

## Investment Fund Research Reports

### FINRA Amends Rules 2210 and 2241 to Conform to the Fair Access to Investment Research Act of 2017

Implementation Date: August 16, 2019

#### Summary

The Securities and Exchange Commission (SEC) has approved a proposed rule change to amend FINRA Rules 2210 (Communications with the Public) and 2241 (Research Analysts and Research Reports) to conform to the requirements of the Fair Access to Investment Research Act of 2017 (FAIR Act).<sup>1</sup> The rule change creates a filing exclusion under Rule 2210 for investment fund research reports that are covered by SEC rules under the FAIR Act, and eliminates the “quiet period” restrictions in Rule 2241 on publishing a report or making a public appearance concerning such funds. The implementation date was August 16, 2019.

The text of the rule is set forth in Attachment A.

Questions concerning this *Notice* should be directed to:

- ▶ Joseph P. Savage, Vice President and Counsel, Office of Regulatory Analysis, at (240) 386-4534 or [joe.savage@finra.org](mailto:joe.savage@finra.org);
- ▶ Philip Shaikun, Vice President and Associate General Counsel, Office of General Counsel (OGC), at (202) 728-8451 or [philip.shaikun@finra.org](mailto:philip.shaikun@finra.org); or
- ▶ Jeanette Wingler, Associate General Counsel, OGC, at (202) 728-8013 or [jeanette.wingler@finra.org](mailto:jeanette.wingler@finra.org).

#### Background and Discussion

The FAIR Act requires the SEC to extend the current safe harbor under Securities Act of 1933 (Securities Act) Rule 139<sup>2</sup> to a “covered investment fund research report” upon terms and conditions that the SEC determines are necessary or appropriate in the public interest, for the protection of investors and for the promotion of capital formation.<sup>3</sup> The FAIR Act further requires the SEC to prohibit any self-regulatory organization (SRO) from maintaining or enforcing specified rules that would restrict publishing or distributing

September 26, 2019

#### Notice Type

- ▶ Rule Amendment

#### Suggested Routing

- ▶ Compliance
- ▶ Legal
- ▶ Operations
- ▶ Research
- ▶ Senior Management

#### Key Topics

- ▶ Advertising Regulation
- ▶ Business Development Companies
- ▶ Commodity and Currency Funds
- ▶ Communications with the Public
- ▶ Exchange Traded Funds
- ▶ Investment Companies
- ▶ Investment Fund Research Reports

#### Referenced Rules & Notices

- ▶ Fair Access to Investment Research Act of 2017
- ▶ FINRA Rule 2210
- ▶ FINRA Rule 2241
- ▶ Investment Company Act of 1940
- ▶ Investment Company Act Rule 24b-3
- ▶ Investment Company Act Rule 24b-4
- ▶ Securities Act of 1933
- ▶ Securities Act Rule 139
- ▶ Securities Act Rule 139b

research on covered investment funds by firms that participated in the fund offering, and to except covered investment fund research reports from the sales material filing requirements in section 24(b) of the Investment Company Act of 1940 (ICA).<sup>4</sup> On November 30, 2018, the SEC adopted rules to implement the mandates of the FAIR Act.<sup>5</sup>

### SEC Rules Under the FAIR Act

The SEC adopted two new rules to effectuate the FAIR Act mandates. First, the SEC adopted new Rule 139b under the Securities Act, which expanded the Securities Act Rule 139 safe harbor to include covered investment fund research reports. Securities Act Rule 139 provides that 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 Securities Act, not to constitute an offer for sale or offer to sell a security that is the subject of a registered offering, provided that the issuer and its securities meet specified conditions in the rule. Rule 139 is sometimes described as a "safe harbor" for such research reports, since they are not subject to many of the Securities Act's requirements for written offers of securities. Prior to the SEC's adoption of rules required by the FAIR Act, Rule 139's safe harbor was not available for a broker-dealer's publication or distribution of research reports pertaining to specific registered investment companies or business development companies (BDCs).

