. Excluding money market funds (''MMF''), mutual fund shares held in retail accounts make up an even larger fraction (95%) of mutual fund shares.

[222] We calculated ''institutional holding'' as the sum of shares held by institutions (as reported on Form 13F filings) divided by shares outstanding (as reported in CRSP).

[223] Year-end 2017 Form 13F filings were used to estimate institutional ownership. Closed-end funds were matched to reported holdings based on CUSIP. We note that there are long-standing questions around the reliability of data obtained from 13F filings. *See* Anne M. Anderson & Paul Brockman, *Form 13F (Mis)Filings,* SSRN Scholarly Paper. Rochester, NY: Social Science Research Network (Oct. 15, 2016), *available at https://papers.ssrn.com/abstract=2809128. See also* Securities and Exchange Commission, Office of Inspector General, Office of Audits, Review of the SEC's Section 13(f) Reporting Requirements (Sept. 27, 2010), *available at https://www.sec.gov/files/480.pdf.*

[224] Staff calculated the percentage of net asset value held by institutions reported on Form 13F for ETFs, ETPs and BDCs as public market value of shares held by institutions divided by public market value of all shares. Mutual funds shares are generally not required to be reported on Form 13F. We estimate institutional ownership of non-MMF mutual funds using ICI Fact Book estimate (95%). *See supra* note 221 and accompanying text.

As depicted in Figure 3, the covered investment fund market is dynamic. In 2017, 638 covered investment funds were created, while 853 were closed or merged into other covered investment funds.[225]

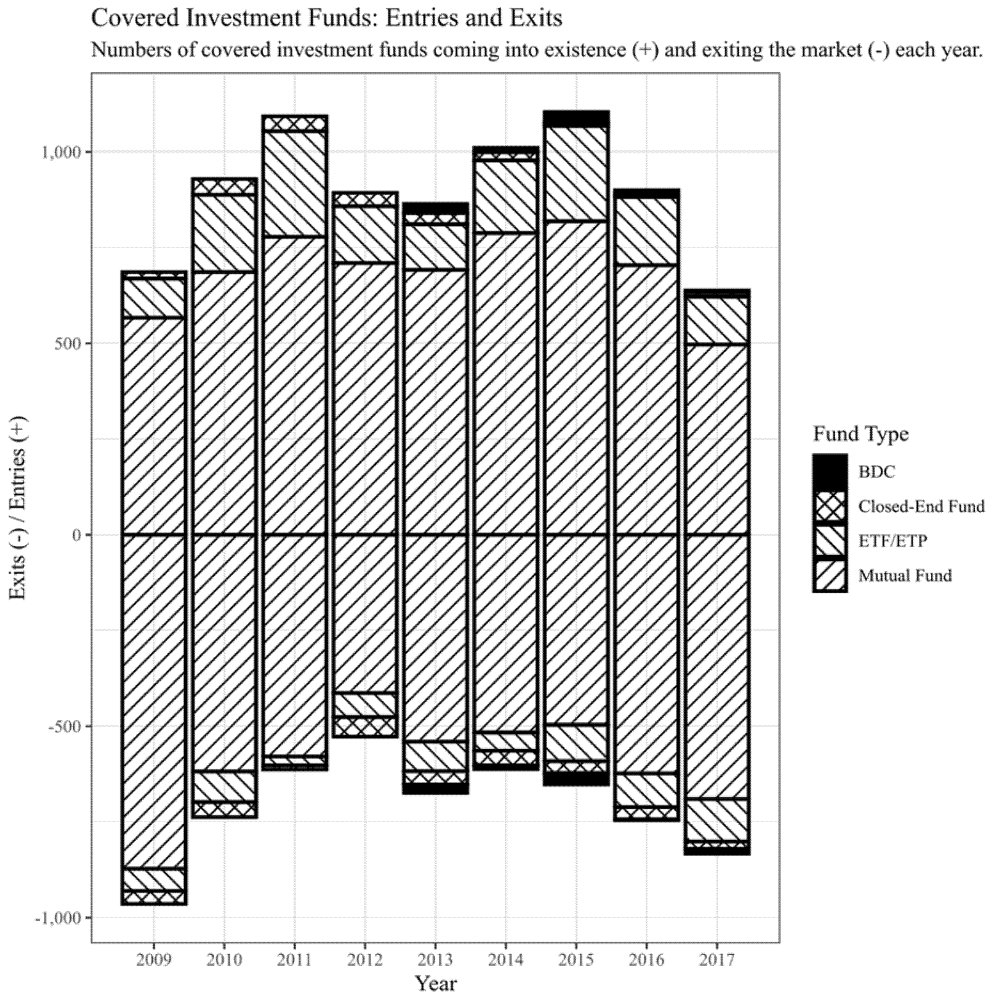

Figure 3: Entries and exits of covered investment funds. Counts based on CRSP mutual fund database, CRSP monthly stock file, and Commission's listing of BDC registrants; see supra note 216. BDC data begins in 2013.

b. Broker-Dealers

The broker-dealers directly affected by the rules we are adopting are those who participate in registered offerings of covered investment funds while at the same time publishing or distributing information about those funds. The Commission does not have comprehensive data on the number or characteristics of broker-dealers currently publishing and distributing communications about covered investment funds, the extent of their communications, and their distribution arrangements with covered investment funds. Therefore we rely on inferences based on the data that are available[226] and make certain assumptions when characterizing the baseline.

We believe that broker-dealers that do not derive revenues from the distribution of covered investment funds are less likely to be directly affected by the rules we are adopting.[227] As discussed above, registered investment companies represent the vast majority of covered investment funds.[228] Broker-dealers report revenues from the distribution of investment company shares in regulatory filings,[229] and we use this to estimate broker-dealers' revenues from distribution of covered investment funds. We estimate that for the 3,882 broker-dealers active in 2017, revenues related to distribution of covered investment funds exceeded $28 billion, or 9% of total broker-dealers' revenues. Of these 3,882 broker-dealers, 1,417 reported revenues from the distribution of investment company shares. These 1,417 ''affected'' broker-dealers accounted for 74% of total broker-dealer revenues and 59% of total broker-dealer assets.[230] As shown in

[225] *See supra* note 216.

[226] We rely here primarily on broker-dealers' quarterly FOCUS reports.

[227] We believe that broker-dealers that do not participate in the distribution of covered investment funds are less likely to publish or distribute research reports about such funds and—to the extent that they do—may not derive significant benefits from the safe harbor of rule 139b.

[228] *See supra* section III.B.1.a.

[229] The sum of FOCUS Supplemental Statement of Income items: 13970 (''revenues from sales of investment company shares''), 11094 (''12b–1 fees''), and 11095 (''mutual fund revenue other than concessions or 12b–1 fees'').

[230] We describe these dealers as ''affected,'' but the degree to which they are affected will vary

Figure 4, among the affected broker-dealers, the importance of revenues from the distribution of covered investment funds varies widely.[231] However, in aggregate, these revenues accounted for 13% of affected broker-dealers' total revenues.[232] For comparison, among the affected broker-dealers, revenues from brokerage trading commissions and account management accounted for 9%, and 20% of total revenues, respectively, while revenues from propriatery trading and underwriting accounted for 4% and 8% of total revenues, respectively.

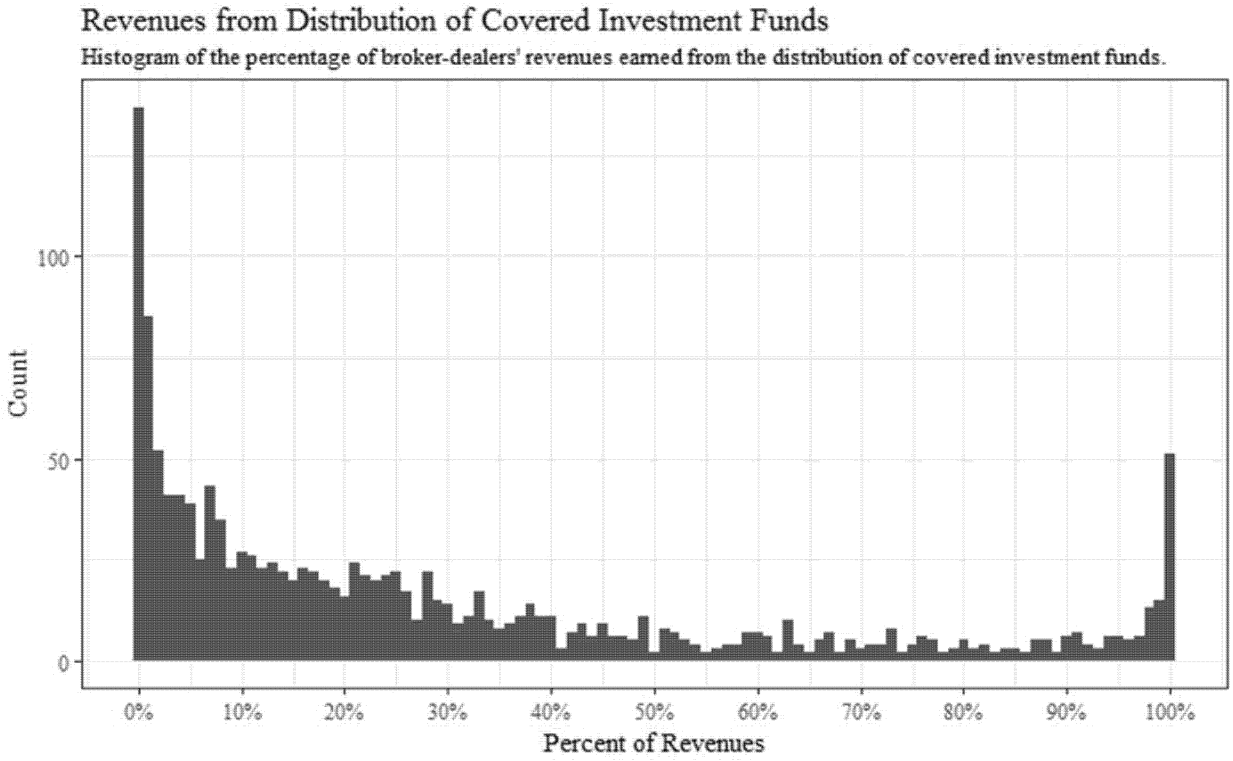

Figure 4: Affected Broker-Dealers' Revenues from Distribution of Covered Investment Funds (estimated). Histogram of the percentage of broker-dealer revenue attributable to distribution of covered investment funds (proxied by commissions on sales of investment company shares).

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c. Research on Covered Investment Funds

The Commission does not have comprehensive data on broker-dealers that publish or distribute research reports on entities that are included within the definition of ''covered investment fund'' under rule 139b.[233] The Commission estimates that in 2017, there were 1,417 broker-dealers that reported revenues from the distribution of covered investment funds.[234] We assume that these broker-dealers will have incentives to publish or distribute research reports about covered investment funds. However, due to the large number of covered investment funds, we do not expect that many broker-dealers' in-house research departments (if they have such departments) are currently capable of providing research on a large percentage of covered investment funds. Most covered investment funds are not followed by dedicated research analysts akin to the analyst coverage that the Commission has previously identified as being one indicator of market interest and following for operating companies.

Existing Commission and SRO rules do not delineate a category of ''research reports'' pertaining to covered investment funds. Consequently, it is not possible to identify with precision broker-dealer communications under the baseline that would be considered ''research reports'' as defined in rule 139b. However, we understand that some broker-dealers have published and distributed communications styled as ''research reports'' in compliance with rule 482 under the Securities Act.[235] FINRA member firms—the vast majority [236] of broker-dealers—file these communications with FINRA.[237] The number of communications filed with FINRA help to provide an estimate of the number of communications currently published or distributed by broker-dealers that could potentially be considered ''research reports'' under rule 139b. FINRA staff has reported reviewing 47,707 filings subject to rule 482 in 2017. FINRA staff reviewed an additional 8,528 communications that are subject to Investment Company Act

based on individual characteristics. Other things being equal, we expect broker-dealers that are currently more active in the marketing of covered investment funds would be more affected.

[231] This suggests that the degree to which the ''affected'' broker-dealers are affected by the rule will also vary widely.

[232] Estimates are based on staff analysis of FOCUS filings.

[233] *See supra* section III.B.1.b.

[234] *See id.*

[235] *See supra* note 162 and accompanying text.

[236] Based on staff analysis of FOCUS filings, we estimate that as of year-end 2017, there were 3,882 registered broker-dealers, 3,755 of which were members of FINRA.

[237] *See supra* note 189 and accompanying text.

rule 34b–1, for a total of 56,235 communications.[238] There are several factors that limit our ability to extrapolate from these estimates the number of communications that broker-dealers currently publish or distribute that would satisfy the definition of ''covered investment fund research report'' under rule 139b. First, these data do not reflect the affiliate exclusion incorporated in the rule 139b definition of ''covered investment fund research report,'' which has the effect of excluding from the safe harbor research reports that are published or distributed by persons covered by the affiliate exclusion.[239] Second, the data do not include communications about entities that would be considered ''covered investment funds,'' but that do not need to comply with the requirements of rule 482 (*e.g.,* commodity- or currency-based trusts or funds). Third, for those communications that are currently filed as rule 482 advertising prospectuses or rule 34b–1 supplemental sales literature, we are uncertain what percentage of these communications broker-dealers would continue to structure as rule 482 advertising prospectuses or rule 34b–1 supplemental sales literature, as opposed to publishing or distributing them as covered investment fund research reports under the rule 139b safe harbor.

We have also analyzed the number of ''research reports'' as defined under FINRA rules 2241 and 2242 that FINRA staff reviewed in 2017. However, for reasons discussed below, we also believe that these data have limited value in assessing the number of covered investment fund research reports whose publication or distribution could be eligible for the safe harbor under rule 139b. FINRA reviewed 354 filings in 2017 that were identified as ''research reports'' as defined in FINRA rules 2241 and 2242. However, the definitions of ''research report'' and ''debt research report'' under FINRA rules 2241 and 2242, respectively, do not correspond in every respect to the term ''research report'' as defined in the FAIR Act and rule 139b.

Under FINRA rule 2241, the term ''research report'' includes any written communication that includes an analysis of equity securities (other than mutual fund securities) and that provides information reasonably sufficient upon which to base an investment decision.[240] Under FINRA rule 2242, the term ''debt research report'' includes any written communication that includes an analysis of a debt security or an issuer of a debt security and that provides information reasonably sufficient upon which to base an investment decision.[241] As discussed above, the FAIR Act and the rule 139b definition of ''research report'' do not require a communication to provide information reasonably sufficient upon which to base an investment decision.[242] Also, unlike the definition of ''research report'' in FINRA rule 2241, the FAIR Act and the rule 139b definitions of ''research report'' include communications about mutual funds. Thus, while the number of ''research reports'' as defined in FINRA rules 2241 and 2242 that FINRA staff has historically reviewed provides an estimate of a subset of communications currently being styled as ''research reports'' whose publication or distribution could be eligible for the rule 139b safe harbor, this number would represent only a small portion of the complete universe of research reports whose publication or distribution could be eligible for this safe harbor. We also understand that the reported number of ''research reports'' as defined in FINRA rules 2241 and 2242 that FINRA staff has historically reviewed also could relate to research reports for securities products other than entities that would be considered ''covered investment funds'' (*e.g.,* certain stocks, bonds, or master limited partnership interests).

In addition to broker-dealers, various firms that are independent of the offering process currently provide data and analysis on different subsets of the covered investment fund universe (*e.g.,* through subscription services or through licensing agreements with broker-dealers). Data aggregators provide various forms of information and analysis about covered investment funds, ranging from automated fund rankings, to analyst research reports.[243] Because data and analysis provided by these firms play an important role in investors' information environment under the baseline, these firms will be affected by changes to the competitive environment resulting from the rules we are adopting.[244] We understand that communications styled as ''research reports'' on covered investment funds distributed by broker-dealers may rely on information obtained from these independent sources. In particular, we understand that information that is commonly provided by these independent firms may include: (1) Information obtained from regulatory filings, such as narrative descriptions of fund objectives, information about key personnel, performance history, fees, and top holdings; (2) statistics and other information derived from public, proprietary, and licensed data sources, such as risk exposures (*e.g.,* geographic, sectoral), quantitative characteristics (*e.g.,* beta, correlations, tracking error), and peer group; and (3) fund ratings. The fund ratings that independent firms may provide are generally based on methodologies proprietary to each firm.[245]

2. Regulatory Structure

The objective of this analysis is to consider the effects of regulations being adopted pursuant to the FAIR Act's statutory mandate. Thus, for the purposes of the baseline, we take into account the regulatory structure in place immediately prior to the enactment of the FAIR Act. We also note that on July 3, 2018, the interim effectiveness provision of the FAIR Act came into effect.[246] This provision allows broker-dealers to rely on the rule 139 safe harbor when publishing or distributing covered investment fund research reports. In addition, under this provision, covered investment funds are deemed to be securities that are listed on a national securities exchange and are not subject to section 24(b) of the Investment Company Act. While the effectiveness of this provision is now part of the regulatory framework, in light of its recent effectiveness and the

[238] Under rule 34b–1, ''sales literature'' required to be filed by section 24(b) shall have omitted to state a fact necessary in order to make the statements made therein not materially misleading unless the sales literature includes certain specified information. *See* rule 34b–1 [17 CFR 270.34b–1]; *see also supra* note 165.

