



July 9, 2018

**Via Electronic Mail ([rule-comments@sec.gov](mailto:rule-comments@sec.gov))**

Mr. Brent J. Fields, Secretary  
U.S. Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-1090

**Re: Covered Investment Fund Research Reports || File Number S7-11-18**

Dear Mr. Fields:

The Securities Industry and Financial Markets Association (“SIFMA”)<sup>1</sup> jointly with the Asset Management Group of the Securities Industry and Financial Markets Association (“SIFMA AMG,”<sup>2</sup> referred to herein together with SIFMA as “SIFMA”) appreciate the opportunity to provide comments to the U.S. Securities and Exchange Commission (the “SEC” or the “Commission”) on its proposal (the “Proposal”)<sup>3</sup> to adopt Rule 139b under the Securities Act of 1933 (the “Securities Act”), which would establish a safe harbor for covered investment fund research. If adopted, among other things, the Proposal would allow a broker-dealer to publish or distribute a “covered investment fund research report” without such report being considered 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, subject to conditions.

## **I. INTRODUCTION**

The Commission was directed to adopt a safe harbor for covered investment fund research pursuant to the Fair Access to Investment Research Act of 2017 (the “FAIR Act”).<sup>4</sup>

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<sup>1</sup> SIFMA brings together the shared interest of hundreds of securities firms, banks and asset managers. SIFMA’s mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association. For more information, visit [www.sifma.org](http://www.sifma.org).

<sup>2</sup> SIFMA AMG brings the asset management community together to provide views on policy matters and to create industry best practices. SIFMA AMG’s members represent U.S. and multinational asset management firms whose combined global assets under management exceed \$39 trillion. The clients of SIFMA AMG member firms include, among others, tens of millions of individual investors, registered investment companies, endowments, public and private pension funds, UCITS and private equity funds.

<sup>3</sup> Covered Investment Fund Research Reports, Securities Act Release No. 10498 (May 23, 2018), 83 Fed. Reg. 26788 (June 8, 2018) (the “Proposing Release”).

<sup>4</sup> Fair Access to Investment Research Act of 2017, Public Law No. 115-66, 131 Stat. 1196 (2017).

Specifically, the FAIR Act requires the Commission to establish a safe harbor for covered investment fund research by revising Rule 139 under the Securities Act, which is an existing safe harbor that applies to research on corporate and certain other issuers. In recent years, through the FAIR Act and other laws and initiatives, Congress has clearly indicated its view that the publication and distribution of research should be encouraged and not overly restricted. With respect to covered investment funds, the House of Representatives Committee on Financial Services (the “**HFS Committee**”) Report accompanying the FAIR Act explained that, because research that covers open-end funds and exchange-traded funds (“**ETFs**”) does not benefit from Rule 139 and other existing safe harbors, “broker-dealers do not publish research regarding ETFs, depriving investors of useful information when deciding whether to invest in this product.” Congress was concerned that this situation “inhibits the free flow of investment research” and enacted the FAIR Act to fix this problem.

Congress has also taken other recent actions intended to encourage the free flow of investment research. For example, in the Jumpstart Our Business Startups Act (“**JOBS Act**”), Congress explicitly prohibited the Commission and FINRA from adopting or maintaining any rule or regulation that would prohibit a broker-dealer from publishing or distributing any research report with respect to the securities of an emerging growth company within any prescribed period of time following the initial public offering date of the emerging growth company or within any prescribed period of time prior to the expiration date of a lock-up agreement. In addition, an interest in Congress to stimulate research coverage for smaller issuers was one of the driving forces behind proposed legislation that likely led to the Commission’s own tick size pilot.<sup>5</sup> As recently as June 21, 2018, the HFS Committee considered and unanimously passed a bill that would require the Commission to “conduct a study to evaluate the issues affecting the provision of and reliance upon investment research into small issuers, including emerging growth companies and companies considering initial public offerings” and to make “recommendations to increase the demand for, volume of, and quality of investment research” on such issuers.<sup>6</sup>

The message from Congress is clear—the Commission should encourage and remove unnecessary barriers to the free flow of investment research. Although Congress provided the Commission with flexibility in how to implement the FAIR Act, subject to certain explicit constraints, SIFMA believes that the Commission must do so with this overarching Congressional goal in mind. SIFMA acknowledges that adopting any regulation requires a careful weighing of risks and benefits. But in balancing these considerations, the Commission

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<sup>5</sup> See Small Cap Liquidity Reform Act of 2013, H.R. 3448, 113th Cong. (2014) (bill that passed the House of Representatives that would have required the Commission to enact a tick size pilot program and report to Congress on, among other things, the extent to which wider tick sizes “are increasing liquidity and active trading by incentivizing ... research coverage...”); H.R. Rep. No. 113-342 (2014) (HFS Committee report accompanying H.R. 3448 quoting committee testimony that a tick size pilot could lead to “increased research coverage to better inform and educate investors on both the opportunities and risks.”).