Rule 139b adopts the FAIR Act's definitions of "covered investment fund," "covered investment fund research report" and "research report," subject to minor non-substantive revisions.<sup>6</sup> The term "covered investment fund research report" includes a research report published or distributed by a broker-dealer about a "covered investment fund,"<sup>7</sup> or any of the covered investment fund's securities. However, a covered investment fund research report excludes research published or distributed by the covered investment fund itself, any affiliate of a covered investment fund, or any broker-dealer that is an investment adviser (or an affiliated person of an investment adviser) to the covered investment fund.<sup>8</sup> A "research report" generally has the meaning given that term under section 2(a)(3) of the Securities Act.<sup>9</sup> Under section 2(a)(3), "research report" means "a written, electronic or oral communication 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."<sup>10</sup> FINRA notes that this definition of research report is broader than the definition of "research report" in FINRA Rule 2241.

To qualify for the Rule 139b safe harbor with respect to an issuer-specific research report, the covered investment fund that is the subject of the report must have been subject to reporting requirements under the Investment Company Act (for funds that are registered investment companies) or the Exchange Act (for funds that are not registered investment companies) for at least 12 calendar months prior to the reliance on the safe harbor, and these reports must have been filed in a timely manner.<sup>11</sup> In addition, the covered

investment fund must satisfy a minimum public market threshold at the date of reliance on Rule 139b (the “float” requirement), which is currently \$75 million.<sup>12</sup> The safe harbor also requires that a broker-dealer’s publication or distribution of research reports be “in the regular course of its business.”<sup>13</sup> Rule 139b contains other conditions for industry reports, and with regard to the presentation of performance information of a registered open-end management investment company or a trust account.<sup>14</sup>

Rule 139b also provides that an SRO may 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 participating in a registered offering or distribution of securities of a covered investment fund, or to participate in a registered offering or other distribution of such securities solely because the member has published or distributed a covered investment fund research report about the fund or its securities.<sup>15</sup>

Second, the SEC adopted new Rule 24b-4 under the Investment Company Act, which specifies that a covered investment fund research report as defined in Rule 139b that concerns a fund registered under the Investment Company Act shall not be subject to section 24(b) of the Act or any rules or regulations thereunder, unless the report is not subject to SRO rules relating to research reports, including the content standards applicable to communications with the public.<sup>16</sup> Section 24(b) of the Investment Company Act generally requires certain registered investment companies and their underwriters to file sales material concerning those funds with the SEC within 10 days of use.<sup>17</sup>

### **Changes to FINRA Rules Required by the FAIR Act**

FINRA has made two changes to its rules required by the FAIR Act and Securities Act Rule 139b. First, FINRA amended Rule 2210 to create a filing exclusion for covered investment fund research reports that qualify for the Securities Act Rule 139b safe harbor. Second, FINRA amended Rule 2241 to eliminate the quiet period restrictions on publishing a research report or making a public appearance concerning a covered investment fund that is the subject of such a report.

#### **Elimination of Filing Requirement**

Section 24(b) of the ICA requires registered open-end management investment companies, registered unit investment trusts (UITs), registered face amount certificate companies (FACCs), and their underwriters to file sales material for the funds with the SEC within 10 days of first use. ICA Rule 24b-3 provides that any sales material shall be deemed filed with the SEC for purposes of section 24(b) upon filing with a registered national securities association that has adopted rules providing standards for the investment company advertising practices of its members and has established and implemented procedures to review that advertising.<sup>18</sup>

Virtually all principal underwriters of mutual funds, exchange-traded funds (ETFs), UITs and FACCs satisfy the section 24(b) requirement by filing their sales material with FINRA. Rule 2210 requires members to file within 10 business days of first use or publication of retail communications that promote or recommend a specific registered investment company or family of registered investment companies (including mutual funds, ETFs, variable insurance products, closed-end funds (CEFs) and UITs). The requirement also includes retail communications that concern public direct participation programs such as a BDC and any other registered security that is derived from or based on a single security, basket of securities, index, commodity, debt issuance or foreign currency.<sup>19</sup>

FINRA has created a new filing exclusion under Rule 2210 for “any covered investment fund research report that 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 under Securities Act Rule 139b.”<sup>20</sup> Rule 2210 defines “covered investment fund research report” as having the same meaning given that term in paragraph (c)(3) of Securities Act Rule 139b.<sup>21</sup> Thus, if a firm publishes or distributes a research report concerning an unaffiliated registered investment fund (and the fund, the fund’s adviser, and their affiliates were not involved with the preparation or approval of the report), the firm will not be required to file it with FINRA, provided that the report qualifies for the Rule 139b safe harbor.