Of the 47,707 filings subject to rule 482, 229 were also subject to rule 34b–1. These 229 are not included in the 8,528 figure. Statistics provided by FINRA.

[239] *See supra* notes 18–21 and accompanying text.

[240] *See* FINRA rule 2241(a)(11).

[241] *See* FINRA rule 2242(a)(3).

[242] *See supra* note 40 and accompanying text.

[243] While various firms provide automated fund rankings for much of the covered investment fund universe, true ''analyst coverage'' is considerably more limited. Morningstar provides ''analyst ratings'' for certain open-end funds, closed-end funds, and ETFs. Based on queries of the Morningstar database, as of October 2018, only 1,562 open-end funds, no closed-end funds, and 200 ETFs had a Morningstar analyst rating. We calculated that in total, as of December 2017, there were 9,564 mutual funds, 596 closed-end funds, and 1,629 ETFs and ETPs. *See supra* note 216.

[244] *See infra* section III.C.5.

[245] *See, e.g.,* Zacks Investment Research, *ETF Rank Guide* (Mar. 12, 2013), *available at https://www.zacks.com/stock/news/94561/zacks-etf-rank-guide;* Morningstar, *Morningstar's Two Rating for Assessing a Fund* (2014), *available at http://corporate1.morningstar.com/Documents/UK/Landing/Morningstars-Two-Ratings-For-Assessing-A-Fund.*

[246] *See* section 2(d) of the FAIR Act.

limited time duration until it will be replaced by rule 139b, as a practical matter, it is unclear to what extent broker-dealers will rely on the interim provision to publish or distribute research reports about covered investment funds.

a. Legal and Regulatory Framework Applicable to Statements Included in Covered Investment Fund Research Reports

A broker-dealer's publication or distribution of a covered investment fund research report could be deemed to constitute an offer that otherwise could be a non-conforming prospectus whose use in the offering may violate section 5 of the Securities Act.[247] We understand that some broker-dealers currently publish and distribute communications styled as ''research reports'' regarding covered investment funds in compliance with rule 482 under the Securities Act.[248] Unlike research reports covered under the rule 139 safe harbor, broker-dealers' publication or distribution of rule 482 advertisements could subject the broker-dealer to liability under section 12(a)(2) of the Securities Act.[249] In addition, rule 482 advertisements regarding open-end investment companies, trust accounts, and money markets funds are subject to requirements on the standardized presentation of performance information.[250]

Additionally, certain SRO rules governing content standards may apply to advertisements styled as ''research reports'' under rule 482 or to communications that would be covered investment fund research reports under rule. These include FINRA rule 2210, which contains general content standards that apply broadly to member communications.[251] In addition, covered investment fund research reports pertaining to funds other than open-end registered investment companies that are not listed or traded on an exchange (*i.e.,* ETFs, ETPs, closed-end funds, and BDCs) may be subject to FINRA rules 2241 and 2242 governing content standards of ''research reports'' as defined by FINRA.[252]

Exposure to liability under section 12(a)(2) of the Securities Act, rule 482 requirements on the standardized presentation of performance information, and the various aforementioned FINRA rules impose costs on broker-dealers. These include conduct costs resulting from additional liability (*e.g.,* foregoing publication of certain reports), and compliance costs associated with the relevant content standards. We are not able to quantify these costs.[253]

b. Filing Requirements

Under the baseline, a research report or other communication about a covered investment fund that is a registered investment company would have to comply with the requirements of Securities Act rule 482 [254] and registered investment company sales material, including rule 482 ''omitting prospectus'' advertisements as well as supplemental sales literature,[255] are required to be filed with the Commission under section 24(b) of the Investment Company Act.[256] Broker-dealers that are FINRA members are also subject to certain additional filing requirements under current FINRA rule 2210.[257]

C. Costs and Benefits

In this section, we first consider the overarching costs and benefits associated with the FAIR Act's statutory mandates. Second, we evaluate the costs and benefits of the specific provisions of the rules we are adopting and their relation to the overarching considerations resulting from the statutory mandate. Next, we discuss the effects on efficiency, competition, and capital formation of the new rules. We conclude with a discussion of alternatives considered.

1. FAIR Act Statutory Mandate

a. Benefits

We believe that the expansion of the rule 139 safe harbor (as mandated by the FAIR Act) will generally reduce broker-dealers' costs of publishing and distributing research reports about covered investment funds. These cost reductions are expected because under the new rules a broker-dealer could publish or distribute covered investment fund research reports without reliance on rule 482 or rule 34b–1 and without being required to file these reports under section 24(b) of the Investment Company Act and the rules and regulations thereunder.[258] Broker-dealers publishing or distributing covered investment fund research reports in reliance on the expanded safe harbor will not be subject to the liability provisions of section 12(a)(2) of the Securities Act,[259] rule 34b–1, or the filing requirements of section 24(b) of the Investment Company Act.[260] Thus, they will be expected to incur lower costs associated with liability under section 12(a)(2), lower conduct costs, and lower compliance costs (including fewer content and filing requirements).[261] Because of these cost reductions, we expect publication and distribution of such reports to increase. First, we expect that certain broker-dealers that had previously published and distributed communications under rule 482 that could be styled as ''research reports'' will aim to meet the conditions of the expanded safe harbor and increase their supply of covered investment fund research as a result. Second, we expect some broker-dealers that have previously not published or distributed such reports (due to the

[247] *See supra* note 5 and accompanying text.

[248] Research reports regarding covered investment funds could also be distributed today as ''supplemental sales literature'' under rule 34b–1 under the Investment Company Act. However, research reports distributed under rule 34b–1 would need to be preceded or accompanied by a statutory prospectus. *See supra* note 167 and accompanying text.

[249] Section 12(a)(2) provides express remedies to the person purchasing the security (*i.e.,* a private right of action) for material misstatements and omissions made by any seller of the security. It also provides a different standard for claims for damages than under Exchange Act rule 10b–5, which requires proof of scienter in the representations made. *See* 15 U.S.C. 77l(a)(2); *see also* rule 10b–5 [17 CFR 240.10b–5].

[250] Research reports that are published or distributed as rule 34b–1 supplemental sales literature also would be subject to requirements relating to the standardized presentation of performance information, because rule 34b–1 incorporates many of the rule 482 requirements relating to performance disclosure. *See supra* notes 166, 248.

[251] *See* FINRA rule 2210(d)(1).

[252] *See supra* note 183 (discussing the scope of these rules in more detail, including noting that the scope of FINRA rules 2241(c)(1) and 2242(c)(2) generally apply only to a subset of communications that would be considered covered investment fund research reports under rule 139b).

[253] In the Proposing Release, we asked commenters to supply data that could aid us in quantifying these costs. No such data was provided in the comment letters received. *See* Proposing Release, *supra* note 2, at 26812.

[254] *See* FINRA rule 2210(d)(5) (providing that non-money market fund open-end management company performance data as permitted by rule 482 in retail communications and correspondence must disclose standardized performance information and, to the extent applicable, certain sales charge and expense ratio information); *see also supra* note 161.

[255] *See supra* note 248.

[256] Rule 24b–3 under the Investment Company Act deems these materials to have been filed with the Commission if filed with FINRA. *See supra* notes 144, 189 and accompanying text.

[257] FINRA rule 2210's filing requirements include a number of exclusions, including an exclusion for certain research reports, except that broker-dealers are required to file research reports with FINRA if they are also required to be filed with the Commission pursuant to section 24(b) of the Investment Company Act. *See supra* notes 176–178, and accompanying text.

[258] *See supra* section II.D.1.

[259] *See supra* note 249.

[260] *See supra* section II.D.1.

[261] However, we would not expect any lower costs of compliance for any research reports that currently are structured as rule 34b–1 supplemental sales literature (and are not rule 482 advertising prospectuses), because supplemental sales literature is not an ''offer'' to which prospectus liability under section 12(a)(2) of the Securities Act would attach.

activity being deemed too costly or subject to too many restrictions), to begin doing so. We believe that the aforementioned effects will generally benefit broker-dealers and advisers to covered investment funds if, as we expect, they increase broker-dealers' sales of covered investment funds.

Because there is limited historical experience dealing specifically with broker-dealers' research reports on covered investment funds, there is little in the way of direct empirical evidence on the value of such reports to investors. Prior research on the informativeness of broker-dealers' research on operating companies suggests that broker-dealers can produce research that positively contributes to the information content of market prices,[262] and—perhaps more importantly—that broker-dealers may enjoy a comparative advantage in its production.[263] However, other studies have questioned the investment value of such research to investors[264] or its continued relevance.[265]

We are cautious in drawing implications from these findings to broker-dealers' research on covered investment funds. While analysts researching operating companies generally endeavor to identify mispricing—to forecast the idiosyncratic component of firms' future returns—covered investment funds represent portfolios of securities, and many covered investment funds are priced at net asset value (''NAV'').[266] Although individual securities within a covered investment fund's portfolio may be viewed as ''mispriced'' by a research analyst, diversification effects will tend to drown out such effects at the fund level and minimize idiosyncratic variation in investors' return on their investment in the fund. Therefore, any ''investment value''[267] of research on covered investment funds would likely be rooted in analysts' ability to predict broader market movements. Such ability is generally believed to be rather rare.[268] We therefore believe that the value to investors of information in broker-dealers' research reports will largely be limited to the synthesis or discovery of factual information about fund characteristics, fees, or other transactions costs. For example, investors may find analysts' views of a fund's management, objectives, risk exposures, tracking error, volatility, tax efficiency, fees, or other fund characteristics to be valuable. Such analysis could be a valuable source of information for investors evaluating relative fund performance.[269]

We believe that the quantity of information available to potential investors of covered investment funds will increase as a result of broker-dealers' increased publication and distribution of covered investment fund research reports. The rules we are adopting will also allow for greater flexibility in the type of information that broker-dealers may communicate to customers.[270] To the extent that this new information is valuable, it will benefit investors by providing them with additional information to help shape investment decisions. Finally, we believe that important negative information about a covered investment fund, such as high fees, high risk exposure, or an inefficient portfolio strategy will be more likely to be publicized as a result of increased competition among information providers, with attendant benefits to investors.[271]

b. Costs

Prior experience and academic research suggests that, unchecked, broker-dealers' conflicts of interest can lead to bias in research reports,[272] and that such bias has the potential to adversely affect investor welfare.[273]

[262] *See, e.g.,* Brad M. Barber, Reuven Lehavy, & Brett Trueman, *Ratings changes, ratings levels, and the predictive value of analysts' recommendations,* 39 Financial Management 2, 533–553 (2010) (broker-dealers' research analysts' upgrades (downgrades) elicit positive (negative) price reactions, respectively). *See also* Scott E. Stickel, *The Anatomy of the Performance of Buy and Sell Recommendations,* 51 Financial Analysts Journal 5, 25–39 (Sept. 1, 1995) (broker-dealers' research provides new information, particularly for smaller firms, where information is less generally available). *See also* Kent L. Womack, *Do Brokerage Analysts' Recommendations Have Investment Value?,* 51 The Journal of Finance 1, 137–167 (1996) (price reactions are permanent and exhibit post-announcement drift).

[263] *See,* Boris Groysberg, Paul Healy & Craig Chapman, *Buy-Side* vs. *Sell-Side Analysts' Earnings Forecasts,* 64 Financial Analysts Journal 4, 25–39 (July 1, 2008) (informativeness of broker-dealers' sell-side research is superior to that of buy-side firms).

[264] *See* Brad Barber, Reuven Lehavy, Maureen McNichols & Brett Trueman, *Can Investors Profit from the Prophets? Security Analyst Recommendations and Stock Returns,* 56 The Journal of Finance 2, 531–563 (Apr. 1, 2001) (investors hoping to exploit research analysts' recommendations must trade frequently and these transaction costs often exceed the gains from trading); *see also* Xi Li, *The persistence of relative performance in stock recommendations of sell-side financial analysts,* 40.1 Journal of Accounting and Economics 3, 129–152 (2005). *See also* Narasimhan Jegadeesh, Joonghyuk Kim, Susan D. Krische & Charles M. C. Lee, *Analyzing the Analysts: When Do Recommendations Add Value?,* 59 The Journal of Finance 3, 1083–1124 (2004) (significant portion of investment value may be attributable to previously documented trading signals, with little incremental value attributable to the broker-dealer research). *See also* Yongtae Kim & Minsup Song, *Management Earnings Forecasts and Value of Analyst Forecast Revisions,* 61 Management Science 7, 1663–1683 (2015) (past estimates of the informativeness of analyst recommendations may be confounded by the impact of forecasts issued by management).

[265] *See* Oya Altınkılıç, Robert S. Hansen & Liyu Ye, *Can analysts pick stocks for the long-run?,* 119 Journal of Financial Economics 2, 371–398 (Feb. 2016) (reductions in transactions costs and increases in computational speed reduced the amount of new information available for analysts to discover).

[266] Closed-end funds, for example, are not priced on a NAV basis and their (mis-) pricing has long served as a puzzle in the finance literature. *See, e.g.,* Charles M.C. Lee, Andrei Schleifer, & Richard H. Thaler, *Investor Sentiment and the Closed-End Fund Puzzle,* 46 The Journal of Finance 1 (Mar. 1991). Similar pricing issues may arise in BDCs.

[267] We mean this in the sense of providing a signal about future investment performance.

[268] *See, e.g.,* Kent Daniel, Mark Grinblatt, Sheridan Titman, & Russ Wermers, *Measuring Mutual Fund Performance with Characteristic-Based Benchmarks,* 52 The Journal of Finance 3, 1035–1058 (July 1997).

[269] *See, e.g.,* W. J. Armstrong, Egemen Genc & Marno Verbeek, *Going for Gold: An Analysis of Morningstar Analyst Ratings,* Management Science (Aug. 2017).

[270] Currently such communications would be subject to rule 482 requirements, including standards on the presentation of performance information. *See supra* section II.C.

[271] *See* Matthew Gentzkow & Jesse M. Shapiro, *Media Bias and Reputation,* 114 Journal of Political Economy 2, 280–316 (Apr. 1, 2006).

[272] *See* Amitabh Dugar & Siva Nathan, *The Effect of Investment Banking Relationships on Financial Analysts' Earnings Forecasts and Investment Recommendations*,* 12 Contemporary Accounting Research 1, 131–160 (Sept. 1, 1995) (''Dugar and Nathan Article'') (affiliated analysts issue more optimistic earnings forecasts and investment recommendations about companies with which their firms had an investment banking relationship). *See also* Hsiou-wei Lin & Maureen F. McNichols, *Underwriting Relationships, Analysts' Earnings Forecasts and Investment Recommendations,* 25 Journal of Accounting and Economics 1, 101–127 (Feb. 26, 1998) (''Lin and McNichols Article'') (affiliated analysts are more optimistic in their long-term growth forecasts and investment recommendations).

[273] *See* Roni Michaely & Kent L. Womack, *Conflict of Interest and the Credibility of Underwriter Analyst Recommendations,* 12 The Review of Financial Studies 4, 653–686 (July 2, 1999) (''Michaely and Womack Article'') (stock recommendations of affiliated analysts perform worse prior to, at the time of, and subsequent to the recommendation); *see also* Patricia M. Dechow, Amy P. Hutton & Richard G. Sloan, *The Relation between Analysts' Forecasts of Long-Term Earnings Growth and Stock Price Performance Following Equity Offerings*,* 17 Contemporary Accounting Research 1, 1–32 (Mar. 1, 2000). *See also* Global Research Analyst Settlement, Litigation Release No. 18438 (Oct. 31, 2003) (The court issued an Order approving a $1.4 billion global settlement of the SEC enforcement actions against several investment firms and certain individuals alleging undue influence of investment banking interests on securities research); *see also* Deutsche Bank Securities Inc. and Thomas Weisel Partners LLC Settle Enforcement Actions Involving Conflicts of Interest Between Research and Investment Banking, SEC Press Release 2004–120 (Aug. 26, 2004). The settlement was an action in response to conflicts of interest that certain broker-dealers were found to have failed to manage in an adequate or appropriate manner and was modified in 2010 to remove certain requirements where FINRA and NYSE rules addressed the same concerns. *See* 2010 Modifications to Global Research Analyst

Broker-dealers' financial incentives to sell covered investment funds could undermine the objectivity of the information they produce about such funds, and the existence of the rule 139b safe harbor could increase opportunities for broker-dealers to promote funds from which they derive the most financial benefits.[274] If such conflicts are unrecognized by or unknown to investors, they could negatively affect investor welfare. Although market mechanisms [275] as well as existing regulation [276] may limit the extent of such actions, there is the potential that they could nonetheless impose costs on investors—particularly retail investors.[277]

The potential for conflicts of interest to lead to actions that impose costs on investors depends in large part on the strength of the underlying incentives. In the context of broker-dealers' research on covered investment funds, the greatest conflicts of interest are faced by broker-dealers serving as investment advisers to covered investment funds, who—due to asset-based management fees—have strong incentives to increase demand for the funds that they advise. Because the FAIR Act by its terms,[278] and also rule 139b,[279] will not extend the safe harbor to a broker-dealer that is publishing or distributing a research report about a covered investment fund for which the broker-dealer serves as an investment adviser (or where the broker-dealer is an affiliated person of the investment adviser), we believe that there will be limited potential for the greatest conflicts of interest to impose costs on investors.

