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SEC Adopts Safe Harbor for Broker-Dealers' Research of Business Development Companies and Other Investment Funds

On November 30, 2018, the SEC [adopted Rule 139b](#) under the Securities Act of 1933, which establishes a non-exclusive safe harbor for independent broker-dealers participating in securities offerings of business development companies (“BDCs”) and other “covered investment funds” that publish or distribute research reports on these investment funds, without the research reports being deemed offers to sell the investment funds’ securities that otherwise could be in violation of the Securities Act. A discussion of the new rule, which will become effective on January 14, 2019, follows.

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Scope of Rule 139b

As directed by the Fair Access to Investment Research Act of 2017, the SEC adopted Rule 139b to extend the current safe harbor available under Rule 139 to a covered investment fund research report. Rule 139 permits the publication or distribution of research reports concerning one or more issuers by a broker-dealer participating in a registered offering of one of the covered issuers’ securities.

Rule 139b defines *covered investment fund* to include BDCs as well as registered investment companies and certain commodity- or currency-based trusts or funds. A *covered investment fund research report* must be published by an independent broker-dealer and, therefore, is defined as a research report published or distributed by a broker-dealer about a BDC (or its securities), *excluding* a research report published or distributed by (i) the BDC or any affiliated person of the BDC or (ii) a broker-dealer that is the investment adviser, or an affiliated person of the investment adviser, for the BDC. If the conditions of Rule 139b are satisfied, a broker-dealer’s publication or distribution of such a report would be deemed *not* to constitute an offer for sale or offer to sell the BDC’s securities for purposes of Sections 2(a)(10) and 5(c) of the Securities Act, even if the broker-dealer is participating in a registered offering of the BDC’s securities.

Rule 139b requires that a covered investment fund research report be either an *issuer-specific research report* or an *industry report*.

Issuer-Specific Research Reports

Reporting History and Timeliness Requirements. To be eligible for an issuer-specific research report, the BDC must have been subject to the reporting requirements of Sections 13 or 15(d) of the Exchange Act for at least twelve calendar months and filed in a timely manner all required Forms 10-K and 10-Q during the immediately preceding twelve calendar months. In addition, the SEC indicated that a broker-dealer may rely on the lack of a Form 12b-25 (indicating that a filing is late) filing as confirmation that a BDC’s filings are timely unless the broker-dealer is otherwise actually aware that the BDC has not made timely filings.

Market Following Requirement. Rule 139b includes a minimum public float requirement for covered investment funds that is intended to act as a proxy for market following. At the time of the broker’s or dealer’s initial publication or distribution of an issuer-specific research report (or reinitiation thereof), and at least quarterly thereafter, the BDC included in the report must have a public float of at least \$75 million.¹

¹ Unlike for registered open-end funds, BDCs and closed-end funds cannot satisfy the \$75 million minimum public float requirement using a net asset value (NAV) calculation.

Regular-Course-of-Business Requirement. The broker-dealer must publish or distribute research reports in the regular course of its business and, in the case of a research report regarding a BDC that does not have a class of securities in “substantially continuous distribution,”² the publication or distribution must not be (i) the initiation of publication of research reports about the BDC or its securities or (ii) the reinitiation of publication following discontinuation of publication of such research reports.

Industry Research Reports

Reporting and Regular-Course-of-Business Requirements. Similar to issuer-specific research reports, an industry research report must, as of the date of reliance on Rule 139b, concern a BDC that is subject to the reporting requirements of Section 13 or Section 15(d) of the Exchange Act. However, unlike for issuer-specific research reports, there is no similar twelve-month reporting history requirement. In addition, a broker-dealer must publish or distribute industry research reports in the regular course of its business. Like the parallel provision in Rule 139, Rule 139b’s regular-course-of-business requirement for industry research reports includes a “similar information” requirement. To satisfy this requirement, at the time a broker-dealer publishes or distributes an industry research report, the broker-dealer must include similar information, in similar reports, about the issuer covered in the industry report (or its securities). However, unlike Rule 139, the “similar information” requirement 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.

Content Requirements. An industry research report must contain (a) similar information with respect to a substantial number of BDC issuers of the same type or investment focus (the “industry representation requirement”) or (b) a comprehensive list of BDCs currently recommended by the broker-dealer (the “comprehensive list requirement”). These requirements are designed to result in industry research reports that cover a broad range of BDCs. A broker-dealer cannot include, however, any BDC 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. Broker-dealers may not selectively apply the Rule 139b safe harbor to certain aspects of a research report. As a result, an industry research report that presented a mix of affiliated BDCs and non-affiliated BDCs within the same report would not qualify for the Rule 139b safe harbor.

Presentation Requirements. The industry research report’s analysis of one BDC may not be given materially greater space or prominence than that accorded to any other BDC in the publication. If fund performance information is included in an industry research report, it must be presented in accordance with certain standardized presentation requirements.

Observations

The expansion of the Rule 139 safe harbor to covered investment funds is intended to generally lower broker-dealers’ costs of publishing and distributing such research reports, which would, in turn, cause broker-dealers to “increase their supply of covered investment fund research as a result.” While the Rule 139b safe harbor generally excludes issuer-specific research reports about newly public and/or smaller funds, BDCs and other covered investment funds, as well as the retail investors that invest in them, are likely to benefit from greater independent broker-dealer research coverage, particularly in the zone of an offering.

² In the adopting release, the SEC stated that determining whether a class of securities is in substantially continuous distribution will be based on an analysis of facts and circumstances. However, the SEC confirmed that “substantially continuous distribution” includes traded BDCs engaged in at-the-market offering programs over consecutive quarters pursuant to Securities Act Rule 415(a)(4) and other types of funds that are engaged in continuous offerings pursuant to Securities Act Rule 415(a)(1)(ix).

It is also worth noting that Rule 139b is separate from other significant regulatory changes for BDCs that are contemplated by the Small Business Credit Availability Act (“SBCAA”), which was enacted on March 23, 2018. The SBCAA will allow BDCs to increase their debt-to-equity leverage as well as permit BDCs to follow more liberalized offering and proxy communications rules that were previously available only to operating companies. In addition, one provision of the SBCAA directed the SEC to amend Rules 138 and 139 to specifically include a BDC as an issuer to which those rules apply. While Rule 139b is modeled after and generally tracks Rule 139, the rules differ from one another in certain respects, some of which are specifically directed by the FAIR Act and others that are intended to adapt certain conditions to BDCs and other covered investment funds.