The FAIR Act provides that nothing in the Act shall be construed in any way as limiting the authority of any SRO “to examine or supervise a member’s practices in connection with the member’s publication or distribution of a covered investment fund research report for compliance with applicable provisions of the Federal securities laws or [SRO] rules related to research reports, including those contained in rules governing communications with the public.”<sup>22</sup> As such, FINRA may still review such reports through examinations, for example, and they will remain subject to the applicable standards of FINRA rules governing communications with the public.<sup>23</sup>

#### **Affiliate Research Reports**

The FAIR Act and Securities Act Rule 139b define “covered investment fund research report” to *exclude* a research report to the extent that the report is published or distributed by the covered investment fund, any affiliate of the covered investment fund, or any broker or dealer that is an investment adviser (or an affiliated person of an investment adviser) for the covered investment fund.<sup>24</sup> Thus, research reports published or distributed by a covered investment fund, its affiliate or any broker-dealer that is an investment adviser (or an affiliate of the investment adviser) for the covered investment fund will still have to be filed under ICA section 24(b) and FINRA Rule 2210.<sup>25</sup>

In some cases an investment adviser or another affiliate of a fund will enter into an agreement with an unaffiliated broker-dealer to act as the principal underwriter for the fund (third-party distributor). Third-party distributors provide a variety of services pursuant to their distribution agreements with funds. Typically, these funds' investment advisers or the funds themselves prepare the retail communications concerning the funds, and then submit the communications to the third-party distributor for compliance review and filing with FINRA. These communications typically are published on the website for the fund or its investment adviser, or the investment adviser or another fund affiliate requests that it be published or distributed through other media.

As the SEC noted in the Release, one factor to consider in evaluating whether a research report has been published or distributed by a person covered by the affiliate exclusion from the definition of covered investment fund research report is the extent of such person's involvement in the preparation of the research report.<sup>26</sup> These determinations would 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. The SEC refers to such affiliate involvement or endorsement as "the entanglement and adoption theory, respectively."<sup>27</sup>

Thus, FINRA does not consider research reports on covered investment funds to be excluded from filing under Rule 2210 if personnel of the covered investment fund, any affiliate of the fund, or any broker-dealer that is the investment adviser or an affiliated person of the investment adviser were entangled with the preparation of the report, or had adopted its contents after it had been prepared.<sup>28</sup> For example, if a third-party distributor publishes or distributes research concerning a fund that was written by personnel of the fund's investment adviser, the report still would be subject to filing under Rule 2210.

#### **FINRA Equity Research Rules**

FINRA Rule 2241 governs the publication of research reports concerning equity securities and the analysts that produce such research. Under Rule 2241, members must establish, maintain and enforce written policies and procedures reasonably designed to identify and effectively manage conflicts of interest related to the preparation, content and distribution of research reports and public appearances by research analysts.<sup>29</sup> Among other things, these policies and procedures must define periods during which the member must not publish or otherwise distribute research reports, and research analysts must not make public appearances, related to the issuer (quiet periods).

These quiet periods restrict a member that has participated as an underwriter or dealer in an initial public offering (IPO) from publishing research or having its research analysts make public appearances for a minimum of 10 days following the date of an IPO. They also restrict a member that has acted as a manager or co-manager of a secondary offering from publishing research or having its research analysts make personal appearances for a minimum of three days following the date of the offering.<sup>30</sup>

While Rule 2241 excludes from its definition of “research report” communications related to mutual funds, the rule applies to communications that meet the definition of “research report” under Rule 2241 concerning other covered investment funds, including CEFs, ETFs, BDCs, UITs and commodity or currency funds, to the extent such research reports are published by an underwriter or dealer in the IPO or manager or co-manager of a secondary offering.<sup>31</sup> Prior to this rule change, such research reports (as defined under Rule 2241) on covered investment funds (other than mutual funds) were subject to Rule 2241’s quiet periods.