Other conflicts of interest may nevertheless arise from incentives in fund distribution arrangements.[280] Distributing broker-dealers may receive compensation from sales loads, 12b–1 fees,[281] shelf space fees, or other revenue sharing agreements, all of which create financial incentives for broker-dealers to promote and sell funds and potentially to promote and sell particular funds or share classes.[282] Associated persons of broker-dealers (*i.e.,* analysts) may face similar conflicts of interests arising from incentives in their compensation agreements.[283] Finally, broker-dealers may have fewer direct or non-pecuniary incentives.[284] However, in all of these cases, the risk that such conflicts of interest could result in actions that negatively impact information communicated to investors is mitigated by the fact that a broker-dealer will bear the costs of such actions, but generally may be unable to fully appropriate the benefits.[285]

It is difficult for us to quantify the aforementioned costs in the context of this rulemaking. We are not aware of any studies directly examining the role that conflicts of interest play in broker-dealers' research reports on covered investment funds in U.S. markets, or of any data that would support a quantitative analysis of an expanded safe harbor in this context.[286] Although one commenter registered similar concerns,[287] no commenters provided any data that would facilitate such a quantitative analysis.[288] As with the potential benefits discussed above, we are limited to characterizing the potential costs qualitatively. While we believe that expanding the rule 139 safe harbor to broker-dealers' publication or distribution of covered investment fund research reports has the potential to impose costs on retail investors, existing regulations, specific provisions of the rules that we are adopting,[289] and certain market mechanisms will reduce these costs.

(1) Existing Regulation

Rules and regulations have been implemented to address potential conflicts of interest that may arise with broker-dealers specifically in the context of research reports.[290] As discussed in detail above,[291] the definition of ''research report'' for purposes of Regulation AC and FINRA rules 2241 and 2242 is narrower than the definition of ''research report'' for purposes of the FAIR Act and rule 139b. However, to the extent a research report meets both the definition of a research report under rule 139b and the definition of research report as defined in Regulation AC, Regulation AC will be applicable to that research report (and, if it meets the definition of ''research report'' in FINRA rule 2241, FINRA rule 2241 also will apply if the research report otherwise were within the scope of rule 2241 [292]). These rules may help promote objective and reliable research.[293]

Settlement, Litigation Release No. 21457 (Mar. 19, 2010).

[274] Such concerns were also noted by one commenter. *See* Morningstar Comment Letter.

[275] *See infra* section III.C.1.b(2).

[276] *See infra* section III.C.1.b(1).

[277] *See infra* section III.C.1.b(2).

[278] *See* section 2(f)(3) of the FAIR Act.

[279] *See* rule 139b(a).

[280] *See* Susan E. K. Christoffersen, Richard Evans & David K. Musto, *What Do Consumers' Fund Flows Maximize? Evidence from Their Brokers' Incentives,* 68 The Journal of Finance 1, 201–235 (Feb. 1, 2013) (where brokers' compensation arrangements with funds are found to drive their customers' fund flows).

[281] *See* rule 12b–1 under the Investment Company Act [17 CFR 270.12b–1].

[282] *See infra* note 298 (noting that the Commission has historically found broker-dealers to have violated sections 17(a)(2) and (3) of the Securities Act by making recommendations of more expensive mutual fund share classes while omitting material facts).

[283] Such conflicts of interest arising from incentives in compensation agreements involving research analysts issuing research reports covered by FINRA Rule 2241 are mitigated by FINRA rules 2241(b)(2)(C), (E), (F), and (K). Additionally, section 501(a)(2) of Regulation AC (17 CFR 242.501(a)(2)) requires specific disclosure regarding research analyst compensation in order to mitigate the conflicts of interest that can arise based on analyst compensation arrangements.

[284] For example, although it is prohibited conduct, a broker-dealer may have a financial incentive to provide coverage for, or to promote, a fund based on an understanding that the fund will participate in offerings underwritten by the broker-dealer. *See, e.g.,* FINRA rule 2241(b)(2) (requiring that a member's written policies and procedures must be reasonably designed to, among other things, ''prevent the use of research reports or research analysts to manipulate or condition the market or favor the interests of the member''); *see also* NASD Fines U.S. Bancorp Piper Jaffray and Managing Director $300,000, FINRA News Release (June 25, 2002) *available at http://www.finra.org/newsroom/2002/nasd-fines-us-bancorp-piper-jaffray-and-managing-director-300000* (announcing settlement with U.S. Bancorp Piper Jaffray and one of its managing directors in which the NASD found that the firm violated a NASD (now FINRA) rule requiring all firms and associated persons to adhere to high standards of commercial honor and just and equitable principles of trade when it threatened to discontinue research coverage of a company if the company did not select it as lead underwriter for an upcoming offering). *But see also* note 183.

Rule 12b–1(h)(1) prohibits funds from compensating a broker-dealer for promoting or selling funds shares by directing brokerage transactions to that broker. *See* rule 12b–1(h)(1) under the Investment Company Act [17 CFR 270.12b–1(h)(1)]; *see also* Prohibition on the Use of Brokerage Commissions to Finance Distribution, Investment Company Act Release No. 26591 (Sept. 2, 2004) [69 FR 54727 (Sept. 9, 2004)].

[285] For example, if a broker-dealer firm publishes biased research about a fund, some of the gains (*i.e.,* compensation from sales of that fund) may accrue to other broker-dealer firms (*i.e.,* other broker-dealer firms that distribute the same fund) while the costs of the action (*i.e.,* reputation costs, litigation risk, and risk of regulatory action) will be borne entirely by the broker-dealer firm that published the biased research.

[286] Authors have examined the impact of conflicts of interest on mutual fund research in China, providing evidence consistent with bias arising from conflicts of interest in that market, though differences between Chinese and U.S. markets and corresponding regulatory frameworks make it difficult to apply inferences drawn from experience in Chinese markets to U.S. markets. *See* Y. Zeng, Q. Yuan & J. Zhang, *Blurred stars: Mutual fund ratings in the shadow of conflicts of interest,* 60 Journal of Banking & Finance 1, 284–295 (2015).

[287] *See* Morningstar Comment Letter.

[288] In the Proposing Release, we requested comment on our characterization of these costs. *See* Proposing Release, *supra* note 2, at 26816.

[289] *See infra* section III.C.2.

[290] *See supra* note 35; *see also* Proposing Release, *supra* note 2, at 26791 n.37.

[291] *See supra* note 183.

[292] *See id.*

[293] *See* section 501 of the Sarbanes-Oxley Act; Regulation Analyst Certification, Securities Act Release No. 8193 (Feb. 20, 2003) [68 FR 9481 (Feb. 27, 2003)]. Several studies have analyzed bias in

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Additionally, as described above, FINRA rule 2210 contains general content standards that apply broadly to member communications, including broker-dealer research reports. These general content standards require, among other things, that all member communications ''must be based on principles of fair dealing and good faith, must be fair and balanced, and must provide a sound basis for evaluating the facts in regard to any particular security or type of security, industry or service.'' [294]

If a broker-dealer recommends [295] a covered investment fund to its customers, additional obligations under the federal securities laws and FINRA rules will apply. As a general matter, broker-dealers must deal with their customers fairly [296]—and, as part of that obligation, have a reasonable basis for any recommendation.[297] Furthermore, when making recommendations, broker-dealers may be generally liable under the antifraud provisions if they do not give ''honest and complete information'' or disclose any material adverse facts or conflicts of interest, including any economic self-interest.[298]

(2) Market Mechanisms

We believe that by facilitating production of information on covered investment funds, the FAIR Act's mandates will contribute to competition among information providers,[299] which we believe can mitigate the effects of conflicts of interest on research reports.[300] With respect to broker-dealers' research on operating companies, analysts' career concerns [301] have also been found to have similar effects, and, in principle, broker-dealers' reputations could as well.[302] However, we believe it is unlikely that analyst career concerns or broker-dealer reputation will play as significant a role in the context of covered investment fund research reports which we expect to be aimed primarily at retail investors. Research reports about operating companies have traditionally been provided to institutional customers as part of a bundle of services provided by full-service brokerages.[303] In this setting, broker-dealers benefit from institutional investors' willingness to pay for broker-dealers' additional bundled services (*e.g.,* research).[304] Such institutional customers are generally capable of producing similar reports, and so can evaluate the quality of broker-dealers' research.[305] Thus, they can provide market discipline: Broker-dealers' provision of low-quality or misleading information could plausibly be discovered and lead to the loss of valuable customer relationships. We do not believe that similar mechanisms would be as effective in the covered investment fund context. We expect broker-dealers to publish and distribute covered investment fund research reports on funds that they distribute to their customers.[306] With retail investors, information asymmetries are greater: Retail investors do not generally possess the capabilities to replicate an analyst report or evaluate its quality.[307] Moreover, the problem of evaluating the performance of analysts is harder in the context of covered

broker-dealers' research following the Global Settlement and subsequent regulatory changes, in particular at sanctioned banks. *See* O. Kadan, L. Madureira, R. Wang, & T. Zach, *Conflicts of interest and stock recommendations: The effects of the global settlement and related regulations* 22 The Review of Financial Studies 10, 4189–4217 (2009). *See also,* S. A. Corwin, S. A. Larocque & M. A. Stegemoller, *Investment banking relationships and analyst affiliation bias: The impact of the global settlement on sanctioned and non-sanctioned banks,* 124 Journal of Financial Economics 3, 614–631 (2017).

[294] *See supra* section II.D.1.

[295] *See, e.g.,* Additional Guidance on FINRA's New Suitability Rule, FINRA Regulatory Notice 12–25 (May 2012), at Q.2, (regarding the scope of ''recommendation''), n.25.

[296] *See, e.g.,* Duker & Duker, Exchange Act Release No. 2350 (Dec. 19, 1939), at 2 (Commission opinion) (''Inherent in the relationship between a dealer and his customer is the vital representation that the customer be dealt with fairly, and in accordance with the standards of the profession.'').

[297] *See* Mac Robbins & Co., Exchange Act Release No. 6846 (July 11, 1962), at 3 (''[T]he making of representations to prospective purchasers without a reasonable basis, couched in terms of either opinion or fact and designed to induce purchases, is contrary to the basic obligation of fair dealing borne by those who engage in the sale of securities to the public.''), *aff'd sub nom., Berko* v. *SEC,* 316 F.2d 137 (2d Cir. 1963). A broker-dealer's recommendation must also be suitable for the customer. *See, e.g.,* J. Stephen Stout, Exchange Act Release No. 43410 (Oct. 4, 2000), at 11 (Commission opinion) (''As part of a broker's basic obligation to deal fairly with customers, a broker's recommendation must be suitable for the client in light of the client's investment objectives, as determined by the client's financial situation and needs.''); *see also* FINRA Rule 2111.05(b) (''The customer-specific obligation requires that a member or associated person have a reasonable basis to believe that the recommendation is suitable for a particular customer based on that customer's investment profile, as delineated in Rule 2111(a).'').

[298] *See, e.g., De Kwiatkowski* v. *Bear, Stearns & Co.,* 306 F.3d 1293, 1302 (2d Cir. 2002); *Chasins* v. *Smith, Barney & Co.,* 438 F.2d 1167, 1172 (2d Cir. 1970). Generally, under the antifraud provisions, whether a broker-dealer has a duty to disclose material information to its customer is based upon the scope of the relationship with the customer, which is fact intensive. *See, e.g., Conway* v. *Icahn & Co., Inc.,* 16 F.3d 504, 510 (2d Cir. 1994) (''A broker, as agent, has a duty to use reasonable efforts to give its principal information relevant to the affairs that have been entrusted to it.''). For example, where a broker-dealer processes its customers' orders, but does not recommend securities or solicit customers, then the material information that the broker-dealer is required to disclose is generally narrow, encompassing only the information related to the consummation of the transaction. *See, e.g., Press* v. *Chemical Inv. Servs. Corp.,* 166 F.3d 529, 536 (2d Cir. 1999). The Commission has historically charged broker-dealers with violating sections 17(a)(2) and (3) of the Securities Act for making recommendations of more expensive mutual fund share classes while omitting material facts. *See, e.g.,* In re IFG Network Sec., Inc., Exchange Act Release No. 54127 (July 11, 2006), at 15 (Commission opinion) (registered representative violated 17(a)(2) and (3) by omitting to disclose to his customers material information concerning his compensation and its effect upon returns that made his recommendation that they purchase Class B shares misleading; ''The rate of return of an investment is important to a reasonable investor. In the context of multiple-share-class mutual funds, in which the only bases for the differences in rate of return between classes are the cost structures of investments in the two classes, information about this cost structure would accordingly be important to a reasonable investor.'').

[299] *See infra* section III.C.5.

[300] *See* Harrison Hong & Marcin Kacperczyk, *Competition and Bias,* 125 The Quarterly Journal of Economics 4, 1683–1725 (Nov. 1, 2010) (reduction in (analyst) competition resulting from mergers reduces analyst coverage and increases bias in the remaining coverage).

[301] *See* Harrison Hong & Jeffrey D. Kubik, *Analyzing the Analysts: Career Concerns and Biased Earnings Forecasts,* 58 The Journal of Finance 1, 313–351 (2003) (analysts' reputation plays a role in the analyst's career outcome); *see also* Andrew R. Jackson, *Trade Generation, Reputation, and Sell-Side Analysts,* 60 The Journal of Finance 2, 673–717 (Apr. 1, 2005) *see also* Lily Fang & Ayako Yasuda, *The Effectiveness of Reputation as a Disciplinary Mechanism in Sell-Side Research,* 22 The Review of Financial Studies 9, 3735–3777 (Sept. 1, 2009) (''Fang and Yasuda Article'')

[302] For a discussion of the role of reputation in financial intermediation, *see* Thomas J. Chemmanur & Paolo Fulghieri, *Investment Bank Reputation, Information Production, and Financial Intermediation,* 49 The Journal of Finance 1, 57–79 (1994) (''Chemmanur and Fulghieri Article''). *See also* Fang and Yasuda Article, *supra* note 301 (analyst reputation mitigates bias, but institutional reputation does not).

[303] *See* Mehran, Hamid, and René M. Stulz, *The Economics of Conflicts of Interest in Financial Institutions,* 85 Journal of Financial Economics 2, 267–296 (Aug. 1, 2007) (''Mehran and Stulz Article''). We note however, that this model has been disrupted by the European MiFID II regulations that took effect in 2018. *See e.g.* CFA Institute, MiFID II: A New Paradigm for Investment Research, *available at https://www.cfainstitute.org/-/media/documents/support/advocacy/mifid_ii_new-paradigm-for-research-report.ashx*

[304] Institutional customers are valuable in that they are willing to pay for brokers-dealers' additional services (*e.g.,* research). Payments for such services need not be direct and may be reflected in (relatively) higher brokerage commissions. *See* Michael A. Goldstein, Paul Irvine, Eugene Kandel & Zvi Wiener, *Brokerage Commissions and Institutional Trading Patterns,* 22 The Review of Financial Studies 12, 5175–5212 (Dec. 1, 2009).

[305] *See id. See also* Ulrike Malmendier & Devin Shanthikumar, *Are Small Investors Naive about Incentives?,* 85 Journal of Financial Economics 2, 457–489 (Aug. 1, 2007) (''Malmendier and Shanthikumar Article'') (institutions account for bias in analysts' recommendations while retail investors do not).

[306] *See supra* section III.B.1.c.

[307] *See* Mehran and Stulz Article, *supra* note 303.

investment funds.[308] Because institutional investors are not major investors in covered investment funds,[309] we believe they are unlikely to provide market discipline in this context.[310]

We also acknowledge that biases resulting from conflicts of interest need not adversely impact investors if investors disregard,[311] discount,[312] or de-bias [313] the recommendations of conflicted analysts.[314] We believe however, that retail investors who are primary clientele for covered investment funds are less likely to be aware of potential bias in analysts' recommendations,[315] may fail to de-bias or otherwise condition their trades based on the credibility of the recommendation,[316] and could thus be led to invest in underperforming securities.[317]

2. Rule 139b

As discussed above, rule 139b conditions eligibility for the safe harbor on satisfaction of several conditions.[318] These conditions are generally modeled on and resemble similar provisions in rule 139 (with differences from rule 139 that the FAIR Act specifically directs, or that tailor the provisions of rule 139 more directly or specifically to the context of covered investment fund research reports).[319] We believe that modeling rule 139b on rule 139 will benefit market participants through regulatory consistency. We address these conditions in turn in the sections that follow.

a. Affiliate Exclusion

Under the affiliate exclusion of rule 139b,[320] a broker-dealer who is an affiliate of a covered investment fund (or is an investment adviser or an affiliated person of the investment adviser to a covered investment fund), would not be eligible for the safe harbor of rule 139b when publishing or distributing a research report about that covered investment fund. The economic benefit of the affiliate exclusion is that it reduces the potential for retail investors to receive research reports containing information that was published, distributed, authorized, or approved by persons whose financial incentives create the greatest conflicts of interest.[321] The primary cost of the affiliate exclusion will be borne by broker-dealers that both distribute covered investment funds and act as investment advisers to such funds (or do so through affiliated persons). These broker-dealers will be unable to provide research reports to their customers on funds that they (or their affiliated persons) advise.[322] In addition, we believe that smaller broker-dealers, and broker-dealers without significant research departments and who would want to rely on pre-publication materials distributed by a covered investment fund, its adviser, or affiliated persons, would also be significantly affected by the new rules.