<sup>6</sup> See, e.g., Improving Investment Research for Small and Emerging Issuers Act, H.R. 6139, 115th Cong. (2018).

should weigh the likelihood and significance of identifiable risks versus the Congressional mandate to further the free flow of investment research.<sup>7</sup>

## **II. EXECUTIVE SUMMARY**

SIFMA appreciates the Commission's efforts to implement the FAIR Act by establishing a safe harbor for covered investment fund research; however, SIFMA believes that in some respects the Proposal may not be entirely consistent with Congress's desire to ensure that investors have the benefit of broadly available investment research. As described below, SIFMA believes that elements of the Proposal would impose unnecessary and unduly burdensome conditions to rely on the safe harbor, as well as overly restrictive interpretations of certain other proposed requirements.

In general, SIFMA supports the Commission's approach of modeling proposed Rule 139b after existing Rule 139, and agrees that ideally the Commission should seek to provide parity between research on corporate securities and covered investment funds. For example, SIFMA agrees that adopting a definition of "research report" in Rule 139b that is identical to the existing definition of "research report" in Rule 139 would help to reduce potential interpretive confusion for market participants who are familiar with the Rule 139 definition. However, SIFMA believes that incorporating many of the other elements of Rule 139 into proposed Rule 139b would not, in practice, create parity between such rules. This largely stems from the fact that broker-dealers typically need only rely on Rule 139 when publishing research on securities on the occasion that such broker-dealer is participating in a distribution of the issuer's securities. But ordinary corporate securities are only in distribution on an occasional basis. Broker-dealers can and do publish research at other times without being constrained by Rule 139's requirements. But because many covered investment funds are in continuous distribution, however, reliance on Rule 139b would be required each and every time research is published.<sup>8</sup> SIFMA believes that the Commission has not sufficiently taken this difference into account in various aspects of the Proposal, including with regard to the proposed eligibility requirements for covered investment funds (reporting history, reporting timeliness, minimum public value), as well as proposed "regular-course-of-business" requirements that would apply to broker-dealers.

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<sup>7</sup> As the Commission has recently recognized, the market for exchange-traded funds, a type of covered investment fund, has grown substantially. The Commission has also recently proposed new rules to "facilitate greater competition and innovation in the ETF marketplace, leading to more choice for investors." See, e.g., Press Release, SEC, SEC Proposes New Approval Process for Certain Exchange-Traded Funds (June 28, 2018), available at <https://www.sec.gov/news/press-release/2018-118>. Given the rapid change in this area, SIFMA believes it is important to ensure investors are fully informed of the risks and benefits of investing in covered investment funds and believes that adopting rules that encourage investment research will help accomplish this goal.

<sup>8</sup> Although it is technically possible for broker-dealers to publish material styled as "research" without reliance on Rule 139b by complying with Rule 482 and treating the material as though it were advertising, as the Commission noted in the Proposing Release, "due to the unavailability of rule 139 ... broker-dealers are generally not in the business of publishing and distributing" research on covered investment funds. See Proposing Release at 26797-98. As a result, throughout this letter, SIFMA assumes that if Rule 139b is unavailable for particular research, broker-dealers will continue to not publish or distribute it.

SIFMA also believes that certain proposed interpretations of the conditions contained in proposed Rule 139b, if the Commission applied them as described in the Proposing Release, may unnecessarily restrict legitimate research activities. This is particularly true with the Commission's proposed incorporation of the "entanglement" and "adoption" theories, which could prohibit broker-dealers from engaging in certain activities designed to ensure the accuracy of research reports. SIFMA believes that these interpretations should be clarified.

The Proposing Release also requests comment on whether certain additional requirements not included in Rule 139 should be added to proposed Rule 139b. For example, the Commission requested comment on whether additional conditions should be added to address potential conflicts of interest and whether broker-dealers should be required to present performance information in a standardized format. As discussed further below, SIFMA believes that the Commission's concerns are adequately addressed by existing rules and practices and that, in some cases, adding such additional requirements would be impractical and unnecessarily impede the purpose of such research.

Finally, while SIFMA recognizes that the Commission is faced with interpreting and implementing a statute that includes some challenging statutory text, in some cases the Commission has taken an unnecessarily narrow view that, if implemented, could allow a "rule of construction" to effectively override a statutory definition and prevailing statutory purpose. SIFMA proposes an alternative that should satisfy the Commission's concerns while remaining true to the legislative intent.

### **III. AFFILIATE EXCLUSION AND CONFLICTS OF INTEREST**

Proposed Rule 139b would incorporate the same definition of "covered investment fund research report" as is set forth in the FAIR Act. This definition excludes a research report that is "published or distributed by the covered investment fund or any affiliate of the covered investment fund, or any research report published or distributed by any broker or dealer that is an investment adviser (or any affiliated person of an investment adviser) for the covered investment fund" (the "**Affiliate Exclusion**"). In the Proposing Release, the Commission proposed guidance on the definition of "covered investment fund research report," including the Affiliate Exclusion, and requested comment on potential changes, as discussed further below.