Accordingly, FINRA amended Rule 2241 to add a new exception from the rule’s quiet period requirements for the publication or distribution of research reports and research analysts’ public appearances if the member has participated in the offering of the subject company’s securities.<sup>32</sup> Under this new exception, the quiet period requirements shall not apply to a research report or a public appearance following any offering of the securities of a covered investment fund that is the subject of a covered investment fund research report.<sup>33</sup> Although not required by the FAIR Act or SEC rules, FINRA also eliminated quiet periods for public appearances concerning a covered investment fund to further advance the policy objectives of the FAIR Act.

The amendments to FINRA Rules 2210 and 2241 became effective on August 16, 2019.

## Endnotes

1. See Securities Exchange Act Release No. 86700 (August 16, 2019), 84 FR 43833 (August 22, 2019) (SR-FINRA-2019-017) (Order Approving a Proposed Rule Change to Amend FINRA Rules 2210 (Communications with the Public) and 2241 (Research Analysts and Research Reports)). See also Securities Exchange Act Release No. 86700A (September 4, 2019), 84 FR 47688 (September 10, 2019) (correction).
2. 17 CFR 230.139.
3. See section 2(a) of the FAIR Act.
4. See section 2(b) of the FAIR Act.
5. See Securities Act Release No. 10580 (November 30, 2018), 83 FR 64180 (December 13, 2018) (the Release).
6. See 17 CFR 230.139b(c).
7. Section 2(f)(2) of the FAIR Act defines “covered investment fund” as:
  - (A) an investment company registered under, or that has filed an election to be treated as a business development company under, the Investment Company Act of 1940 (15 U.S.C. 80a-1 et seq.) and that has filed a registration statement under the Securities Act of 1933 (15 U.S.C. 77a et seq.) for the public offering of a class of its securities, which registration statement has been declared effective by the [SEC]; and
  - (B) a trust or other person—
    - i. issuing securities in an offering registered under the Securities Act of 1933 (15 U.S.C. 77a et seq.) and which class of securities is listed for trading on a national securities exchange;
    - ii. the assets of which consist primarily of commodities, currencies, or derivative instruments that reference commodities or currencies, or interests in the foregoing; and
    - iii. that provides in its registration statement under the Securities Act of 1933 (15 U.S.C. 77a et seq.) that a class of its securities are purchased or redeemed, subject to conditions or limitations, for a ratable share of its assets.
8. See section 2(f)(3) of the FAIR Act.
9. However, the term does not include an oral communication. See section 2(f)(6) of the FAIR Act.
10. See section 2(a)(3) of the Securities Act, 15 U.S.C. 77b(a)(3).
11. See 17 CFR 230.139b(a)(1)(i)(A).
12. See 17 CFR 230.139b(a)(1)(i)(B). The required float value does not include shares held by affiliates of the fund, and is based on General Instruction I.B.1 to Form S-3.
13. See 17 CFR 230.139b(a)(1)(ii).
14. See 17 CFR 230.139b(a)(2) and (a)(3).
15. See 17 CFR 230.139b(b).
16. See 17 CFR 270.24b-4.
17. See 15 U.S.C. 80a-24(b). This filing requirement applies to sales material concerning any registered open-end management investment company, any registered unit investment trust or any registered face-amount certificate company.
18. FINRA is currently the only national securities association registered under the Exchange Act that has adopted such rules and procedures.