We expect covered investment funds and their investment advisers to engage in a broad range of marketing activities to support the distribution of fund shares (particularly in the case of redeemable securities such as those issued by mutual funds), and that funds and their advisers prepare and distribute materials to distributing broker-dealers intended to increase sales. The affiliate exclusion and associated guidance [323] will reduce the potential for retail investors to receive research reports containing materials from persons whose financial incentives create the greatest conflicts of interest.[324]

The affiliate exclusion is also likely to limit the benefits of the rule for certain broker-dealers. Many broker-dealers distributing covered investment fund securities do not have sizeable research departments, and we understand that very few broker-dealers operate at a scale that would allow for comprehensive coverage of the covered investment funds that they distribute. We believe that under the affiliate exclusion, it would be inappropriate for such broker-dealers to publish or distribute research report provided by a covered investment fund or the fund's affiliates.[325] Thus, the affiliate exclusion could have the effect of limiting broker-dealers' ability and willingness to publish and distribute research reports about the funds they distribute: In order to rely on the rule to publish or distribute a covered investment fund research report, these broker-dealers would need to conduct their own research in-house or to rely on independent third-party service providers for their information.

[308] Traditional analyst research reports on operating companies largely focus on firm-specific factors, and thus are more akin to ''stock picking'' than ''market timing'': They attempt to forecast the idiosyncratic component of firms' future returns. Covered investment funds represent portfolios of securities and diversification effects reduce the amount of idiosyncratic variation in their returns. Thus, abstracting from fees, ''fund picking'' is more akin to ''market timing'' than ''stock picking.'' Market timing is a skill that is relatively rare and econometrically difficult to detect. *See, e.g.,* Kent Daniel, Mark Grinblatt, Sheridan Titman & Russ Wermers, *Measuring Mutual Fund Performance with Characteristic-Based Benchmarks,* 52 The Journal of Finance 3, 1035–1058 (July 1997).

[309] *See supra* section III.B.1.a.

[310] *See* Alexander Ljungqvist, Felicia Marston, *et al., Conflicts of Interest in Sell-Side Research and the Moderating Role of Institutional Investors,* 85 Journal of Financial Economics 2, 420–456 (Aug. 1, 2007) (securities of interest to institutional investor receive coverage that is less biased).

[311] *See* Dugar and Nathan Article, *supra* note 272.

[312] *See* Michaely and Womack Article, *supra* note 273.

[313] *See* Lin and McNichols Article, *supra* note 272.

[314] Institutional market participants generally attribute bias in sell-side analysts' research reports to conflicts of interest. *See* Michaely and Womack Article, *supra* note 273.

[315] *See* Michael B. Mikhail, Beverly R. Walther & Richard H. Willis, *When Security Analysts Talk, Who Listens?,* 82 The Accounting Review 5, 1227–1253 (2007) (''Mikhail Walther and Willis Article''). *See also* Diane Del Guercio & Paula A. Tkac, *Star Power: The Effect of Morningstar Ratings on Mutual Fund Flow,* 43 Journal of Financial and Quantitative Analysis 4, 907–936 (Dec. 2008) (retail investors in mutual funds are very sensitive to fund rankings). *See* Christopher R. Blake & Matthew R. Morey, *Morningstar Ratings and Mutual Fund Performance,* 35 The Journal of Financial and Quantitative Analysis 3, 451–483 (2000) (mutual fund ranking have little predictive power for future performance).

[316] *See id.;* Malmendier and Shanthikumar Article, *supra* note 305.

[317] *See* Mikhail Walther and Willis Article, *supra* note 315. *See also* Malmendier and Shanthikumar Article, *supra* note 305. *See also* Amanda Cowen, Boris Groysberg & Paul Healy, *Which Types of Analyst Firms Are More Optimistic?,* 41 Journal of Accounting and Economics 1, 119–146 (Apr. 1, 2006) (finding that analysts at retail brokerage firms are more optimistic than those serving only institutional investors). *See* Xuanjuan Chen, Tong Yao & Tong Yu, *Prudent Man or Agency Problem? On the Performance of Insurance Mutual Funds,* 16 Journal of Financial Intermediation 2, 175–203 (Apr. 1, 2007) (underperformance of mutual funds sponsored by insurance companies is attributed to inadequate monitoring by less sophisticated retail customers who are subject to cross-selling efforts by their insurer). *See also* Daniel Bergstresser, John M. R. Chalmers, and Peter Tufano, *Assessing the Costs and Benefits of Brokers in the Mutual Fund Industry,* 22 Review of Financial Studies 10, 4129–4156 (Oct. 2009) (broker-sold mutual funds deliver lower risk-adjusted returns (even before subtracting distribution fees) than direct-sold funds). *See also* Diane Del Guercio & Jonathan Reuter, *Mutual Fund Performance and the Incentive to Generate Alpha,* 69 The Journal of Finance 4, 1673–1704 (Aug. 1, 2014) (underperformance of actively managed mutual funds is attributed to the underperformance of funds sold by brokers; the authors find little evidence for underperformance in the subset of funds that are sold directly to investors).

[318] *See supra* section II.B.

[319] *See supra* paragraph accompanying notes 12–15.

[320] *See* section 2(f)(3) of the FAIR Act. *See supra* section II.A.1.

[321] *See supra* section III.C.1.b.

[322] *See supra* notes 18–21 and accompanying text.

[323] *See supra* section II.A.1.

[324] Persons covered by the affiliate exclusion may have strong financial interests to increase sales of associated covered investment funds. *See supra* paragraph accompanying note 278.

[325] Among other things, we believe it would be inappropriate for any person covered by the affiliate exclusion, or for any person acting on its behalf, to publish or distribute a research report indirectly that the person could not publish or distribute directly under the rule. *See supra* paragraph accompanying note 30.

b. Regular-Course-of-Business Requirement

Under rule 139b, research reports (both issuer-specific research reports and industry research reports) need to be published or distributed by the broker-dealer in the ''regular course of its business'' in order to rely on the safe harbor.[326] For issuers that do not have a class of securities in ''substantially continuous distribution,'' issuer-specific research reports that represent the initiation of publication of research reports about the issuer or its securities or reinitiation following discontinuation of publication of such research reports would be deemed to not satisfy the regular-course-of-business requirement.[327] The regular-course-of-business requirement of rule 139b is similar to that of rule 139, except that, as directed by the FAIR Act, rule 139b specifies that the ''initiation or reinitiation requirement'' only applies to research reports regarding a covered investment fund that does not have a class of securities in substantially continuous distribution.[328]

Given the breadth of the definition of ''research report'' under the FAIR Act (and the definition of ''research report'' that we are adopting under rule 139b), certain communications that are currently treated as covered investment fund advertisements under Securities Act rule 482 could fall under the rule 139b definition of ''research report.''[329] Investors, particularly retail investors, may be unaware of the differences in regulatory status and purpose among the various types of communications regarding registered investment companies and BDCs. This may result in investors not being able to readily discern what constitutes a research report and what constitutes an advertisement about these issuers. We continue to believe 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.[330] Therefore, in principle we expect this requirement to benefit investors by reducing opportunities for communications published or distributed under the safe harbor to cause confusion about their intended purpose. However we also believe that establishing whether a research report is published in the ''regular course of business'' could, in practice, prove uniquely challenging in the covered investment funds context.[331]

First, in the context of covered investment funds, the distinction between communications intended as sales materials and those intended as research could be difficult to discern. Research reports about debt and equity securities have traditionally been provided to institutional customers as part of the broker-dealer's collection of services.[332] Institutional customers are generally capable of producing similar reports, and so can more readily evaluate the quality of broker-dealers' research.[333] In these circumstances, broker-dealers have a compelling business rationale for producing high-quality research as distinct from sales materials.

In contrast, we expect covered investment fund research reports to be produced by broker-dealers that distribute covered investment funds to retail investors.[334] Thus, we believe that cultivating a reputation for high-quality research is less likely to serve as the primary business rationale for broker-dealers' publication and distribution of research reports on covered investment funds. Rather, we expect that facilitating the marketing of covered investment funds to customers (so as to increase revenues derived from distribution arrangements) will motivate these activities. In this setting, the distinction between different types of communications will not be as clear.

Second, the information environment surrounding covered investment funds further complicates establishing whether publishing research reports about covered investment funds is undertaken in the regular course of business. In the context of research reports about operating companies, a research analyst ''following'' an operating company continually monitors that company so as to provide timely forecasts and recommendations. Because of differences in the nature of covered investment funds and operating companies, we believe that the same is less likely to hold for a research analyst ''following'' a covered investment fund.[335] We believe that the opportunities for acquiring idiosyncratic information relevant to future returns of covered investment funds are generally more limited: Covered investment funds represent portfolios of securities and diversification effects reduce the value of idiosyncratic (*i.e.,* firm-specific) information.[336] Consequently, we expect research analysts ''following'' covered investment funds to focus instead on information related to fund characteristics (*e.g.,* fees, portfolio composition, or index tracking strategy) and on developments at the sector- or macro-level. Because we do not expect the arrival of such information to be as frequent, we expect that the inclusion of new analysis in research reports about covered investment funds could be more rare than in the context of operating company research reports. Consequently, the publication or distribution of covered investment fund research reports could occur relatively infrequently, or could be driven largely by market-wide factors. This could make it more difficult to establish whether a covered investment fund research report is published in the regular course of business.

We noted in the Proposing Release that due to the aforementioned distinctions in the information environment and business rationale, we believed that the regular-course-of-business requirement in the context of rule 139b may be more challenging to apply in practice than the regular-course-of-business requirement in the context of rule 139 and that the potential benefits of this requirement in rule 139b may be more limited. We also noted that the effects of the regular-course-of-business requirement would be clearer in cases where, in the case of issuer-specific research reports, the bright-line ''initiation or reinitiation'' requirement applies (*i.e.,* where the covered investment fund does not have a class of securities in substantially continuous distribution). For such cases, the regular-course-of-business requirement would condition the availability of the safe harbor on the research report not representing the initiation or reinitiation of coverage by the broker-dealer publishing or distributing said research report. However, because the universe of covered investment funds is dominated

[326] *See supra* sections II.B.1.c and II.B.2.b.

[327] *See supra* notes 112–114 and accompanying text.

[328] *See* section 2(b)(1) of the FAIR Act; *see also supra* note 101 and accompanying text.

[329] *See supra* note 162 and accompanying text.

[330] *See* Proposing Release, *supra* note 2, at 26797.

[331] *See* Proposing Release, *supra* note 2, at 26797–98 (requesting comment on the application of the regular-course-of-business requirement in the context of broker-dealers' publication or distribution of covered investment fund research reports and unique concerns relevant to this context (*e.g.,* whether the requirement should be modified to address broker-dealers that have not previously published or distributed covered investment fund research reports)).

[332] *See* Mehran and Stulz Article, *supra* note 303.

[333] *See id; see also* Malmendier and Shanthikumar Article, *supra* note 305.

[334] *See supra* section III.B.1.c.

[335] The regular-course-of-business requirement generically requires ''research reports'' to be published or distributed in the regular course of a broker-dealer's business and is not limited to covered investment fund research reports. *See* Proposing Release, *supra* note 2, at 26797.

[336] *See supra* notes 267–268 and accompanying text.

by funds with a class of securities that could be considered to be in substantially continuous distribution,[337] the bright-line test of the regular-course-of-business requirement would impact only a small subset of funds.

Related concerns were voiced by several commenters who questioned the feasibility of satisfying the regular-course-of-business requirement under the proposed rules.[338] As discussed above, we have included additional guidance to mitigate concerns about the interpretation of the regular-course-of-business requirement.[339] While we believe that this guidance should address commenters' concerns about the feasibility of satisfying the regular-course-of-business requirement, we acknowledge that—due to the reasons discussed above—broker-dealers evaluating whether their research activities satisfy the regular-course-of-business requirement are likely to face more uncertainty when those activities relate to covered investment funds than when those activities relate to operating companies. However, we believe that broker-dealers would only issue covered investment fund research reports if the benefits are likely to outweigh the costs, including uncertainty.

c. Reporting History and Minimum Market Value Requirements for Issuers Appearing in Issuer-Specific Research Reports

Under rule 139b, a broker-dealer's publication or distribution of issuer-specific research reports does not qualify for the safe harbor unless the covered investment fund included in the report satisfies a minimum public market value threshold of $75 million.[340] Issuers are also required to have been subject to the reporting requirements of the Investment Company Act (for covered investment funds that are registered investment companies) or the reporting requirements under section 13 or section 15(d) of the Exchange Act (for covered investment funds that are not registered investment companies) for a period of at least 12 calendar months prior to reliance on the rule as well as to have timely filed all required reports during the preceding 12 calendar months.[341]

The covered investment funds market is dynamic.[342] In 2017, more than six hundred covered investment funds entered the market, while more than eight hundred exited. The entry and exit of covered investment funds creates a situation in which a younger covered investment fund may not be widely followed by market participants.[343] Thus, for covered investment funds, the universe of young—and potentially less-followed—issuers is large.[344] Moreover, securities issued by covered investment funds may not be subject to significant levels of market scrutiny. Unlike securities issued by operating companies (that generally have diverse groups of investors, including institutional investors, money managers, arbitrageurs, activist investors, and short sellers), covered investment funds are primarily held by retail investors.[345] As covered investment fund shares are not a major component of institutional investors' portfolios, we believe that they are less likely to garner wide-spread attention from the types of sophisticated institutional investors most capable of subjecting them to scrutiny.[346]

We believe that in the context of covered investment funds, where we expect limited market discipline from institutional investors and where large numbers of new funds are created each year, the information available to investors could be sparse. In such an environment, a single research report about a covered investment fund could have a disproportionate effect on retail investors' beliefs about the fund and—in the case of a biased research report—have a negative effect on investor welfare. We believe that conditioning the availability of the safe harbor on the aforementioned reporting history and market valuation requirements would help restrict the availability of the safe harbor in situations where we expect the information environment to be most limited: For new funds and for funds with limited trading or interest.[347]

As noted by several commenters, because young and small covered investment funds are relatively common, the costs associated with these conditions on the availability of a safe harbor could be significant.[348] In particular, as shown in Table 1, the $75 million minimum public market valuation condition will limit the availability of the safe harbor with respect to broker-dealers' publication or distribution of research reports for approximately one-third of all covered investment funds.[349] Research reports about nearly half of extant ETFs, ETPs will not qualify for the safe harbor.[350] Availability of the safe harbor would be least impacted for research reports about BDCs and closed-end funds.[351]

Although small funds represent a very small fraction of covered investment fund assets, they are relatively large in number.[352] Because nearly one-third of covered investment funds will not satisfy the eligibility criteria for the safe harbor, we believe that those funds will be less likely to receive coverage by broker-dealers insofar as the inability to rely on the safe harbor reduces broker-dealers' willingness to publish and distribute research reports.

[337] *See supra* section III.B.1.a.

[338] *See supra* sections II.B.1.c, II.B.2.b.

[339] *See supra* paragraph accompanying note 118.

[340] *See* rule 139b(a)(1)(i)(B).

[341] Including Forms N–CSR, N–Q, N–PORT, N–MFP, and N–CEN as applicable for registered investment companies, and Forms 10–K, 10–Q, and 20–F as applicable for covered investment funds that are not registered investment companies. *See* rule 139b(a)(1)(i)(A).

[342] *See supra* section III.B.1.a.

[343] In contrast, there were fewer than one hundred U.S. IPOs for operating companies in 2016. *See* Jay Ritter, Initial Public Offerings: Updated Statistics (Aug. 8, 2017), *available at https://site.warrington.ufl.edu/ritter/files/2017/08/IPOs2016Statistics.pdf.*

[344] For example, Morningstar notes that funds with short track records are unlikely to be provided coverage. *See* Morningstar, Morningstar Manager Research Coverage Decision-Making (June 2018), *available at https://morningstardirect.morningstar.com/clientcomm/Morningstar_Manager_Research_Coverage_Decision_Making.pdf.*

[345] *See supra* section III.B.1.a.

[346] *See supra* note 310 and accompanying text.

[347] For example, while Morningstar provides analyst ratings for 200 ETFs and 1,562 open-end funds, among ETFs and open-end funds falling below the $75 million minimum public market value threshold, only 27 received an analyst rating. *See supra* notes 243 and 344.