#### ***A. Entanglement and Adoption Theories***

In discussing the Affiliate Exclusion, the Commission states that it believes that 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. As an example, the Commission notes that a broker-dealer could not include in a research report "materials that were specifically authorized or approved by a person covered by the affiliate exclusion." Further, the Commission notes that determinations as to whether a person covered by the Affiliate Exclusion has published a research report indirectly "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 the

preparation of the information or explicitly or implicitly endorsed or approved the information.” These interpretations are referred to as the “entanglement theory” and the adoption theory,” respectively.

SIFMA agrees that the Affiliate Exclusion should prevent a broker-dealer from relying on Rule 139b to simply publish in its own name materials that were primarily prepared and provided by a person covered by the Affiliate Exclusion. However, SIFMA is concerned that the Commission’s proposed interpretation of the Affiliate Exclusion is unnecessarily restrictive, as it would potentially limit legitimate research activities. Specifically, SIFMA believes that the Affiliate Exclusion should not prohibit a broker-dealer from obtaining information from a covered investment fund or any excluded affiliate that is similar to the information that an analyst would typically want or need to cover an operating company, such as performance data, holdings, or investment objectives or strategies. Nor should the Affiliate Exclusion prevent a firm from submitting sections of a research report to a covered investment fund or an affiliate for factual review.

These activities, which are common practice in connection with the preparation of research on corporate issuers, do not give rise to the same conflicts of interest or independence concerns that the Affiliate Exclusion is designed to address and help to ensure that research reports distributed to investors by broker-dealers are accurate. In addition, while FINRA’s equity research rule, FINRA Rule 2241, generally prohibits pre-publication review of research reports subject to such rule by a subject company and certain other persons,<sup>9</sup> the rule expressly permits such review for purposes of factual confirmation, subject to conditions. The Commission should clarify that the use of information specifically confirmed by a person covered by the Affiliate Exclusion as described above would not jeopardize the availability of the safe harbor.

### ***B. Other Conflicts of Interest***

In the Proposing Release, the Commission asks a series of questions relating to potential conflicts of interest that may not be addressed by the Affiliate Exclusion, including whether the Commission should add additional restrictions or conditions to mitigate conflicts.

SIFMA acknowledges that it is possible that other conflicts not directly addressed by the Affiliate Exclusion may exist, but believes that existing rules and practices are sufficient to mitigate these potential conflicts of interest. For example, as noted by the Commission, research that falls within the FINRA definition of “research report” would be subject to various FINRA rules governing conflicts of interest. Among other things, FINRA rules require broker-dealers to disclose in research reports specific types of conflicts, such as whether “the member or its affiliates beneficially own 1% or more of any class of common equity securities of the subject company,”<sup>10</sup> as well as “any other material conflict of interest of the research analyst or member that the research analyst or an associated person of the member with the ability to

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<sup>9</sup> See FINRA Rule 2241(b)(2)(A) and (N).

<sup>10</sup> FINRA Rule 2241(c)(4)(F).

influence the content of a research report knows or has reason to know at the time of the publication or distribution of a research report.”<sup>11</sup>

SIFMA believes that existing rules and practices are sufficient to mitigate conflicts of interest even with respect to research under proposed Rule 139b that does not constitute a “research report” under the FINRA definition.<sup>12</sup> For example, such research would still be subject to the general content standards of FINRA Rule 2210(d), which require, among other things, that the communication “be based on principles of fair dealing and good faith” and that the communication may not omit a material fact that would cause the communication to be misleading. In addition, all research under Rule 139b would remain subject to the anti-fraud requirements of the federal securities laws.<sup>13</sup> As a result, firms would be required to determine, based on the context, whether particular disclosures are warranted. While this would be a case-by-case and facts and circumstances analysis, SIFMA notes that as a general matter, material that is “research” under the FAIR Act but not under FINRA Rule 2241 may not warrant the sort of extensive disclosures required under FINRA Rule 2241 because, by its very nature, in many cases it would not be reasonably sufficient upon which to base an investment decision.<sup>14</sup>

#### **IV. ISSUER-SPECIFIC RESEARCH REPORTS**

##### ***A. Reporting History Requirement***

As proposed, in order for a broker-dealer to rely on the Rule 139b safe harbor with respect to a particular covered investment fund, the fund must have been subject to relevant requirements under the Investment Company Act and/or the Exchange Act to file certain periodic reports for at least 12 calendar months prior to the broker-dealer’s reliance on proposed Rule 139b. This threshold is not mandated by the FAIR Act, which instead provides that the Commission may not impose a time period longer than the period referenced in Rule 139.

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<sup>11</sup> FINRA Rule 2241(c)(4)(I).

<sup>12</sup> As the Commission has noted, the FAIR Act definition of “research report” is broader than the FINRA definition, including because the FINRA definition is limited to materials that “provides information reasonably sufficient upon which to base an investment decision,” while material can be considered research under the FAIR Act “whether or not it provides information reasonably sufficient upon which to base an investment decision.” *See, e.g.*, Proposing Release at 26805 n. 174.

