February 20, 2019

SEC Proposes to Expand "Test-the-Waters" Accommodation

On February 19, the SEC proposed a rule (available here) that would expand the "test-the-waters" accommodation—currently available only to emerging growth companies, or "EGCs"—to all issuers, including investment company issuers. If adopted, the proposed rule (Rule 163B under the Securities Act) would allow all issuers to engage in test-the-waters communications with certain institutional investors regarding a contemplated registered securities offering prior to, or following, the filing of a registration statement related to the offering. The proposal is part of the SEC's ongoing assessment of the Securities Act offering communications framework and its effort to encourage additional registered offerings in the United States.

The amendments are intended to facilitate IPOs and other registered offerings by providing increased flexibility with respect to communications with institutional investors. Notably, the impact of this accommodation on the IPO market may be limited, as EGCs have comprised an estimated 87% of IPOs that have gone effective since the Jumpstart Our Business Startups Act (the "JOBS Act") was enacted in 2012.

Background

The JOBS Act created Section 5(d) of the Securities Act, which permits an EGC and any person acting on its behalf to engage in oral or written communications with potential investors that are qualified institutional buyers ("QIBs") or institutional accredited investors ("IAIs") before or after filing a registration statement in order to gauge investor interest in a contemplated securities offering. The SEC's proposal follows action taken by the Division of Corporation Finance in 2017 to extend another EGC accommodation—the ability to initially submit certain filings on a confidential basis—to all issuers.

Proposed Rule

Proposed Rule 163B would permit any issuer (including a non-reporting issuer), or any person authorized to act on its behalf, to engage in oral or written communications with potential investors that are, or are reasonably believed to be, QIBs or IAIs, either prior to or following the filing of a registration statement, to determine investor interest in a registered securities offering. These communications, while exempt from restrictions imposed by Section 5 of the Securities Act on written and oral offers prior to or after filing a registration statement, would nonetheless still be considered "offers" as defined in Section 2(a)(3) of the Securities Act and would therefore be subject to Section 12(a)(2) liability in addition to the anti-fraud provisions of the federal securities laws. The communications would not need to be filed with the SEC (and would be excluded from the definition of free writing prospectus) and would not need to include any specified legends.

The proposed rule does not specify the steps that an issuer should take to establish a reasonable belief that the intended recipients of test-the-waters communications are QIBs or IAIs or otherwise to verify investor status, as is the case for reliance on Rule 506(c) of Regulation D.

The proposed rule would be non-exclusive; attempted compliance would not act as an exclusive election and an issuer could rely on other Securities Act communications rules or exemptions when determining how, when and what to communicate related to a contemplated securities offering.

Information provided in a test-the-waters communication under the proposed rule cannot conflict with material information in the related registration statement. As is currently the practice with regard to EGCs, the SEC or its staff could request that an issuer furnish it with any test-the-waters communication used in connection with an offering. Issuers subject to Regulation FD would also need to consider whether any information in a test-the-waters communication could trigger disclosure obligations under Regulation FD or whether an exemption under Regulation FD would apply. To avoid the application of Regulation FD, the proposing release notes that an issuer could consider obtaining confidentiality agreements from any potential investor engaged under the proposed rule.

Comments are due 60 days after publication of the proposed rule in the Federal Register.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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