[348] *See* SIFMA Comment Letter I; ICI Comment Letter; Fidelity Comment Letter; *see also* BlackRock Comment Letter.

[349] 30% of all covered investment funds have public market valuations less than $75 million. *See* Table 1.

[350] 41% of ETF and ETPs have public market valuations less than $75 million. *See* Table 1.

[351] 12% of closed-end funds and 7% of BDCs have public market valuations less than $75 million. *See* Table 1.

[352] *See* Table 1.

TABLE 1—COVERED INVESTMENT FUNDS WITH PUBLIC MARKET VALUE LESS THAN $75 MILLION, AND THE FRACTION OF COVERED INVESTMENT FUND ASSETS HELD BY THESE FUNDS

[For each covered investment fund type, we report the percentage of funds of that type with a public market value below $75 million and the percentage of covered investment fund assets held in funds with public market values below $75 million. Mutual fund, ETF, and ETP statistics are based on data from CRSP mutual fund database (2017Q3). Close-end fund statistics are based on data from CRSP monthly stock file (Dec. 2017). BDC statistics are based on Commission's listing of registered BDCs, and regulatory filings (2017) compiled by Compustat and Audit Analytics]

Covered investment fund type	Funds with public market value <$75 million	
	Number of funds (%)	Fund assets (%)
Open-end	30	<1
Closed-end	12	<1
ETF/ETP	41	<1
BDC	7	<1
Total	30	<1

Several commenters raised concerns that—in addition to the aforementioned costs—compliance with the reporting history and minimum market value requirements as proposed could be operationally challenging for broker-dealers.[353] In general, we do not believe that verifying covered investment funds' reporting history and public market valuation represents a significant additional burden for broker-dealers in this position.[354]

Another commenter noted that some broker-dealers provide investors research about large numbers of funds on a largely automated basis, and that ensuring compliance with the reporting history and minimum public market value requirements would create ''operational hurdles'' for these broker-dealers.[355] We believe that broker-dealers that choose to automate publication of research reports will make significant investments in technology to implement this automation, and that broker-dealers with infrastructure capable of automating publication of research reports should have little difficulty implementing the procedures required for similarly automating the verification of these requirements.[356] However, in a change from the proposal, final rule 139b will not require the minimum public market valuation condition to be verified at the time of reliance.[357] Rather, the final rule requires that this condition be satisfied at the time of the broker's or dealer's first publication or distribution of a research report on the covered investment fund, and at least quarterly thereafter.[358] We believe this change should simplify compliance without materially affecting the provisions' effectiveness.[359]

Finally, one commenter raised concerns that because of shortcomings in the data currently available about affiliates' holdings, it may not be possible for broker-dealers to establish the public market value of a covered investment fund if affiliate holdings are to be excluded from the calculation.[360] Although we believe that that the information required to make this calculation may be available to broker-dealers, we understand that it may not currently be generally available in a structured form amenable to automation. This could present operational difficulties for broker-dealers developing processes for automated report publication. In a change from the proposal, final rule 139b eliminates the requirement that the public market valuation calculation be calculated net of affiliates' holdings for most covered investment funds. We believe that this change is unlikely to materially affect the effectiveness of the minimum public market value requirement[361] while eliminating a plausible obstacle to its automated verification in the vast majority of cases. We acknowledge, however, that retaining the requirement to adjust for affiliate holdings in the public market valuation calculation for commodity- and currency-based trusts could reduce the amount of automated coverage provided to such trusts by broker-dealers.[362]

d. Reporting Requirement for Issuers Appearing in Industry Reports

Under rule 139b an industry research report could only include covered investment funds that are required to file reports pursuant to section 30 of the Investment Company Act (or, for covered investment funds that are not registered investment companies under the Investment Company Act, required to file reports pursuant to section 13 or section 15(d) of the Exchange Act).[363] As discussed above, these conditions generally track parallel conditions under rule 139, but have been modified so that they would be applicable with respect to covered investment fund issuers. We do not expect these conditions to have economic effects

[353] *See* SIFMA Comment Letter I; *see also* Fidelity Comment Letter.

[354] For example, much of this information is currently accessible through the publicly available EDGAR system and/or third-party data providers.

[355] *See* Fidelity Comment Letter; *see also* paragraphs accompanying *supra* notes 64, 73.

[356] We note that a software system capable of automatically generating non-trivial research reports about a given covered investment funds would contain data access modules providing programmatic access to the covered investment fund's historical filings and pricing data. Conditional on the existence of such modules, implementation of tests for the reporting history and minimum market value requirements would represent a *de minimis* cost.

[357] *See supra* section II.B.1.b.

[358] *See* rule 139b(a)(1)(i)(B).

[359] We believe that implementing periodic assessments would be simpler and less costly than implementing an assessment at the time of reliance. At the same time, we do not believe that there would be a material difference in the set of covered investment funds captured by the minimum public valuation threshold under these two approaches. *See supra* paragraph accompanying note 104.

[360] *See* SIFMA Comment Letter II.

[361] Covered investment funds are subject to unique legal provisions that generally restrict affiliate ownership and provide additional legal protections when affiliate ownership is permitted. *See, e.g.,* Investment Company Act sections 12, 17, and 57 and rules thereunder. In addition, unlike rule 139, rule 139b does not permit affiliates of covered investment funds to rely on the safe harbor, mitigating the risk that a fund with significant affiliate holdings would be the subject of market moving research by those same affiliates.

[362] *See supra* note 99.

[363] *See* rule 139b(a)(2)(i). As discussed previously, each issuer included in an issuer-specific research report also would be required to be subject to these reporting requirements, as well as the requirement to have filed in a timely manner all of the periodic reports required to be filed during the preceding 12 calendar months. *See supra* section II.B.1.a.

beyond marginally improving economic efficiency by more closely aligning regulations with their intended context.

e. Content and Presentation Requirements for Industry Research Reports

Under rule 139b, the content and presentation standards for industry research reports of rule 139 are tailored to the context of covered investment funds. Under rule 139b (and rule 139), issuers appearing in industry research reports are subject to fewer conditions than issuers that are subjects of issuer-specific research reports.[364] We believe that in the absence of content and presentation requirements such as these, an industry research report could be used to circumvent the conditions associated with the safe harbor available for issuer-specific research reports. We therefore believe that the content and presentation standards we are adopting have benefits similar to those of the parallel content and presentation requirements in rule 139, and provide meaningful limits for industry research reports.[365]

We believe the compliance costs imposed by these requirements on the production of industry research reports would be low, particularly as broker-dealers are already familiar with similar conditions in rule 139, making implementation of presentation conditions for industry research reports on covered investment funds less burdensome.

f. Presentation of Performance Information

Given the definition of ''research report'' under the FAIR Act (and the definition of ''research report'' being adopted under rule 139b), certain communications by broker-dealers that historically have been treated as advertisements for registered investment companies under rule 482 now could be distributed as covered investment fund research reports under the rule 139b safe harbor.[366] In the Proposing Release, we raised concerns that not including provisions similar to rule 482 in proposed rule 139b could result in investors receiving communications about covered investment funds where the character of the communication (*i.e.,* bona fide research versus advertising) is unclear.[367] Conflicts of interest resulting from broker-dealers' financial incentives could affect the manner in which performance data is presented in research reports, potentially leading to misleading presentation of performance data. In addition, investors could be confused if performance is presented differently in an advertisement and in a research report, particularly if the research report doesn't adequately disclose the methodologies used to produce the performance that could explain the differences. Retail investors, in particular, may be unable to assess the non-standardized performance figures when considering their investment decisions.

As discussed above, unlike in the Proposing Release, final rule 139b incorporates provisions on the presentation of performance information in research reports about registered investment companies that mirror those of rule 482 and—with respect to closed-end funds—Form N–2.[368] Incorporating these presentation standards in rule 139b reduces the potential for confusion between (i) registered open-end management investment company advertisements and selling materials covered by rule 482 and registered closed-end investment company selling materials covered by Form N–2 and (ii) rule 139b research reports.[369] Additionally, incorporating some of these provisions into rule 139b would reduce the potential for investor confusion resulting from divergent standards in the presentation of performance data.

Because fees can represent a significant drag on investment returns,[370] because different performance measures may be more or less favorable at different times, and because retail investors are known to be sensitive to past performance data,[371] we believe that the manner in which past performance data is presented can be an important factor driving investors' investment decisions. As discussed above, even unaffiliated broker-dealers may have incentives, stemming from funds' distribution arrangements, to promote a covered investment fund, or to promote certain funds over others.[372] When broker-dealers publish or distribute research reports on covered investment funds, their choices with respect to how fees are disclosed, which performance measures are quoted, and for what time periods could be affected by these considerations. This in turn can adversely affect investors, particularly unsophisticated investors. We believe that these additional requirements on the presentation of performance information will limit opportunities for selective performance disclosure and will curtail opportunities to circumvent the performance reporting requirements of rule 482 and Form N–2.

By limiting opportunities for selective performance disclosure, we believe that final rule 139b will also reduce the potential for investor confusion. Under the final rule, there will be fewer opportunities for the performance disclosure in registered investment company advertisements and research reports to diverge. There also could be less potential for investor confusion when comparing research reports about different covered investment funds, or reports issued by different broker-dealers. These results would benefit investors. As discussed in the Proposing Release, the extent of the benefits resulting from requirements on the presentation of performance information depends on their effectiveness in ensuring consistent disclosure and/or alerting investors to factors that could influence their understanding of the disclosure in a research report. The extent of the benefit also would depend on the audience who will be reading research reports about registered investment companies. As discussed in the Proposing Release, we believe that retail investors would generally be less likely to be able to identify sources of bias (and disregard or discount bias) in communications about covered investment funds than institutional investors and therefore could benefit from limitations on selective performance disclosure. We believe that rule 482 standards on the presentation of performance information have been effective at limiting selective disclosure in applicable registered investment company advertisements, and that they will be similarly effective for research reports falling under rule 139b. Moreover, as noted above, we believe that retail investors will be the primary consumers of such research reports, and that such investors would be most likely

[364] *See supra* sections II.B.1, II.B.2.

[365] *See supra* sections II.B.2.c, II.B.2.d.

[366] *See supra* note 162 and accompanying text. Similarly, ''research reports'' regarding covered investment funds that broker-dealers today might publish or distribute as ''supplemental sales literature'' under Investment Company Act rule 34b–1 (which must be preceded or accompanied by a statutory prospectus) could be distributed as covered investment fund research reports under rule 139b. *See supra* note 165 and accompanying text.

[367] *See* Proposing Release, *supra* note 2, at 26825.

[368] Rule 482 does not set forth requirements on the presentation of performance information in research reports about registered closed-end investment companies. *See supra* section II.C.

[369] *See supra* paragraph accompanying notes 165–167.

[370] *See, e.g.,* Mark M. Carhart, *On Persistence in Mutual Fund Performance,* 52 The Journal of Finance 1, 57–82 (Mar. 1997).

[371] *See* Erik R. Sirri & Peter Tufano, *Costly Search and Mutual Fund Flows,* 53 The Journal of Finance 5, 1589–1622 (Oct. 1, 1998).

[372] *See supra* section III.C.1.b.

to benefit from these additional provisions.

As discussed in the Proposing Release, we believe that the most significant costs associated with additional requirements on the manner in which performance information may be presented would result from their potential to limit the manner in which the content of broker-dealers' research reports is presented. Although we are not preventing alternative performance measures from being included in research reports, by limiting the prominence afforded to such performance measures we could adversely affect broker-dealers' ability to provide valuable analysis. For example, a broker-dealer who wishes to center its analysis on a fund's risk-adjusted returns would be limited in how such information could be presented in the report, even though certain audiences for research reports could consider this information to be particularly relevant.

We believe that broker-dealers' direct compliance costs under these additional provisions would be minimal. Because we believe that broker-dealers that will publish research reports are likely currently distributing advertisements under rule 482, these broker-dealers likely already have processes and systems to produce charts and tables of performance measures using timely data under the presentation standards required by the final rules. However, we acknowledge that the final rules' will impose costs on broker-dealers that did not previously distribute advertisements under rule 482 and they would need to develop processes and systems to implement these presentation standards. We estimate the one-time implementation costs attributable to the new presentation standards for each broker-dealer publishing research reports to be approximately 5 hours or $1,310.[373] Further, we expect the systems necessary to satisfy the requirement for timely data under rule 482(g) would generally be available to broker-dealers publishing research reports.

3. Rule 24b–4

Rule 24b–4 excludes a covered investment fund research report from the coverage of section 24(b) of the Investment Company Act and the rules and regulations thereunder, except to the extent that such report is not subject to the content provisions of SRO rules related to research reports, including those contained in the rules governing communications with the public regarding investment companies or substantially similar standards. As discussed above, this rule is meant to implement section 2(b)(4) of the FAIR Act, which we interpret to exclude covered investment fund research reports from section 24(b) of the Investment Company Act so long as they continue to be subject to the general content standards in FINRA rule 2210(d)(1).[374] For covered investment fund research reports that are published or distributed by FINRA member firms, all such research reports would be subject to the content standards of FINRA rule 2210(d)(1), and thus we would interpret these research reports to be excluded from the Commission's filing requirements under the rule.[375]

As discussed above, where covered investment fund research reports would no longer be required to be filed with the Commission pursuant to section 24(b), rule 24b–4 could have the effect of narrowing the types of communications regarding registered investment companies that would be filed with FINRA (under current FINRA rule 2210).[376] However, we believe that administrative processes related to handling regulatory reviews of communications subject to filing requirements impose costs on broker-dealers, which in turn can reduce their willingness to publish and distribute such communications. Consequently, although we do not believe that limiting these filing requirements as required by the FAIR Act represents a first-order economic effect of the new rules, we believe that doing so will reduce administrative costs for broker-dealers publishing or distributing covered investment fund research reports. At the same time, as discussed above, we believe that eliminating these filing requirements may have the result that some communications that are were subject to FINRA's filing requirements would no longer be subject to routine review.[377] While these communications may still be reviewed by FINRA—for example, through examinations, targeted sweeps, or spot-checks—we believe that an effect of the FAIR Act, as implemented through rule 24b–4, may be to reduce the monitoring by FINRA and the Commission of broker-dealers' communications with customers for compliance with the applicable rules and regulations.[378]

4. Amendments to Rule 101 of Regulation M and Form 12b–25

As discussed above, rule 101 of Regulation M prohibits a person who participates in a distribution from attempting to induce others to purchase securities covered by the rule during a specified period.[379] However, rule 101 provides an exception for research activities that satisfy the conditions of Securities Act rule 138 or rule 139. The conforming amendment expands this exception to include research activities that satisfy the conditions of rule 139b. We believe that broker-dealers would generally be unable to make use of the rule 139b safe harbor absent this conforming amendment. Consequently, we do not consider its effects separately.

As discussed above, we are making 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.[380] The amendments to Form 12b–25 that the Commission is adopting are ministerial actions that correct outdated references and therefore will have no separate economic effect, including no effect on competition.

5. Effects on Efficiency, Competition, and Capital Formation

The primary effects on economic efficiency and capital formation resulting from rules 139b and 24b–4 obtain from the statutory mandates of the FAIR Act. Because financial intermediaries such as broker-dealers are generally assumed to possess some comparative advantage in the production of information about securities, efficiency considerations would—in the absence of significant market imperfections—dictate that broker-dealers should be active in the production of such information. To the extent that the increase in broker-dealers' production of research reports about covered investment funds—that we expect to occur as a result of the FAIR Act's statutory mandates [381]—is valuable to investors, we expect it to increase allocative efficiency, with

[373] Calculated as 5 hours × Senior Business Analyst at $262 per hour = $1.310. The hourly wage rate is from SIFMA's Management & Professional Earnings in the Securities Industry 2013, modified to account for an 1,800-hour work year; multiplied by 5.35 to account for bonuses, firm size, employee benefits and overheard; and adjusted to account for the effects of inflation.

[374] *See supra* note 183 and accompanying text.

[375] *See id.*

[376] *See id.*

[377] *See supra* section II.D.1.

[378] *But see supra* note 195 and accompanying text (noting 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''); *see also* section 2(c)(2) of the FAIR Act.

[379] *See supra* section II.E.

[380] *See id.*

[381] *See supra* section III.C.1.a.

attendant positive consequences on capital formation. As noted earlier, the existence of the safe harbor could provide increased opportunities for broker-dealers to publish and distribute research on funds from which they derive financial benefits.[382] To the extent that this could limit the value investors derive from research reports that broker-dealers publish and distribute, any potential gains to efficiency and improvements to capital formation could be reduced (or eliminated).

Beyond the aforementioned broader effects on efficiency and capital formation resulting from the FAIR Act's statutory mandates, we believe that the specific conditions [383] on the availability of the safe harbor in rule 139b will generally further economic efficiency and facilitate capital formation by reducing the potential for retail investors to receive research reports whose publication or distribution may be motivated by financial incentives that could cause a conflict of interest. We believe that the affiliate exclusion and related guidance will have the largest impact because it addresses the greatest conflicts of interests in this context: Those arising from broker-dealers in investment advisory relationships.[384] In addition, we believe that the Commission's various tailoring of the new rules to the covered investment fund context will yield marginal efficiency improvements from reductions in regulatory ambiguity.