<sup>13</sup> *See* section 2(c)(1) of the FAIR Act (stating that nothing in the Act shall be construed as in any way limiting the applicability of the antifraud or antimanipulation provisions of the Federal securities laws and rules adopted thereunder to a covered investment fund research report).

<sup>14</sup> SIFMA further notes that the broader definition of “research” under the FAIR Act should allow broker-dealers to rely on Rule 139b with respect to material often referred to as “desk commentary”—typically brief, written analysis distributed to eligible institutional investors that comes from sales and trading or principal trading personnel but that may rise to the level of a research report under FINRA’s rules. *See* FINRA Regulatory Notice 17-16 (April 2017). Requiring extensive disclosures in these brief materials would be impractical and operationally challenging.

SIFMA understands that the proposed 12-month period under Rule 139b is based on the same period contained in Rule 139 with respect to corporate issuers. The Commission explained that, like Rule 139, this 12-month period “would provide investors with publicly-available information about the issuers included in a research report for a full year.” However, SIFMA believes that this justification ignores a significant difference between when broker-dealers would need to rely on Rule 139 versus Rule 139b. Because corporate issuers’ securities are generally not in continuous distribution, the 12-month period under Rule 139 does not actually mean that broker-dealers cannot issue research until 12 months after the company’s initial public offering. Rather, many firms will publish research on a corporate issuer as soon as 25 days after the offering date of the issuer’s securities, even if it participated in that offering. Indeed, even this 25-day period is a self-imposed market practice intended to align with the expiration of a dealer’s prospectus delivery requirement,<sup>15</sup> while the mandated “quiet periods” before research can be published under FINRA’s research rules (where not eliminated by the JOBS Act) are as short as ten days following an IPO.<sup>16</sup> As a result, broker-dealers often publish research as soon as 25 days after an IPO. The 12-month period under Rule 139 only becomes relevant if the broker-dealer is participating in a follow-on offering within a year of its IPO, in which case, the firm would not be able to rely on the safe harbor.

The situation for covered investment fund research, however, is quite different. Because such funds are typically in continuous distribution, reliance on Rule 139b would be the only mechanism to be sure that research is not deemed to be an offer. As a result, carrying over the 12-month period from Rule 139 would not actually create parity between research on corporate issuers and covered investment funds, as Congress intended, as imposing the 12-month requirement on covered investment funds will effectively require broker-dealers to wait more than 12-times as long to initiate research on covered investment funds than they must for corporate securities.

In addition, SIFMA believes that the focus on the length of time an issuer has been subject to the reporting requirements is less relevant for a covered investment fund than it may be for a corporate security. Covered investment funds themselves derive their value from the other assets that they hold, which in many cases, will be other securities that have been registered with the Commission for a significant length of time. The covered investment fund is merely a vehicle through which investors access those other assets, for which substantial information is likely already available.

Whatever risks the Commission believes are mitigated by imposing a 12-month quiet period must be weighed against the barrier such a rule creates to the free flow of research. For example, the Commission suggests that this requirement is being imposed because if there is limited information about a fund, “a single ‘research report’ about a covered investment fund could have a disproportionate effect on retail investors’ beliefs about the fund.”<sup>17</sup> However, SIFMA believes that this is precisely the time when it is important to encourage independent research. Under the Proposal, the only information available to investors during the first year

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<sup>15</sup> See Rule 174(d) under the Securities Act.

<sup>16</sup> See FINRA Rule 2241(b)(2)(I).

<sup>17</sup> See Proposing Release at 26819.

of the fund's operations would come from persons with an interest in distributing the fund's securities. Allowing research to be published during this period would therefore broaden the mix of information available to provide investors with independent analysis of newer covered investment funds, which would allow retail investors to make better informed investment decisions.

Requiring a 12-month quiet period would also force research reports that analyze a small number of covered investment funds to ignore newer market entrants. This would put newer covered investment funds at a competitive disadvantage to incumbent funds and risk research reports presenting an incomplete view of the market. For example, consider a new ETF that is introduced that tracks the same index or commodity as one or more existing ETFs, but has some different attributes (expense ratio, share price, volume, or typical bid-ask spread) that may make it more or less attractive, depending on the investors' investment size or time horizon.<sup>18</sup> A research report analyzing these different ETFs would have to exclude any with under 12-months of reporting history, even though its lower fees or smaller share price may make it the better option for some investors. The new ETF would be artificially excluded, both burdening competition and potentially harming investors.

As a result, SIFMA believes that the time period before a broker-dealer may rely on the proposed safe harbor should be shortened. Specifically, SIFMA believes that broker-dealers should be able to rely on the safe harbor 25 days following the initial offering of the covered investment fund, establishing parity between research on corporate issuers and on covered investment funds.

### ***B. Reporting Timeliness Requirement***

Under the Proposal, not only would a broker-dealer relying on the safe harbor need to ensure that a covered investment fund has been subject to applicable reporting requirements for at least 12 months, but the broker-dealer would also have to ensure that the covered investment fund has filed such reports in a timely manner during the preceding 12-month period. In the Proposing Release, the Commission explains that this timeliness requirement tracks similar requirements under Rule 139. However, as with the reporting history requirement, SIFMA does not believe that this requirement would apply to covered investment funds in the same way that it applies to corporate issuers.