19. See FINRA Rules 2210(c)(3)(A), (B) and (D). Also, for a one-year period beginning on the date reflected in FINRA's Central Registration Depository (CRD®) system as the date that FINRA membership became effective, a member must file with FINRA at least 10 business days prior to first use any broadly disseminated retail communication, regardless of whether it concerns a registered investment company or public direct participation program. See FINRA Rule 2210(c)(1)(A). In addition, a member must file at least 10 business days prior to first use any retail communication concerning registered investment companies that includes performance rankings or comparisons that are not generally published, or that were created by the investment company, its underwriter, or an affiliate. See FINRA Rule 2210(c)(2)(A).
20. See FINRA Rule 2210(c)(7)(P).
21. See FINRA Rule 2210(a)(7).
22. See section 2(c)(2) of the FAIR Act.
23. See section 2(c)(2) of the FAIR Act; see also Release, *supra* note 5, at 64194-64196 and fn. 185.
24. See section 2(f)(3) of the FAIR Act and Securities Act Rule 139b(c)(3).
25. If a research report concerns both a covered investment fund that is an affiliate of the member that is publishing or distributing the research report, as well as a third-party fund that is not affiliated with the member publishing or distributing the report, the research report would not qualify as a covered investment fund research report. See Release, *supra* note 5, at 64191 (“[w]e 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”).
26. See Release, *supra* note 5, at 64182.
27. See *id.*
28. See Release, *supra* note 5, at 64181-64183 (discussion of affiliate exclusion).
29. See FINRA Rule 2241(b)(1).
30. See FINRA Rule 2241(b)(2)(I). This provision contains specified exceptions to the quiet periods for research reports and public appearances following an offering of securities of an Emerging Growth Company, for reports or appearances that discuss significant news or events concerning a subject company, and for reports and appearances regarding subject companies with “actively traded securities” as defined in SEC Regulation M.
31. See FINRA Rule 2241(a)(11).
32. As discussed above, because the definition of “research report” under Rule 2241 is narrower than the definition of “research report” under the FAIR Act, not all covered investment fund research reports are subject to Rule 2241. Nevertheless, to the extent that a covered investment fund research report is also a research report subject to Rule 2241, the publication and distribution of such reports are not subject to the rule’s quiet periods.
33. FINRA defines the terms “covered investment fund” and “covered investment fund research report” as having the same meanings as in Securities Act Rule 139b. See FINRA Rules 2241(a)(15) and (16).

## Attachment A

Below is the text of the rule change. New language is underlined; deletions are in brackets.

\* \* \* \* \*

### 2000. DUTIES AND CONFLICTS

\* \* \* \* \*

### 2200. COMMUNICATIONS AND DISCLOSURES

#### 2210. Communications with the Public

##### (a) Definitions

(1) through (6) No Change.

(7) “Covered investment fund research report” has the meaning given that term in paragraph (c)(3) of Securities Act Rule 139b.

(b) No Change.

##### (c) Filing Requirements and Review Procedures

(1) through (6) No Change.

##### (7) Exclusions from Filing Requirements

The following communications are excluded from the filing requirements of paragraphs (c)(1) through (c)(4):

(A) through (O) No Change.

(P) Any covered investment fund research report that is deemed for the 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 under Securities Act Rule 139b.

(d) through (g) No Change.

\* \* \* \* \*

#### 2241. Research Analysts and Research Reports

##### (a) Definitions

(1) through (14) No Change.

(15) “Covered investment fund” has the meaning given the term in paragraph (c) (2) of Securities Act Rule 139b.

(16) “Covered investment fund research report” has the meaning given that term in paragraph (c)(3) of Securities Act Rule 139b.

**(b) Identifying and Managing Conflicts of Interest**

(1) No Change

(2) A member’s written policies and procedures must be reasonably designed to promote objective and reliable research that reflects the truly held opinions of research analysts and to prevent the use of research reports or research analysts to manipulate or condition the market or favor the interests of the member or a current or prospective customer or class of customers. Such policies and procedures must:

(A) through (H) No Change.

(I) define periods during which the member must not publish or otherwise distribute research reports, and research analysts must not make public appearances, relating to the issuer:

(i) of a minimum of 10 days following the date of an initial public offering if the member has participated as an underwriter or dealer in the initial public offering; or

(ii) of a minimum of three days following the date of a secondary offering if the member has acted as a manager or co-manager of that offering.

This subparagraph (I) shall not apply to the publication or distribution of a research report or a public appearance following: (1) an initial public offering or secondary offering of the securities of an Emerging Growth Company or (2) any offering of the securities of a covered investment fund that is the subject of a covered investment fund research report;

(iii) No Change.

(J) through (N) No Change.

(c) through (j) No Change.

**• • • Supplementary Material: -----**

No Change.

\* \* \* \* \*