With respect to competition, we believe that expansion of the rule 139 safe harbor will increase competition in the market for research reports on covered investment funds. Under the baseline, the market for research reports on covered investment funds is dominated by a small number of independent research firms, with few broker-dealers producing original research about such funds.[385] We believe that the availability of the safe harbor will encourage some broker-dealers to publish proprietary research on covered investment funds. However, due to the high costs associated with maintaining research departments capable of covering the large covered investment fund universe,[386] we believe that most broker-dealers will continue to rely on content licensed from independent firms.[387] We also believe that there are competitive implications stemming from the guidance we have given to address possible circumvention of the affiliate exclusion.[388] This guidance may have the effect of placing smaller broker-dealers—who may not operate at a scale large enough to sustain a research department—at a competitive disadvantage. These smaller broker-dealers may find that they are unable to compete with larger broker-dealers in the provision of ''original'' research about covered investment funds.

6. Alternatives Considered

We considered several alternative approaches to implementing the FAIR Act mandates that could satisfy the requirements of the FAIR Act. We summarize these here.

a. Conditions on Issuers Appearing in Issuer-Specific Research Reports

As discussed above, we believe that conditioning the availability of the safe harbor on the $75 million minimum public market value requirement will promote investor protection by limiting research reports to issuers that have a demonstrated market following.[389] However, we acknowledge that it will mean that research reports about significant numbers of smaller covered investment funds would not qualify for inclusion in research reports under the safe harbor.[390] We believe that this will reduce the effect of the new rules on the availability of research reports about smaller covered investment funds.[391]

Depending on the distribution of covered investment funds' public market values, a somewhat lower threshold could significantly increase the number of covered investment funds that qualify for inclusion in research reports without undermining investor protection (because it would not materially increase the number of qualifying funds without a demonstrated market following). Conversely, a significantly higher threshold could further promote investor protection without significantly decreasing the number of qualifying funds (however, as discussed below, we did not consider this alternative because the FAIR Act prevents us from conditioning the availability of the safe harbor on a minimum public market

[382] *See supra* section III.C.1.b.

[383] *See supra* section III.C.2.

[384] *See supra* section III.C.2.a.

[385] *See supra* section III.B.1.c.

[386] *See supra* section III.B.1.a.

[387] We expect that broker-dealers that choose to publish research on covered investment funds will generally not license it to their competitors.

[388] *See supra* section III.C.2.a.

[389] *See supra* section II.B.1.b.

[390] See SIFMA Comment Letter I; *see also* ICI Comment Letter; BlackRock Comment Letter.

[391] *See supra* section III.C.2.c.

value requirement that is greater than what is required under rule 139).

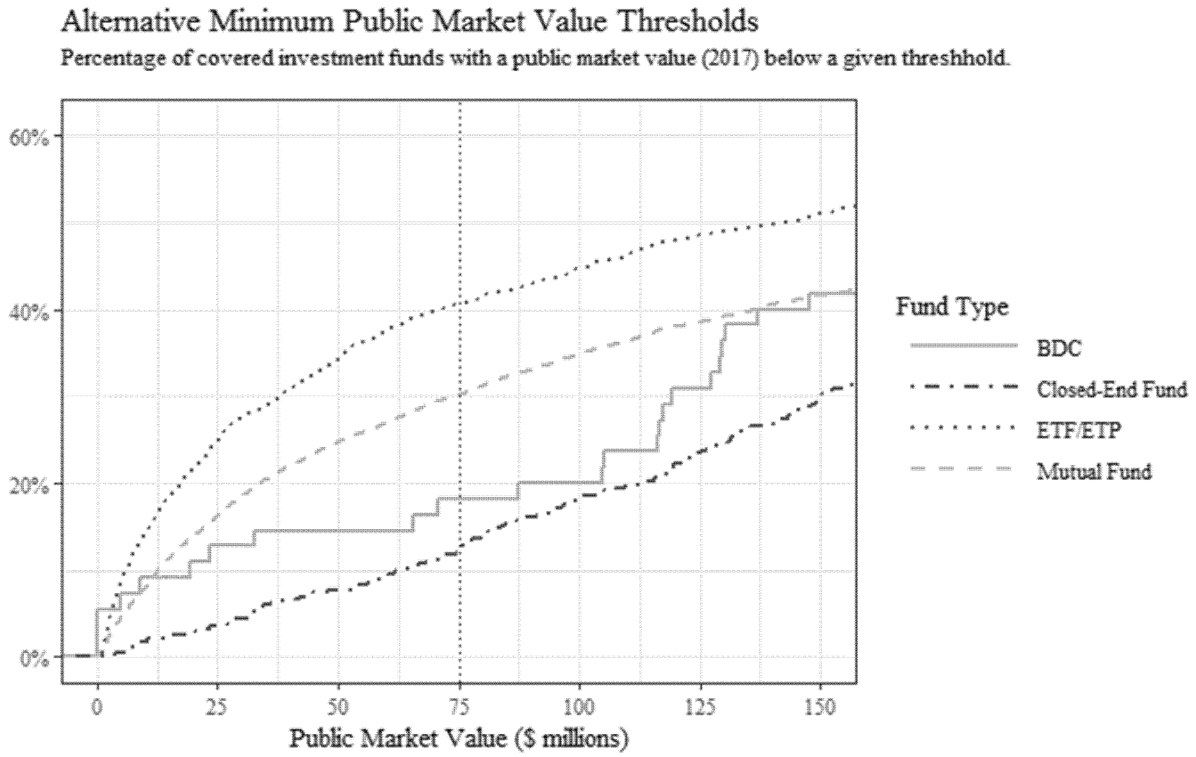

Figure 5: Percentage of covered investment funds with a public market value (2017) below a given threshold.

We have considered a range of alternative minimum public market values thresholds. Figure 5 plots the percentage of covered investment *funds* whose public market valuations would fall under each alternative threshold. Figure 5 shows that although the safe harbor would not be available to significant numbers of covered investment funds under the $75 million threshold, material increasing its availability would only be achievable through large reductions to the threshold. This is due to large numbers of funds being very small: As shown in Figure 6, over 600 covered investment funds have a public market valuation of $5 million or less. We do not believe that a significantly lower threshold would be effective at promoting investor protection because, as discussed above in section III.C.2.c, we expect the information environment to be more limited for smaller funds than for larger funds.[392] At the same time, we believe that imposing the threshold would only restrict the availability of research for covered investment funds that have small economic significance. As shown in Figure 7, covered investment funds falling below the $75 million threshold account for less than 1% of the dollars invested in each of the four covered investment fund types.

[392] One commenter suggested lowering the threshold to no more than $20 million; *see* SIFMA Comment Letter I. Another commenter noted that 41% of all ETFs and exchange-traded products would be excluded by the $75 million threshold; *see* Fidelity Comment Letter. Although these commenters argued that lowering the threshold could benefit investors by increasing the number of funds for which covered investment fund research reports were available, they did not address the question of the potential cost to investors resulting from a lower threshold. *See supra* section III.C.2.c.

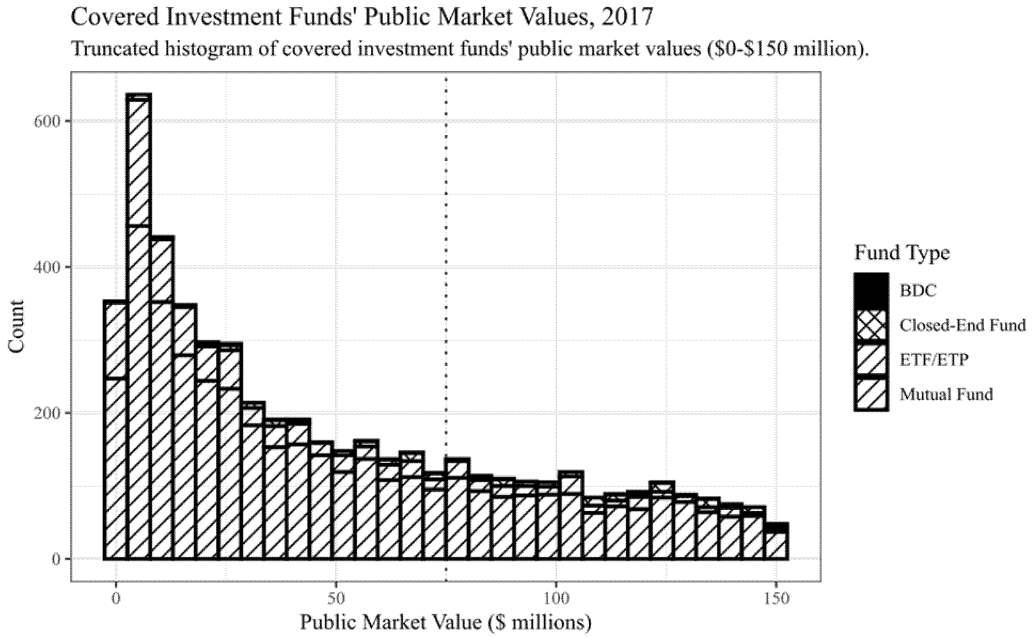

Figure 6: Truncated histogram of covered investment funds' public market values ($0–$150 million), 2017.

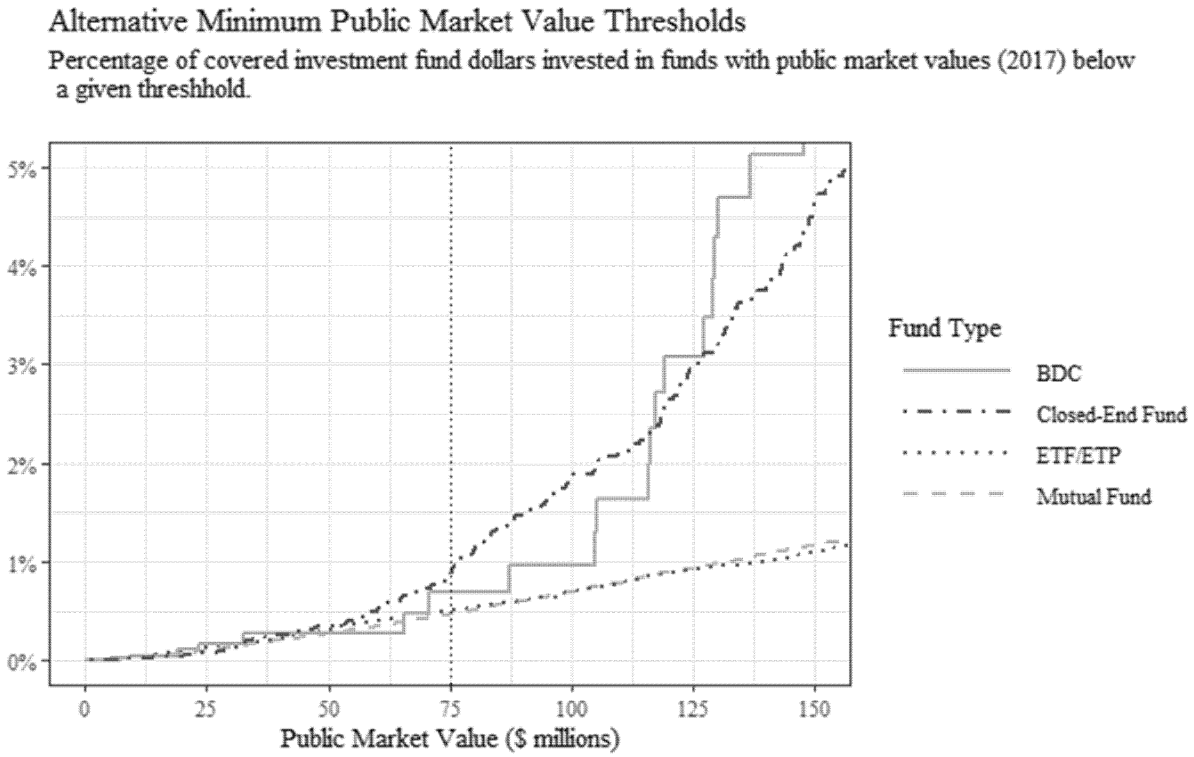

Figure 7: Percentage of covered investment fund dollars invested in funds with a public market value (2017) below a given threshold.

The FAIR Act prevents us from conditioning the availability of the safe harbor on a minimum public market value requirement that is greater than what is required under rule 139.[393] This effectively prevents us from conditioning the availability of the safe harbor for research reports on the subject covered investment fund having a public float of more than $75 million. Consequently, we do not consider

[393] *See supra* note 83 and accompanying text.

higher minimum public market value thresholds.

b. Conditions on Issuers Appearing in Industry Research Reports

(1) Applying Uniform Conditions on Issuers Appearing in Issuer-Specific and Industry Research Reports

With respect to conditions affecting the availability of the safe harbor for industry research reports, we considered applying to industry research reports the same requirements as would apply to issuer-specific research reports. As with the restrictions on issuer-specific research reports, similarly restricting industry research reports could help ensure that funds included in research reports are well-followed, and could restrict the availability of the safe harbor in situations where we expect the information environment to be most limited: For new funds and for funds with niche markets.

In the context of research reports about covered investment funds, cost-benefit considerations for including additional conditions on industry reports differ slightly from those that apply in the context of traditional research reports about equity and debt securities. In the context of research reports about equity and debt securities, analysis of an industry, in the case of operating companies, may require the discussion of specific firms within that industry. For example, a discussion about a mature industry (*e.g.,* automobiles) may require discussion of a disruptive new entrant (*e.g.,* autonomous vehicle start-up). In the context of the rule 139 safe harbor, the new entrant may not satisfy the reporting history and minimum float requirements. This would reasonably prevent an issuer-specific research report about the new entrant from qualifying for the safe harbor. However, it would not further the goal of facilitating coverage of the industry to limit the safe harbor for industry reports to reports that do not discuss the new entrant: Analysis of the industry may require discussion of specific issuers that would not qualify for inclusion in issuer-specific research reports.

In the context of covered investment funds, a similar rationale would not apply as broadly. Rule 139b content requirements for industry research reports would reference covered investment fund issuers of the same ''type or investment focus,'' rather than the issuers' ''industry or sub-industry'' (*i.e.,* a broad category of similar businesses).[394] Although it is clear that an industry research report about some covered investment fund types (*e.g.,* emerging growth bonds) may have reasons to include a discussion of issuers that may not be eligible for inclusion in issuer-specific research reports (*e.g.,* best-performing new fund), it is not clear that such reasons would rise to the level of requiring the discussion of such issuers. Unlike the effects of an operating company issuer on its ''industry,'' the effects of a covered investment fund issuer on its fund ''type'' is very limited.

(2) Allowing Affiliates To Appear in Comprehensive List of Recommended Issuers

We considered providing that a comprehensive list of recommended issuers may include issuers that are affiliates of the broker-dealer that is publishing or distributing the research report under certain circumstances, including: If affiliates were identified; if disclosure about the affiliated issuers were limited; or if any performance information included in a list that includes affiliated issuers were presented in accordance with rule 482.[395] Generally, we believe that including such provisions would benefit broker-dealers that play a significant role both as investment advisers to, and as distributors of, covered investment funds. However, as discussed above, we believe that broker-dealers publishing or distributing research reports about affiliated funds would have the potential for the most significant conflicts of interest.[396] Moreover, permitting affiliated funds to be included in such comprehensive lists could result in confusion: Broker-dealers would be able to offer recommendations for affiliated funds in industry research reports, but there would be no safe harbor enabling them to publish or distribute issuer-specific research reports (which could provide the basis for such recommendations) as a result of the affiliate exclusion.

c. Approach to Regular-Course-of-Business Requirement

As discussed in section III.C.2.b, in principle we expect a regular-course-of-business requirement to reduce opportunities for the safe harbor to be used in ways that lead to investor confusion. However, we also believe that in the context of covered investment funds, establishing whether a report is published in the ''regular course of business'' could present more challenges than in the rule 139 context of research reports about the securities of operating companies.[397] Thus, we requested comment on and have considered various alternative approaches to the regular-course-of-business requirements.[398] Specifically, we have considered that this requirement be defined more specifically to address, for example, circumstances in which a broker-dealer has not previously published or distributed research reports.[399] For example, we considered whether rule 139b should provide a ''start-up'' period to allow broker-dealers to establish a regular course of business of publishing research reports.[400] We have also considered requiring that the regular-course-of-business requirement incorporate more specific requirements regarding the persons preparing such reports (*e.g.,* that they must be employed by a broker-dealer to prepare such research in the regular course of his or her duties).[401]

Conditioning availability of the safe harbor on a broker-dealer's having published research reports for a given period of time, or on the broker-dealer's having operated for some amount of time, could lead to the publication of reports that are more likely to be recognized as research.[402] Moreover, we believe that broker-dealers with a longer operating history and those who have published research reports—relying on the existing rule 139 safe harbor or otherwise without relying on the safe harbor—will have made greater investments in their reputations. Such investments increase the reputational costs associated with the publication of research reflecting conflicts of interest, which as discussed above could mitigate the effects of conflicts of interest on research reports.[403]

In rule 139b, we have chosen not to incorporate these more specific alternative approaches to the regular-

[394] *See supra* section II.B.2.c.