As noted above, broker-dealers typically rely on Rule 139 only when it is involved in a distribution of the issuer's securities. This means that the situations in which a broker-dealer will be required to confirm that an issuer has filed its required reports in a timely manner are limited. Further, issuers engaging in secondary offerings where Rule 139 is relevant, often do so on Form S-3. As the Commission is aware, eligibility for Form S-3 itself requires that all reports have been timely filed—so the timely filing requirement is otherwise already being confirmed for Form S-3 eligibility purposes.

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<sup>18</sup> See, e.g., Asjlynn Loder, *State Street Introduces Cheapest Gold ETF Yet*, Wall Street Journal (June 27, 2018), available at <https://blogs.wsj.com/moneybeat/2018/06/27/state-street-introduces-cheapest-gold-etf-yet/> (discussing new ETF that tracks the price of gold but with lower fees and share size as compared to existing funds, which may increase transaction costs but decrease management fees, potentially making it a better option for longer-term investors).



Many covered investment funds, however, are in continuous distribution. As a result, as proposed, reliance on Rule 139b would require broker-dealers to establish procedures or systems to confirm that the funds it covers have filed the trailing 12-months of reports in a timely manner each and every time the firm publishes virtually any material on the fund. Further, because covered investment funds may not themselves be simultaneously engaging in offerings on Form S-3, the timeliness of the issuer's preceding 12 months of reports is not otherwise being analyzed. As a result, SIFMA believes that this requirement would be operationally challenging. It is also not clear why the timeliness of a covered investment fund's reporting would cause a third party's research on such a fund to present greater risks to investors—or that such risks justify barring investors from accessing independent research.

Although SIFMA questions the need for the reporting timeliness requirement at all, if the Commission retains it, it should take steps to alleviate the ongoing burden that it would place on broker-dealers. Specifically, firms should only be required to confirm that a particular covered investment fund has filed its reports in a timely manner at the time that the broker-dealer *initiates* research coverage on such fund, and not repeatedly for research reports that the firm publishes or distributes on the same covered investment fund.

### ***C. Minimum Public Value Requirement***

Similar to Rule 139, the Proposal would condition the availability of the Rule 139b safe harbor on the covered investment fund having a minimum of \$75 million in public market value or net asset value. Like the reporting history, this threshold is not mandated by the FAIR Act, which instead provides that the Commission may not impose a minimum float requirement greater than the one in Rule 139. The Commission explained that it proposed this requirement because it believes that public float serves 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.

SIFMA believes that this requirement is not necessary or appropriate in the context of covered investment funds. First, such a threshold would greatly limit the extent of research that could be produced. As the Commission noted in the Proposing Release, approximately one-third of all covered investment funds have public market valuations of less than \$75 million. In other words, this threshold would deny investors access to research on a significant population of exchange-traded and other covered investment funds.<sup>19</sup> Even worse, investors would generally be denied access to this research indefinitely since, as described above, broker-dealers would always need to rely on Rule 139b to publish or distribute research on covered investment funds that are in continuous distribution. On the other hand, broker-

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<sup>19</sup> Similar to SIFMA's point above with regard to a minimum reporting history, *supra* text accompanying note 18, a minimum market value threshold would also put newer funds that have not yet reached \$75 million in value at a competitive disadvantage to preexisting funds that may carry higher fees, while also forcing broker-dealers to exclude any discussion of relevant (but smaller) funds from a report analyzing funds offering similar exposures. This result would appear to harm investors more than it protects them, and does not appear justified where information about covered investment funds' underlying holdings is equally available regardless of the fund's market value.

dealers can publish research on a corporate issuer without regard to any minimum market value without relying on Rule 139, so long as the broker-dealer is not at the time participating in a distribution of the issuer's securities.

The fact that this requirement would be perpetual for covered investment funds would also make the proposed safe harbor operationally challenging, as firms would have to ensure that the value requirement is satisfied every time a firm produces or publishes research. This would be particularly difficult for covered investment funds, whose value may fluctuate around the minimum value threshold on a regular basis. Further, the fluctuation in value often occurs as a result of the performance of underlying assets rather than market acceptance of the fund. This means that the market value threshold is less relevant in the context of covered investment funds—there may be a significant amount of information in the market about such underlying companies or other holdings, even if the size of the covered investment fund is relatively small.

Finally, it would also not be novel to permit or even encourage research on smaller issuers. For example, even in the context of research on individual smaller corporate issuers where the risks to investors are greater, in Section 105(d) of the JOBS Act, Congress explicitly prohibited the Commission and FINRA from adopting or maintaining any rule or regulation that would prohibit a broker-dealer from publishing or distributing any research report with respect to the securities of an emerging growth company within any prescribed period of time following the initial public offering date of the emerging growth company or within any prescribed period of time prior to the expiration date of a lock-up agreement.<sup>20</sup>

As a result of the foregoing, SIFMA believes that the Commission should eliminate the minimum value requirement. If the Commission chooses to retain a minimum value requirement, SIFMA believes the requirement should be no more than \$20 million. Based on SIFMA's analysis, this minimum value would allow broker-dealers to publish research on approximately 90 percent of all covered investment funds, thereby only preventing investors from accessing research on only 10 percent, rather than 31 percent, of covered investment funds.

