Linklaters

February 2019

U.S. Securities Law Briefing:
SEC Proposes Expansion of "Testing the Waters" to All Issuers

As expected, the U.S. Securities and Exchange Commission (the "SEC") has issued a proposed rule that would expand an exception to the strict communications rules governing U.S. public offerings by permitting all issuers to communicate with certain institutional investors at an earlier stage of the offering process.

The proposal is another in the series of offering-friendly, and in particular IPO-friendly, reforms that both Congress and the SEC have implemented beginning with the Jumpstart Our Business Startups Act of 2012 (the "JOBS Act"). There will be a 60-day public comment period following the proposed rule's publication in the Federal Register.

The proposal is another in the series of offering-friendly, and in particular IPO-friendly, reforms that both Congress and the SEC have implemented beginning with the JOBS Act.

The U.S. Securities Act of 1933 (the "Securities Act") restricts communications by issuers contemplating a registered securities offering during the initial phases of the offering process. Written and oral communications with potential investors prior to filing a registration statement are generally prohibited, with potentially severe consequences for "gun-jumping" violations. The current restrictions have historically prevented market participants from engaging in pilot-fishing, market-testing and pre-marketing in many SEC-registered transactions, most significantly in U.S. IPOs. The JOBS Act provided an exception to these prohibitions by permitting emerging growth companies ("EGCs")[1] to communicate — or "test the waters" — with qualified institutional buyers ("QIBs")[2] or institutional accredited investors ("IAIs")[3] prior to or following the date of filing of a registration statement with the SEC.

[1] An EGC is an issuer that had total annual gross revenues of less than $1.07 billion during its most recently completed fiscal year.

[2] Rule 144A under the Securities Act defines QIBs to include institutions that, acting for their own account or the accounts of other QIBs, in the aggregate, own and invest on a discretionary basis at least $100 million in securities of unaffiliated issuers. Banks and other specified financial institutions must also have a net worth of at least $25 million. A registered broker-dealer qualifies as a QIB if, in the aggregate, it owns and invests on a discretionary basis at least $10 million in securities of issuers that are not affiliated with the broker-dealer.

[3] An IAI is an institutional investor that is also an accredited investor, as defined in 17 CFR 230.501 ("Rule 501") of Regulation D.

Proposed Securities Act Rule 163B

As proposed, new Securities Act Rule 163B would permit any issuer (including investment companies), 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, in order to determine whether such investors might have an interest in a contemplated registered securities offering. The proposed rule would provide an exemption for such communications from both Securities Act Section 5(b)(1), which limits written communications to a Section 10 "statutory prospectus," and Section 5(c), which prohibits any written or oral offers prior to the filing of a registration statement. The SEC is also proposing to amend Rule 405 under the Securities Act to exclude a written communication used in reliance on Rule 163B from the definition of free writing prospectus.

Reliance on Rule 163B would be non-exclusive and an issuer could rely on other Securities Act communications rules or exemptions (such as Rules 163 or 164 under the Securities Act) when determining how, when, and what to communicate in connection with a contemplated securities offering. As proposed, there would also be no filing or legending requirements.

Under the proposed rule, test-the-waters communications may not conflict with material information in the related registration statement, which is consistent with the way the exception is currently applied to EGCs. The SEC staff may request (and have, in the EGC context, often done so) that an issuer furnish the SEC staff with any test-the-waters communication. Issuers subject to Regulation FD[4] would also need to consider whether any information in a test-the-waters communication would trigger disclosure obligations under Regulation FD, or whether an exemption under Regulation FD would apply.[5]

Further, while the Rule 163B communications would be exempt from the gun-jumping provisions of Section 5, they nonetheless would still be considered "offers" as defined in Section 2(a)(3) of the Securities Act and would thus be subject to Section 12(a)(2) liability in addition to the anti-fraud provisions of the U.S. federal securities laws.

* * *

[4] Regulation FD applies to all companies that have a class of securities registered under Section 12 of the Exchange Act or that are required to file reports under Section 15(d) of the Exchange Act. It does not, however, apply to foreign private issuers.

[5] For example, Regulation FD generally does not apply if the selective disclosure was made to a person who owes a duty of trust or confidence to the issuer or to a person who expressly agrees to maintain the disclosed information in confidence. An issuer could consider obtaining confidentiality agreements from any potential investors in order to avoid the application of Regulation FD.

The SEC's proposal is not surprising given earlier remarks by SEC Chair Jay Clayton and the popularity of the SEC's 2017 decision to allow all issuers, not just EGCs, to submit their registration statements to the SEC on a confidential basis. We expect that the testing-the-waters expansion will be similarly well received.

We will continue to monitor developments in this area and welcome any queries you may have.

Contacts

For further information please contact:

Mike Bienenfeld
Partner

+44 20 7456 3660

mike.bienenfeld@linklaters.com

Jeff Cohen
Partner

+1 212 903 9014

jeffrey.cohen@linklaters.com

Matthew Poulter
Partner

+1 212 903 9306

matthew.poulter@linklaters.com

Luis Roth
Partner

+33 156 435 842

luis.roth@linklaters.com

Pam Shores
Partner

+44 20 7456 4650

pam.shores@linklaters.com

Tom Shropshire
Partner

+44 20 7456 3223

tom.shropshire@linklaters.com

Scott Sonnenblick
Partner

+1 212 903 9292

scott.sonnenblick@linklaters.com

or any of your other usual Linklaters contacts.