[395] *See id.*

[396] *See supra* section III.C.1.b.

[397] *See supra* section II.B.2.b.

[398] *See* Proposing Release, *supra* note 2, at 26797–98. We did not receive comments specifically addressing the economic effects of alternative approaches to the regular-course-of-business requirement.

[399] *See id.*

[400] *See id.*

[401] *See id.*

[402] *See id.*

[403] *See* Chemmanur and Fulghieri Article, *supra* note 302; *see also supra* section III.C.1.b. However, we note that the efficacy of an institutional reputation mechanism has not found empirical support in related settings. *See* Fang and Yasuda Article, *supra* note 301 (where sell-side research analysts' reputation mitigates manifestation of conflicts of interest from underwriting relationships, while institutional reputation does not).

course-of-business requirement. While we note the potential benefits of such approaches in enhancing the value that covered investment fund research reports may provide investors, we also understand that these more specific alternatives may restrict the flow of relevant information to investors.

d. Presentation of Performance Information

As discussed above, we have chosen to incorporate rule 482 and Form N–2 requirements on the presentation of performance information in final rule 139b.[404] We also considered the alternatives of including rule 156 guidance factors (or a subset thereof), requirements relating to disclosure of nonrecurring fees, and requirements on the timeliness of performance data.[405] We also considered a requirement in rule 139b to incorporate general narrative disclosure into a research report about a registered investment company, aimed at reducing potential investor confusion.[406] For example, we could have required such research reports to incorporate a legend stating that the document is a research report and is not subject to the Commission's regulations applicable to sales and advertising. We also could have required such a research report to incorporate similar disclosure without requiring that it be structured as a legend (which would require the disclosure of similar concepts but would not require any particular wording).[407]

In general, imposing additional requirements on the presentation of performance information would further reduce opportunities for research reports to present fund performance information in a manner inconsistent with similar information presented in advertisements and supplemental sales literature. We believe that these additional requirements would therefore reduce investor confusion and opportunities for the safe harbor to be used to present misleading information to investors.[408] However, imposing these additional requirements would increase compliance costs for broker-dealers. In particular, imposing rule 156 (or similar) guidance factors would make determinations of compliance with the provisions of rule 139b less certain. This could make broker-dealers reluctant to rely on the rule 139b safe harbor and impede the publication and distribution of broker-dealer research on covered investment funds.

The alternatives of including various forms of disclosures to the effect that a ''research report'' is not subject to the Commission's regulations applicable to sales and advertising would impose the lowest costs on broker-dealers. However, we believe that requiring disclosure to this effect is unlikely to have significant beneficial effects in the retail context.

IV. Paperwork Reduction Act

New rule 139b contains ''collection of information'' requirements within the meaning of the Paperwork Reduction Act of 1995 (''PRA'').[409] Specifically, rule 139b(a)(3) requires that broker-dealers that provide performance information in their covered investment fund research reports about (i) open-end funds must be in accordance with specified rule 482 presentation requirements or (ii) closed-end funds must be in accordance with a specified instruction set forth in Form N–2. The title for this collection of information is: ''Rule 139b Disclosure of Standardized Performance,'' a new collection of information. We are requesting comment on this collection of information requirement in this Release, and intend to submit these requirements to the Office of Management and Budget (''OMB'') for review under the PRA.[410] If approved, responses to the new collection of information requirement would not be mandatory for broker-dealers seeking to rely upon rule 139b but would be necessary for those broker-dealers that would like to provide performance information in their covered investment fund research reports. Responses to the information collections will not be kept confidential. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid OMB control number.

In the Proposing Release, we solicited comment on whether rule 139b should include a standardized performance disclosure requirement.[411] In response to comments received, we have decided to adopt such a requirement.[412] We believe that standardized performance presentation is an appropriate requirement because investors tend to consider fund performance a significant factor in evaluating or comparing investment companies, and the requirement addresses potential investor confusion if a communication were not easily recognizable as research as opposed to an advertising prospectus or supplemental sales literature. Rule 139b requires that research reports about open-end funds that include performance information must present it in accordance with paragraphs (d), (e), and (g) of rule 482. Rule 139b also requires that research reports about closed-end funds that include performance information must present it in accordance with instructions to item 4.1(g) of Form N–2.

It is difficult to provide estimates of the burdens and costs for those broker-dealers that will include performance information in a rule 139b research report. As discussed above, this is difficult to estimate because current data collected does not reflect the affiliate exclusion, does not include the entire universe of covered investment funds, and it is uncertain what percentage of communications currently filed as rule 482 advertising prospectuses (or rule 34b–1 supplemental sales materials) will instead be published in reliance on rule 139b, as covered investment fund research reports.[413] For purposes of the PRA, we estimate that 10% of the rule 482 and rule 34b–1 communications currently filed by broker-dealers with FINRA (approximately 65,000) could be considered as rule 139b covered investment fund research reports. We estimate that broker-dealers will publish annually 6,500 (10% of 65,000) covered investment fund research reports. Moreover, we assume for purposes of the PRA that all estimated rule 139b research reports will include fund performance information. We further

[404] *See supra* sections II.C and III.C.2.f.

[405] *See* Proposing Release, *supra* note 2, at 26825–26.

[406] *See id.*

[407] *See id.*

[408] *See id.*

[409] 44 U.S.C. 3501–3521.

[410] In the Proposing Release, we did not submit a PRA analysis because—although there was a set of requests for comment on the subject—the proposal did not include a standardized performance disclosure requirement, and we believed our proposal did not contain a ''collection of information'' requirement within the meaning of the PRA. *See* Proposing Release, *supra* note 2, at 26826.

As discussed in the Proposing Release, *supra* note 2, at 26826, and above, certain communications that previously would have been treated as rule 482 advertising prospectuses or rule 34b–1 supplemental sales literature could be considered covered investment fund research reports subject to the rule 139b safe harbor. This could result in a reduction in the information collection burdens for rules 482 and 34b–1 if fewer materials are filed. In connection with the extension of a currently approved collection for rules 482 and 34b–1, the Commission will adjust the burdens associated with these collections of information to reflect these changes, as appropriate. At this time, we do not have any comments regarding overall burden estimates for the final rule. This Release is requesting such comments.

[411] *See* Proposing Release, *supra* note 2, at 26803–04.

[412] *See supra* section II.C.

[413] *See supra* note 239 and accompanying paragraph.

estimate that 1,417 broker-dealers would likely be respondents to the collection of information with a frequency of 4.6 responses per year.[414] We further estimate that 50% of these broker-dealers will have experience in complying with standardized performance requirements under rule 482. For the 50% of this subset of broker-dealers that do not have experience with complying with rule 482, we estimate that there will be a one-time implementation cost for each broker-dealer of 5 internal burden hours. Additionally, we estimate that each research report will require 3 hours of ongoing internal burden hours by a broker-dealers' personnel to comply with the rule 139b collection of information requirements, which for each broker-dealer is estimated to be 13.8 internal burden hours.[415] Accordingly, we estimate that the standardized performance presentation requirements will result in an average annual hour burden of about 16.3 hours per broker-dealer[416] in the first year of compliance and about 13.8 hours per broker-dealer for each of the next two years. Amortized over three years, the average annual hour burden will be about 14.63 hours per broker-dealer.[417]

In sum, we estimate that rule 139b's requirements will impose a total annual internal hour burden of 20,731 hours on broker-dealers.[418] We do not think there is an external cost burden associated with this collection of information.

Request for Comment

We request comment on our approach and the accuracy of the current estimates. Pursuant to 44 U.S.C. 3506(c)(2)(A), the Commission solicits comments to: (1) Evaluate whether the collections of information are necessary for the proper performance of the functions of the agency, including whether the information will have practical utility; (2) evaluate the accuracy of the Commission's estimate of the burden of the collections of information; (3) determine whether there are ways to enhance the quality, utility, and clarity of the information to be collected; and (4) evaluate whether there are ways to minimize the burden of the collections of information on those who are required to respond, including through the use of automated collection techniques or other forms of information technology.

The agency has submitted the proposed collections of information to OMB for approval. Persons wishing to submit comments on the collection of information requirements of the proposed amendments should direct them to the Office of Management and Budget, Attention Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and should send a copy to Brent J. Fields, Secretary, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549, with reference to File No. S7–11–18. As OMB is required to make a decision concerning the collections of information between 30 and 60 days after publication of the proposal, a comment to OMB is best assured of having its full effect if OMB receives it within 30 days of publication. Requests for materials submitted to OMB by the Commission with regard to these collections of information should be in writing, refer to File No. S7–11–18, and be submitted to the Securities and Exchange Commission, Office of FOIA Services, 100 F Street NE, Washington, DC 20549.

V. Final Regulatory Flexibility Act Analysis

This Final Regulatory Flexibility Act Analysis has been prepared in accordance with section 4(a) of the Regulatory Flexibility Act (''RFA'').[419] It relates to new rule 139b, new rule 24b–4, and revisions to the rules under the Securities Act and the Exchange Act to implement the FAIR Act. An Initial Regulatory Flexibility Analysis (''IRFA'') was prepared in accordance with the RFA and included in the Proposing Release.[420] The Proposing Release included, and solicited comment on, the IRFA.

A. Need for, and Objectives of, the Rules and Rule Amendments

Rule 139b provides that, if certain conditions are satisfied, a broker-dealer's publication or distribution of a covered investment fund research report is 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 of the covered investment fund, even if the broker-dealer is participating or may participate in a registered offering of the covered investment fund's securities. Rule 24b–4 provides that a covered investment fund research report about a registered investment company will not be subject to section 24(b) of the Investment Company Act (or the rules and regulations thereunder), except to the extent the research report is otherwise not subject to the content standards in SRO rules related to research reports, including those contained in the rules governing communications with the public regarding investment companies or substantially similar standards. The revision to paragraph (a) of rule 139 would clarify that rule 139 does not affect the availability of any other exemption or exclusion from sections 2(a)(10) or 5(c) of the Securities Act that may be available to a broker-dealer (as provided, for example, by the provisions of rule 139a or new rule 139b). The revision to rule 101 under Regulation M is a conforming amendment intended to harmonize treatment of research under the Securities Act and Exchange Act rules by permitting distribution participants under Regulation M, such as brokers-dealers, to publish or disseminate any information, opinion, or recommendation relating to a covered security if the conditions of rule 138, rule 139, or rule 139b under the Securities Act are met. The new rules and rule revisions implement the directives under the FAIR Act to extend the current safe harbor available under rule 139 to broker-dealers' publication or distribution of covered investment fund research reports. The reasons for, and objectives of, the new rules and rule revisions are discussed in more detail in section II above.

B. Significant Issues Raised by Public Comments

In the Proposing Release, we requested comment on each aspect of the IRFA, including the number of small entities that would be affected by the proposed rules and amendments, the existence or nature of the potential impact of the proposals on small entities discussed in the analysis and how to quantify the impact of the proposed rules. We did not receive comments specifically addressing the impact of the rules and amendments on small entities subject to the rule.

C. Small Entities Subject to the Rules

The new rules affect broker-dealers that publish or distribute covered investment fund research reports. As such, broker-dealers that are small

[414] *See supra* note 230 and accompanying text. 6,500 covered investment fund research reports/1,417 broker-dealers = 4.6 annual responses per broker-dealer.

[415] 4.6 annual responses per broker-dealer × 3 internal burden hours = 13.8 annual internal burden hours per broker-dealer.

[416] (50% of * 13.8 hours ongoing compliance) + (50% * (13.8 hours ongoing compliance + 5 hours of initial compliance hours)).

[417] ((16.3 internal burden hours in year 1) + (13.8 internal burden hours in year 2) + (13.8 internal burden hours in year 3))/3.

[418] 14.63 annualized burden hours * 1,417 broker-dealers.

[419] *See* 5 U.S.C. 604(a).

[420] *See* Proposing Release, *supra* note 2, at 26826–29.

entities are affected by the adopted rules. A broker-dealer is a small entity if it has total capital (net worth plus subordinated liabilities) of less than $500,000 on the date in the prior fiscal year as of which its audited financial statements were prepared pursuant to § 240.17a–5(d),[421] and it is not affiliated with any person (other than a natural person) that is not a small business or small organization.[422] As of December 31, 2017, the Commission estimates that there were approximately 1,043 broker-dealers that would be considered small entities as defined above.[423] To the extent a small broker-dealer publishes or distributes covered investment fund research reports and seeks to rely on the rule 139b safe harbor—and is without a significant research department or wants to rely on pre-publication materials distributed by a covered investment fund, its adviser, or affiliated persons—it may be significantly affected by the final rules. Generally, we believe larger broker-dealers engage in these activities, and we did not receive comments on whether and how the rules we are adopting today affect small broker-dealers. We also did not receive comment on the number of small entities that would be affected by our adoption, including any available empirical data.

D. Reporting, Recordkeeping, and Other Compliance Requirements

We believe that there are no reporting, recordkeeping, and other compliance requirements with respect to rule 139b and the revision to Regulation M. As such, we believe that there are no attendant costs and administrative burdens for small entities associated with these activities, as they relate to rule 139b and the revision to Regulation M.

Rule 139b extends the safe harbor under rule 139 to broker-dealers' publication or distribution of covered investment fund research reports. As a result of the FAIR Act communications that historically have been treated as covered investment fund advertisements under rule 482 now could fall under the new rule 139b definition of ''research report.''

As discussed above, section 24(b) of the Investment Company Act requires registered open-end investment companies to file sales literature addressed to or intended for distribution to prospective investors with the Commission.[424] Section 2(b)(4) of the FAIR Act directs the Commission to provide that a covered investment fund research report shall not be subject to section 24(b) of the Investment Company Act or the rules and regulations thereunder, except that such report may still be subject to 24(b) and the rules and regulations thereunder if it is otherwise not subject to the content standards in the rules of any SRO related to research reports, including those contained in the rules governing communications with the public regarding investment companies or substantially similar standards.[425] Registered investment company sales literature, including rule 482 advertisements, are required to be filed with the Commission under section 24(b) of the Investment Company Act.[426] These filings are typically done by broker-dealers' compliance staff. The Commission implemented section 2(b)(4) of the FAIR Act via new rule 24b–4, which provides that a covered investment fund research report about a registered investment company shall not be subject to section 24(b) of the Investment Company Act (or the rules and regulations thereunder), unless the research report is not otherwise subject to the content standards in SRO rules related to research reports, including those contained in the rules governing communications with the public regarding investment companies or substantially similar standards.[427] We interpret section 2(b)(4) of the FAIR Act as excluding covered investment fund research reports from section 24(b) of the Investment Company Act so long as they continue to be subject to the general content standards in FINRA rule 2210(d)(1), described above (or substantially similar SRO rules).[428] Thus, covered investment fund research reports, by operation of rule 24b–4, would no longer be subject to filing requirements under section 24(b) because they would be subject to the general content standards of FINRA rule 2210(d)(1).[429] Rule 24b–4 would affect broker-dealers that, in lieu of a safe harbor such as that provided by rule 139b, would have published or distributed communications styled as ''research reports'' in compliance with rule 482, which communications would be required to be filed with the Commission subject to section 24(b) of the Investment Company Act. The Commission estimates that there were approximately 1,043 broker-dealers, as of December 31, 2017, that would be considered small entities as defined above.[430] As such, we believe that the administrative costs of broker-dealers that previously filed these communications pursuant to section 24(b) of the Investment Company Act will be reduced. However, large and small broker-dealers will not be affected differently by rule 24b–4.

The amendments are discussed in detail in Section II above. We discuss the economic impact, including the estimated compliance costs and burdens, of the amendments in Section III above.

E. Agency Action To Minimize Effect on Small Entities

The RFA directs us to consider significant alternatives that would accomplish the Commission's stated objectives, while minimizing any significant adverse impact on small entities. In connection with the proposals, we considered the following alternatives: (i) Establishing different compliance or reporting requirements that take into account the resources available to small entities; (ii) exempting broker-dealers that are small entities from certain proposed conditions that must be satisfied in order for the rule 139b safe harbor to be available (*e.g.,* the extent to which the proposed regular-course-of-business requirements would apply to small broker-dealers); (iii) clarifying, consolidating, or simplifying the conditions that must be satisfied for the rule 139b safe harbor to be available for broker-dealers that are small entities; and (iv) using performance rather than design standards.

We do not believe that establishing different compliance and reporting requirements or timetables for broker-dealers that are small entities, or exempting broker-dealers that are small entities from certain conditions, would

[421] *See* rule 0–10(c)(1) under the Exchange Act [17 CFR 240.0–10(c)(1)]. Alternatively, if a broker-dealer is ''not required to file such statements, a broker or dealer that had total capital (net worth plus subordinated liabilities) of less than $500,000 on the last business day of the preceding fiscal year (or in the time that it has been in business, if shorter).'' *See id.*

[422] *See* rule 0–10(c)(2) under the Exchange Act [17 CFR 240.0–10(c)(2)].