In addition, similar to SIFMA's suggestion with regard to the filing of timely reports, SIFMA believes that Rule 139b should only require that a broker-dealer confirm that a particular covered investment fund satisfies this requirement at the time that the broker-dealer *initiates* research coverage on such fund, and not at the time each and every report is published or distributed thereafter. This would alleviate the operational complexities of monitoring each fund's market value at the time of each publication. Further, as a policy matter, it would seem counterproductive to require that a firm that has been publishing research on a covered

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<sup>20</sup> The Commission's staff has noted that although "[t]he JOBS Act did not explicitly permit publication or distribution of a research report or public appearance relating to an emerging growth company after the expiration, termination, or waiver of a lock-up agreement" and "did not expressly address quiet periods after a secondary offering of an emerging growth company's securities...[t]he staff believes that the policies underlying the change in Section 105(d) are equally applicable to quiet periods during these other time periods." See Division of Trading and Markets, Jumpstart Our Business Startups Act Frequently Asked Questions About Research Analysts and Underwriters (Aug. 22, 2012), available at <https://www.sec.gov/divisions/marketreg/tmjjobsact-researchanalystsfaq.htm>. See also FINRA Rule 2241(b)(2)(I) (excluding emerging growth companies from FINRA's quiet period requirements).

investment cease publication at the very time when the fund is experiencing a decline in its value. Investors may be particularly interested in independent research on such a fund at that time, and cost to investors of blocking the flow of investment research from a firm that has a history of covering the fund does not seem justified by any regulatory benefit.

***D. Regular-Course-of-Business Requirement***

Under proposed Rule 139b, a broker-dealer would be able to rely on the safe harbor for issuer-specific research reports only if it “publishes or distributes research reports in the regular course of its business.” In the Proposing Release, the Commission also suggested that a broker-dealer would satisfy this requirement with respect to a particular covered investment fund only if it regularly published or distributed research on the *same types* of securities as those covered in the research.<sup>21</sup>

SIFMA believes that the Commission’s interpretation of the regular-course-of-business requirement as applying to particular types of securities is too narrow and impractical in the context of covered investment funds, and may contravene Congress’s directive that the Commission not condition the Rule 139b safe harbor on whether particular research constitutes such broker’s or dealer’s initiation or reinitiation of research coverage.

Although this requirement tracks an existing requirement in Rule 139, as noted above, broker-dealers typically rely on Rule 139 only when an issuer is in distribution; once a distribution is complete, the safe harbor is not necessary. This means that a broker-dealer can begin to satisfy the regular course of business requirement by publishing research on a particular type of security outside the distribution period. This is not possible in the context of covered investment funds that are in continuous distribution. For these securities, broker-dealers would never be able to satisfy the regular course of business requirement because they would never be able to begin publishing research on such securities without relying on the safe harbor.

For this reason, the Commission’s proposed interpretation is also inconsistent with Section 2(b)(1) of the FAIR Act, which provides that, in the case of a covered investment fund with a class of securities in substantially continuous distribution, the Commission may not condition the safe harbor on whether particular research “constitutes such broker’s or dealer’s initiation...of research coverage on such covered investment fund or its securities.” In other words, Congress prohibited the Commission from conditioning the safe harbor on a broker-dealer having previously published research on a particular covered investment fund, to the extent the fund is continuously distributed, because the broker-dealer would never have the opportunity to begin to satisfy this requirement. Indeed, the fact that Rule 139 does not have this carve out for continuously distributed securities was one of the specific reasons Congress

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<sup>21</sup> See Proposing Release at p. 26797 n. 104 (“We believe it is appropriate to include the regular-course-of-business requirement because it is important that the broker-dealer have a history of publishing or distributing a particular type of research. If a broker or dealer begins publishing research about a different type of security around the time of a public offering of an issuer’s security and does not have a history of publishing research on those types of securities, such publication or distribution could be viewed as a way to provide information about the publicly-offered securities in circumvention of the provisions of section 5 of the Securities Act.”)

adopted the FAIR Act. Conditioning the safe harbor on a broker-dealer having published research on a particular type of security, to the extent such type of security is continuously distributed, would effectively lead to the same result.

SIFMA believes that the Commission should remove the regular-course-of-business requirement or clarify that a broker-dealer would satisfy the regular-course-of-business requirement as long as it regularly publishes any type of research, rather than research on a particular type of security. This would make it possible for firms to initiate research coverage on covered investment funds, even where such funds are in continuous distribution.

At the same time, SIFMA does not believe that firms should be required to have a traditional research department to rely on the safe harbor, which is suggested by the Commission in the Proposing Release. For example, the factors that the Commission points to in the Proposing Release as indicative of a firm publishing research in the ordinary course include whether the broker-dealer has “a research department with research analysts,” and maintains related policies and procedures. But these factors are only indicative of whether the firm publishes “research” that would subject it to FINRA’s research rules, not whether it publishes “research” that falls under the FAIR Act. Imposing these factors as a condition to Rule 139b would effectively limit the availability of the Rule 139b safe harbor to firms that are publishing “research” subject to FINRA rules, excluding firms publishing research as specifically defined by Congress for these purposes.

As a result, to the extent that the Commission retains any “regular course of business” requirement, the Commission should make clear that (i) this 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,<sup>22</sup> and (ii) other factors may also satisfy this requirement for firms producing research that is not subject to FINRA’s research rules. These other factors could include whether the firm regularly produces research (as defined under the FAIR Act), regardless of whether such research has been subject to FINRA’s research rules.

Even with such guidance, SIFMA anticipates that firms considering initiating covered investment funds research that is not subject to FINRA research rules may be unclear as to

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<sup>22</sup> The Commission’s proposed interpretation that a factor in determining whether a broker-dealer satisfies the “regular course of business” requirement under proposed Rule 139b is whether the report is “published or distributed by a research analyst in the research department at a broker-dealer that regularly covers *that ... industry*” (emphasis added) should similarly be eliminated. Tracking whether a firm has regularly covered a particular *industry* is complicated by the fact that the economy is dynamic and constantly evolving, along with concepts of distinct and static industry classifications. For example, the publishers of the Global Industry Classification Standard (“GICS”) recently announced a realignment of various industry classifications, with certain companies previously categorized as consumer-discretionary and information-technology being shifted into a new “communications services” category, itself renamed from the telecommunications category. See, e.g., Press Release, S&P Dow Jones Indices and MSCI, S&P Dow Jones Indices and MSCI Announce Revisions to the Global Industry Classification Standard (GICS) Structure in 2018 (Nov. 15, 2017), available at <https://www.msci.com/documents/10199/d56e739d-4455-4bc1-afdd-d738c2ce5a05>.

whether they satisfy a “regular course of business” requirement. Although the Commission is restricted from requiring filing of covered investment fund research, SIFMA believes that the Commission could provide that, where a firm is unsure of whether its prior activities would be sufficient to meet the regular course of business requirement, the firm would have the alternative option to meet this requirement by notifying the Commission or FINRA that it is initiating research on covered investment funds (this would be a notification of the commencement of this activity generally, rather than on a fund-by-fund basis). The Commission or FINRA, as part of their ordinary examination activities, could review these materials to evaluate whether they believe that they were appropriately classified as research.

## **V. INDUSTRY RESEARCH REPORTS**

Proposed Rule 139b would permit a firm to produce industry research reports that either (i) include similar information with respect to a substantial number of covered investment fund issuers of a type or investment focus (a “Similar Fund Report”) or (ii) contain a comprehensive list of covered investment fund securities that the broker-dealer currently recommends, *other* than those that would be covered by the Affiliate Exclusion (the “Recommended List Report”).

SIFMA requests that the Commission confirm first that a Similar Fund Report *may* include funds that would otherwise be covered under the Affiliate Exclusion, so long as there is a substantial number of funds covered that would not be subject to the Affiliate Exclusion. SIFMA believes that excluding such funds from a list of similar funds could be misleading and unnecessarily withhold relevant information from investors. SIFMA believes that other conditions of the rule, such as (i) that there be a “substantial number” of funds listed, (ii) that only “similar information” about each fund is provided and (iii) that no particular funds be given materially greater space or prominence, should be sufficient to satisfy the purposes of the Affiliate Exclusion, while not providing investors with misleadingly incomplete information.

As to Recommended List Reports, SIFMA acknowledges that the Affiliate Exclusion would prevent a broker-dealer from relying on Rule 139b with regard to affiliated covered investment funds in such a report. However, SIFMA requests that the Commission clarify that including funds excluded under the Affiliate Exclusion in a Recommended List Report would not jeopardize the availability of the safe harbor with respect to the non-affiliated funds. For example, SIFMA seeks that the Commission clarify that, consistent with the non-exclusivity provision of proposed Rule 139b, in a single Recommended List Report, a broker-dealer may treat references to affiliated funds as an “offer” and comply with Rule 482 with respect to those affiliated funds, while relying on Rule 139b with respect to other covered investment funds not subject to the Affiliate Exclusion.

## **VI. PRESENTATION OF PERFORMANCE INFORMATION IN RESEARCH REPORTS ABOUT REGISTERED INVESTMENT COMPANIES**

The Commission requested comment on whether Rule 139b should require that performance information be presented in the standardized format required under Rule 482, although it did not propose such a requirement. SIFMA does not believe performance

information in research reports should be subject to Rule 482. As the Commission knows, Rule 482 is intended to apply to investment company *advertisements*, which research under Rule 139b is not intended to be.