[423] This estimate is derived from an analysis of data for the period ending Dec. 31, 2017 obtained from FOCUS Reports (''Financial and Operational Combined Uniform Single'' Reports) that broker-dealers generally are required to file with the Commission and/or SROs pursuant to rule 17a–5 under the Exchange Act [17 CFR 240.17a–5].

[424] *See* 15 U.S.C. 80a–24(b); 17 CFR 270.24b–3; *supra* section II.D.1.

[425] *See supra* section II.D.1.

[426] *See supra* notes 187–189 and accompanying text. Rule 24b–3 under the Investment Company Act deems these materials to have been filed with the Commission if filed with FINRA. *See id.*

[427] *See* rule 24b–4; *see also* discussion accompanying *supra* notes 179–183.

[428] *See supra* paragraph accompanying notes 183–185.

[429] *See supra* section II.D.1.

[430] *See supra* note 423.

permit us to achieve our stated objectives. We have considered a variety of approaches to achieve our regulatory objectives and the directives of the FAIR Act. We do not believe that the new rules impose any significant new compliance obligations, because the new rules generally reduce the restrictions regarding communications that would be considered covered investment fund research reports.

As discussed above, the FAIR Act directs us to extend the current safe harbor available under rule 139 to broker-dealers' publication or distribution of covered investment fund research reports, and thus rule 139b's framework, including its scope and conditions, is modeled after and generally tracks rule 139.[431] Rule 139 does not incorporate conditions that affect the availability of the rule's safe harbor differently for broker-dealers that are small (versus large) entities. We likewise do not believe it is necessary or appropriate that rule 139b incorporate conditions that would affect the availability of the new rule's safe harbor differently based on whether a broker-dealer is a small entity. We have considered whether a different regular-course-of-business requirement would help mitigate investor confusion in the case of covered investment fund research reports about registered investment companies, as discussed in more detail above.[432] This could have had the effect of limiting the availability of the rule 139b safe harbor to certain broker-dealers, which in turn could have direct or indirect effects on the availability of the safe harbor to smaller broker-dealers. However, for the reasons discussed above,[433] we are not adopting a regular-course-of-business requirement, in either the new rule 139b provisions on issuer-specific research reports or the provisions on industry reports, other than a requirement that tracks the provisions of rule 139 (modified as directed by the FAIR Act).

Nor do we believe that clarifying, consolidating, or simplifying the amendments for small entities would satisfy those objectives. Because rule 139b's framework (including its scope and conditions) is modeled after and generally tracks rule 139, rule 139b, like rule 139, does not treat small broker-dealers differently than large broker-dealers, including by clarifying, consolidating, or simplifying any conditions.

Further, with respect to using performance rather than design standards, the rule generally uses performance standards for all broker-dealers relying on the rule, regardless of size. We believe that providing broker-dealers with the flexibility with respect to the design of covered investment fund research reports that they may publish or distribute in reliance on the safe harbor is appropriate in light of the diversity of entities included in the universe of covered investment funds. We also believe that this approach is appropriate in light of the diverse methodologies that might be taken with respect to research about these entities (particularly because the term ''research report'' in the FAIR Act and the rule is defined broadly, as discussed above[434]). However, we note that the rule also uses design standards with respect to certain of its conditions (*e.g.,* the conditions relating to reporting history and minimum public market value that apply to issuers that could appear in an issuer-specific research report). These are substantially similar to design standards used in rule 139, and they would apply with respect to the research reports published or distributed by all broker-dealers relying on the new rule, regardless of their size.[435] For the reasons discussed above, we believe that this use of design standards is appropriate for the furtherance of investor protection, and to help ensure that the rule is not used to circumvent the prospectus requirements of the Securities Act.[436]

VI. Statutory Authority

We are adopting the rules contained in this document under the authority set forth in the Securities Act, particularly sections 6, 7, 8, 10, 17(a), 19(a), and 28 thereof [15 U.S.C. *77a et seq.*]; the Exchange Act, particularly, sections 2, 3, 9(a), 10, 11A(c), 12, 13, 14, 15, 17(a), 23(a), 30, and 36 thereof [15 U.S.C. 78a *et seq.*]; the Investment Company Act, particularly, sections 6, 23, 24, 30, and 38 thereof [15 U.S.C. 80a *et seq.*]; and the FAIR Act, particularly, section 2 thereof.

List of Subjects

17 CFR Part 230

Advertising, Confidential business information, Investment companies, Reporting and recordkeeping requirements, Securities.

17 CFR Part 242

Brokers, Fraud, Reporting and recordkeeping requirements, Securities.

17 CFR Part 249

Reporting and recordkeeping requirements, Securities.

17 CFR Part 270

Confidential business information, Fraud, Investment companies, Life insurance, Reporting and recordkeeping requirements, Securities.

Text of Rules and Amendments

For the reasons set out in the preamble, title 17, chapter II of the Code of the Federal Regulations is amended as follows.

PART 230—GENERAL RULES AND REGULATIONS, SECURITIES ACT OF 1933

■ 1. The authority citation for part 230 continues to read, in part, as follows:

Authority: 15 U.S.C. 77b, 77b note, 77c, 77d, 77f, 77g, 77h, 77j, 77r, 77s, 77z–3, 77sss, 78c, 78d, 78j, 78*l,* 78m, 78n, 78o, 78o–7 note, 78t, 78w, 78*ll*(d), 78mm, 80a–8, 80a–24, 80a–28, 80a–29, 80a–30, and 80a–37, and Pub. L. 112–106, sec. 201(a), sec. 401, 126 Stat. 313 (2012), unless otherwise noted.

* * * * *

■ 2. Amend § 230.139 by revising the introductory text of paragraph (a) to read as follows:

§ 230.139 Publications or distributions of research reports by brokers or dealers distributing securities.

(a) *Registered offerings.* Under the conditions of paragraph (a)(1) or (2) of this section, a broker's or dealer's publication or distribution of a research report about an issuer or any of its securities shall be deemed for purposes of sections 2(a)(10) and 5(c) of the 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 that the issuer proposes to file, or has filed, or that is effective, even if the broker or dealer is participating or will participate in the registered offering of the issuer's securities. For purposes of the Fair Access to Investment Research Act of 2017 [Pub. L. 115–66, 131 Stat. 1196 (2017)], a safe harbor has been established for covered investment fund research reports, and the specific terms of that safe harbor are set forth in § 230.139b.

* * * * *

■ 3. Add § 230.139b to read as follows:

[431] *See supra* paragraph accompanying notes 12–15.

[432] *See supra* section III.C.6.c.

[433] *See id.*

[434] *See supra* section II.A.2.

[435] *See, e.g., supra* sections II.B.1.a (Reporting History and Timeliness Requirements) and II.B.1.b (Market Following Requirement).

[436] *See supra* notes 49–50 and accompanying text.

§ 230.139b Publications or distributions of covered investment fund research reports by brokers or dealers distributing securities.

(a) *Registered offerings.* Under the conditions of paragraph (a)(1) or (2) of this section, the publication or distribution of a covered investment fund research report by a broker or dealer that is not an investment adviser to the covered investment fund and is not an affiliated person of the investment adviser to the covered investment fund shall be deemed for purposes of sections 2(a)(10) and 5(c) of the 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 of the covered investment fund that is effective, even if the broker or dealer is participating or may participate in the registered offering of the covered investment fund's securities. This section does not affect the availability of any other exemption or exclusion from sections 2(a)(10) or 5(c) of the Act available to the broker or dealer.

(1) *Issuer-specific research reports.* (i) At the date of reliance on this section:

(A) The covered investment fund:

(1) Has been subject to the reporting requirements of section 30 of the Investment Company Act of 1940 (the ''Investment Company Act'') (15 U.S.C. 80a–29) for a period of at least 12 calendar months and has filed in a timely manner all of the reports required, as applicable, to be filed for the immediately preceding 12 calendar months on Forms N–CSR (§§ 249.331 and 274.128 of this chapter), N–Q (§§ 249.332 and 274.130 of this chapter), N–PORT (§ 274.150 of this chapter), N–MFP (§ 274.201 of this chapter), and N–CEN (§§ 249.330 and 274.101 of this chapter) pursuant to section 30 of the Investment Company Act; or

(2) If the covered investment fund is not a registered investment company under the Investment Company Act, has been subject to the reporting requirements of section 13 or section 15(d) of the Securities Exchange Act of 1934 (the ''Exchange Act'') (15 U.S.C. 78m or 78o(d)) for a period of at least 12 calendar months and has filed in a timely manner all of the reports required to be filed for the immediately preceding 12 calendar months on Forms 10–K (§ 249.310 of this chapter) and 10–Q (§ 249.308a of this chapter), or 20–F (§ 249.220f of this chapter) pursuant to section 13 or section 15(d) of the Exchange Act; and

(B) At the time of the broker's or dealer's initial publication or distribution of a research report on the covered investment fund (or reinitation thereof), and at least quarterly thereafter;

(1) If the covered investment fund is of the type defined in paragraph (c)(2)(i) of this section, the aggregate market value of voting and non-voting common equity held by affiliates and non-affiliates equals or exceeds the aggregate market value specified in General Instruction I.B.1 of Form S–3 (§ 239.13 of this chapter);

(2) If the covered investment fund is of the type defined in paragraph (c)(2)(ii) of this section, the aggregate market value of voting and non-voting common equity held by non-affiliates equals or exceeds the aggregate market value specified in General Instruction I.B.1 of Form S–3 (§ 239.13 of this chapter); or

(3) If the covered investment fund is a registered open-end investment company (other than an exchange-traded fund) its net asset value (inclusive of shares held by affiliates and non-affiliates) equals or exceeds the aggregate market value specified in General Instruction I.B.1 of Form S–3 (§ 239.13 of this chapter); and

(ii) The broker or dealer publishes or distributes research reports in the regular course of its business and, in the case of a research report regarding a covered investment fund that does not have a class of securities in substantially continuous distribution, such publication or distribution does not represent the initiation of publication of research reports about such covered investment fund or its securities or reinitiation of such publication following discontinuation of publication of such research reports.

(2) *Industry reports.* (i) The covered investment fund is subject to the reporting requirements of section 30 of the Investment Company Act or, if the covered investment fund is not a registered investment company under the Investment Company Act, is subject to the reporting requirements of section 13 or section 15(d) of the Exchange Act;

(ii) The covered investment fund research report:

(A) Includes similar information with respect to a substantial number of covered investment fund issuers of the issuer's 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

(B) Contains a comprehensive list of covered investment fund securities currently recommended by the broker or dealer (other than securities of a covered investment fund that is an affiliate of the broker or dealer, or for which the broker or dealer serves as investment adviser (or for which the broker or dealer is an affiliated person of the investment adviser));

(iii) The analysis regarding the covered investment fund issuer or its securities is given no materially greater space or prominence in the publication than that given to other covered investment fund issuers or securities; and

(iv) The broker or dealer publishes or distributes research reports in the regular course of its business and, at the time of the publication or distribution of the research report (in the case of a research report regarding a covered investment fund that does not have a class of securities in substantially continuous distribution), is including similar information about the issuer or its securities in similar reports.

(3) *Disclosure of standardized performance.* In the case of a research report about a covered investment fund that is a registered open-end management investment company or a trust account (or series or class thereof), any quotation of the issuer's performance must be presented in accordance with the conditions of paragraphs (d), (e), and (g) of § 230.482. In the case of a research report about a covered investment fund that is a registered closed-end investment company, any quotation of the issuer's performance must be presented in a manner that is in accordance with instructions to item 4.1(g) of Form N–2 (§§ 239.14 and 274.11a–1 of this chapter), provided, however, that other historical measures of performance may also be included if any other measurement is set out with no greater prominence than the measurement that is in accordance with the instructions to item 4.1(g) of Form N–2.

(b) *Self-regulatory organization rules.* A self-regulatory organization shall not maintain or enforce any rule that would prohibit the ability of a member to publish or distribute a covered investment fund research report solely because the member is also participating in a registered offering or other distribution of any securities of such covered investment fund; or to participate in a registered offering or other distribution of securities of a covered investment fund solely because the member has published or distributed a covered investment fund research report about such covered investment fund or its securities. For purposes of section 19(b) of the Exchange Act (15 U.S.C. 78s(b)), this paragraph (b) shall be deemed a rule under that Act.

(c) *Definitions.* For purposes of this section:

(1) *Affiliated person* has the meaning given the term in section 2(a) of the Investment Company Act.

(2) *Covered investment fund* means:

(i) An investment company (or a series or class thereof) registered under, or that has filed an election to be treated as a business development company under, the Investment Company Act and that has filed a registration statement under the Act for the public offering of a class of its securities, which registration statement has been declared effective by the Commission; or

(ii) A trust or other person:

(A) Issuing securities in an offering registered under the Act and which class of securities is listed for trading on a national securities exchange;

(B) The assets of which consist primarily of commodities, currencies, or derivative instruments that reference commodities or currencies, or interests in the foregoing; and

(C) That provides in its registration statement under the Act that a class of its securities are purchased or redeemed, subject to conditions or limitations, for a ratable share of its assets.

(3) *Covered investment fund research report* means 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.

(4) *Exchange-traded fund* has the meaning given the term in General Instruction A to Form N–1A (§§ 239.15A and 274.11A of this chapter).

(5) *Investment adviser* has the meaning given the term in section 2(a) of the Investment Company Act.

(6) *Research report* means a written communication, as defined in § 230.405 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.

■ 4. Effective May 1, 2020, amend § 230.139b by removing ''N–Q (§§ 249.332 and 274.130 of this chapter),'' in paragraph (a)(1)(i)(A)*(1).*

PART 242—REGULATIONS M, SHO, ATS, AC, NMS, AND SBSR AND CUSTOMER MARGIN REQUIREMENTS FOR SECURITY FUTURES

■ 5. The authority citation for part 242 continues to read as follows:

Authority: 15 U.S.C. 77g, 77q(a), 77s(a), 78b, 78c, 78g(c)(2), 78i(a), 78j, 78k–1(c), 78*l,* 78m, 78n, 78o(b), 78o(c), 78o(g), 78q(a), 78q(b), 78q(h), 78w(a), 78dd–1, 78mm, 80a–23, 80a–29, and 80a–37.

■ 6. Section 242.101 is amended by revising paragraph (b)(1) to read as follows:

§ 242.101 Activities by distribution participants.

* * * * *

(b) * * *

(1) *Research.* The publication or dissemination of any information, opinion, or recommendation, if the conditions of § 230.138, § 230.139, or § 230.139b of this chapter are met; or

* * * * *

PART 249—FORMS, SECURITIES EXCHANGE ACT OF 1934

■ 7. The authority citation for part 249 continues to read, in part, as follows:

Authority: 15 U.S.C. 78a *et seq.* and 7201 *et seq.;* 12 U.S.C. 5461 *et seq.;* and 18 U.S.C. 1350; Sec. 953(b), Pub. L. 111–203, 124 Stat. 1904; Sec. 102(a)(3), Pub. L. 112–106, 126 Stat. 309 (2012); Sec. 107, Pub. L. 112–106, 126 Stat. 313 (2012), and Sec. 72001, Pub. L. 114–94, 129 Stat. 1312 (2015), unless otherwise noted.

* * * * *

■ 8. Amend Form 12b–25 (referenced in § 249.322) as follows:

■ a. On the cover page accompanying the checkboxes, removing the phrase ''Form N–SAR'' and adding in its place ''Form N–CEN'';

■ b. On the cover page below the checkboxes, removing the checkbox and accompanying phrase ''Transition Report on Form N–SAR'';

■ c. In Part II, removing the phrase ''Form N–SAR'' and adding in its place ''Form N–CEN''; and

■ d. In Part III, removing the phrase ''Form N–SAR'' and adding in its place ''Form N–CEN''.

Note: the text of Form 12b–25 does not, and this amendment will not, appear in the Code of Federal Regulations.

PART 270—RULES AND REGULATIONS, INVESTMENT COMPANY ACT OF 1940

■ 9. The authority citation for part 270 continues to read, in part, as follows:

Authority: 15 U.S.C. 80a–1 *et seq.,* 80a–34(d), 80a–37, 80a–39, and Pub. L. 111–203, sec. 939A, 124 Stat. 1376 (2010), unless otherwise noted.

* * * * *

■ 10. Add § 270.24b–4 to read as follows:

§ 270.24b–4 Filing copies of covered investment fund research reports.

A covered investment fund research report, as defined in paragraph (c)(3) of § 230.139b of this chapter under the Securities Act of 1933 (15 U.S.C. 77a *et seq.*), of a covered investment fund registered as an investment company under the Act, shall not be subject to section 24(b) of the Act or the rules and regulations thereunder, except that such report shall be subject to such section and the rules and regulations thereunder to the extent that it is otherwise not subject to the content standards in the rules of any self-regulatory organization related to research reports, including those contained in the rules governing communications with the public regarding investment companies or substantially similar standards.

By the Commission.

Dated: November 30, 2018.

Brent J. Fields,

Secretary.

[FR Doc. 2018–26613 Filed 12–12–18; 8:45 am]

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