Further, it would be inappropriate for the Commission to constrain the presentation of performance data in research reports. Analysts seeking to convey insight or analysis about one or more covered investment funds may have a particular aspect of performance information that they wish to highlight. Limiting the way in which performance information is presented may undermine their ability to share this analysis.

Finally, materials distributed under Rule 139b would be subject to various other requirements that would help to address the Commission's concerns regarding potential investor confusion. For example, all FINRA 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."<sup>23</sup> In addition, "[n]o member may omit any material fact or qualification if the omission, in light of the context of the material presented, would cause the communications to be misleading."<sup>24</sup> While these would not require that performance be presented in the particular way required of advertisements under Rule 482, they would ensure that performance information is presented in a balanced and non-misleading manner.

## **VII. FILING REQUIREMENTS**

FINRA Rule 2210(c) requires FINRA members to file certain retail communications with FINRA, including "[r]etail communications that promote or recommend a specific registered investment company or family of registered investment companies (including mutual funds, exchange-traded funds, variable insurance products, closed-end funds, and unit investment trusts)." However, research reports as defined in FINRA Rule 2241 that concern only securities that are listed on a national securities exchange are excluded from FINRA's filing requirements, so long as they are not otherwise required to be filed with the Commission pursuant to Section 24(b) of the Investment Company Act.<sup>25</sup>

As mandated by the FAIR Act, the Commission proposes to exclude covered investment fund research from filing under Section 24(b) of the Investment Company Act of 1940. Once excluded from filing under Section 24(b), research under the Proposal that constitutes a research report under FINRA's rules would also be excluded from FINRA's filing requirements.<sup>26</sup>

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<sup>23</sup> FINRA Rule 2210(d)(1).

<sup>24</sup> *Id.*

<sup>25</sup> *See* FINRA Rule 2210(c)(7). Investment company sales material filed with FINRA is deemed to be filed with the Commission for purposes of Section 24(b) of the Investment Company Act. *See* Rule 24b-3 under the Investment Company Act.

<sup>26</sup> Research under the Proposal may also be excluded from filing with FINRA under other FINRA rules. *See, e.g.*, FINRA Rule 2210(c)(7)(C) (excluding from FINRA's filing requirements

The Commission noted, however, that the FAIR Act included a rule of construction providing that the FAIR Act not be construed as limiting “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.” As a result, the Commission noted its belief that the FAIR Act “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.”

SIFMA notes that it is difficult to reconcile this rule of construction with the statutory definition of “research.” Under the FAIR Act, “research” includes “information, opinions, or recommendations,” and Congress clearly intended to eliminate special filing requirements for covered investment fund research. The Commission’s proposed reading of the rule of construction, if adopted by FINRA to require the filing of “research” if it was not actually “research,” would create an exceedingly difficult to apply standard, under which a firm would need to determine whether the “purpose” of material that met the definition of “research” was sufficiently analytical to avoid filing.

To avoid this ambiguity, SIFMA proposes another interpretation of the rule of construction. First, as “research” is defined to include “information, opinions, or recommendations,” material that provides opinions or recommendations are inherently intended for the purpose of providing analysis, and the Commission should recognize them as outside of FINRA’s authority to require filing. The question then only remains with regard to research that contains only “information.”

SIFMA believes that the rule of construction should be read to permit FINRA to require filing of research that provides only “information” if a user of the research would not be able to use the information provided for research and analysis. Such a report would then not be for the purpose of research and analysis, but rather for promotional purposes and thus treated as advertising. For example, the Commission explicitly recognizes Similar Fund Reports as a category of Industry-Specific Reports that would be eligible for the benefits of the FAIR Act. But while a Similar Fund Report would provide investors with extensive *information* about a substantial number of covered investment funds, it may not itself provide further analysis. Its purpose instead is to provide information that investors can use to perform their own further research and analysis, and FINRA should not be able to require it to be filed under the rule of construction.<sup>27</sup>

SIFMA believes that this interpretation would more clearly distinguish—and still permit FINRA to require filing of—material that is purely promotional material or traditional advertising, as such material is unlikely to actually provide information that can be used for research and analysis.

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“[r]etail communications that do not make any financial or investment recommendation or otherwise promote a product or service of the member”).

<sup>27</sup> Indeed, SIFMA believes that no industry reports should be subject to the filing requirement. The broad content and equal treatment requirements applicable to these types of reports make it difficult to imagine a scenario in which these reports would be used for purposes of promoting a particular covered investment fund.

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SIFMA appreciates the opportunity to comment on the Proposal. If you have any questions or would like additional information, please do not hesitate to contact Sean C. Davy, Managing Director, SIFMA, at (212) 313-1118 ([sdavy@sifma.org](mailto:sdavy@sifma.org)), Timothy Cameron, Managing Director, SIFMA, at (202)-962-7447 ([tcameron@sifma.org](mailto:tcameron@sifma.org)) or our outside counsel, Annette L. Nazareth, Davis Polk & Wardwell LLP, at (202) 962-7075 ([annette.nazareth@davispolk.com](mailto:annette.nazareth@davispolk.com)).

Very truly yours,



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