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SEC Proposes to Expand "Test-the-Waters" Modernization Reform to All Issuers

On February 19, 2019, the SEC proposed new rule 163B under the Securities Act of 1933 that would permit all issuers to engage in "test-the-waters" communications with qualified institutional buyers ("QIBS") and institutional accredited investors ("IAIs") about a contemplated registered securities offering. These communications could take place prior to, or following, the filing of a registration statement relating to the offering. The proposed rule tracks the language of Section 5(d) of the Securities Act, which was adopted in 2012 as part of the JOBS Act and which permitted "emerging growth companies" ("EGCs") to use test-the-waters communications.

Background

Permitting issuers to "test the waters" is intended to provide increased flexibility to issuers with respect to their communications about contemplated registered securities offerings, as well as a cost-effective means for evaluating market interest before incurring the costs associated with such an offering. The SEC's proposing release observed that EGCs accounted for nearly 90% of IPOs that have gone effective since the JOBS Act was enacted in 2012, and that a significant percentage of EGCs conducting IPOs have availed themselves of the accommodation afforded by Section 5(d). The proposed rule, if adopted, would make this flexibility available to all issuers.

Proposed Securities Act Rule 163B

The proposed rule would permit any issuer, or any person authorized to act on its behalf, including an underwriter, 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 whether such investors might have an interest in a contemplated registered securities offering. All issuers—including non-reporting issuers, EGCs, non-EGCs, well-known seasoned issuers, and investment companies (including registered investment companies and business development companies)—would be eligible to rely on the proposed rule.

Under the proposed rule, there would be no filing or legending requirements. The proposed rule would be non-exclusive, and an issuer could rely on other Securities Act communications rules or exemptions when determining how, when, and what to communicate about a contemplated securities offering.[1] Further, issuers subject to Regulation FD would 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.

Under the proposed rule, any potential investor solicited must meet, or issuers must reasonably believe that the potential investor meets, the requirements of the rule. The proposed rule provides issuers with the flexibility to use methods that are cost-effective but appropriate in light of the facts and circumstances of each contemplated offering and each potential investor, but does not prescribe the specific actions that an issuer must take to establish a reasonable belief that the intended recipients of test-the-waters communications are QIBs or IAIs.

Although test-the-waters communications are most often associated with initial public offerings, the reach of the proposed rule is much broader than IPOs. It would allow any company – including established public companies – to communicate with QIBs and IAIs through so-called "non-deal road shows." It therefore represents another step in the de-regulation of "offers," recognizing that investors, particularly QIBs and IAIs, do not need to be protected against

[1] Note that EGCs would be able to rely on the proposed rule and would continue to be able to rely on the statutory accommodation in Section 5(d). The SEC's proposing release also contains a table that provides a helpful summary of some of the existing provisions that issuers may rely on in addition to, or in lieu of, proposed rule 163B. *See* Solicitations of Interest Prior to a Registered Public Offering, Securities Act Release No. 10607, pp. 20-21 (Feb. 19, 2019) (available here).

receiving offers. While in itself the proposed rule represents only an incremental improvement, it adds to the reduction of regulatory friction, making it more attractive for companies to become and to stay public.

Considerations for Use by Investment Companies

Issuers that are registered investment companies or business development companies (together, "funds") would also be eligible to engage in test-the-waters communications under the proposed rule. The proposed rule would allow funds to communicate with QIBs and IAIs about a contemplated offering without either being an EGC or complying with the requirements of Section 24(b) of the Investment Company Act of 1940 (the "1940 Act") or Rules 482 or 34b-1, including the associated filing, disclosure, and legending requirements. To promote consistent treatment of different types of issuers' test-the-waters communications, the proposed rule contains related amendments that would exclude funds' test-the-waters communications conducted under the proposed rule from the filing requirements in Rule 497 under the Securities Act and in Section 24(b) of the 1940 Act and the rules thereunder.

In contrast, private funds – *i.e.*, issuers that would be investment companies but for Sections 3(c)(1) or 3(c)(7) of the 1940 Act – are unlikely to benefit from the proposed rule. The test-the-waters communications permitted by the proposed rule take place prior to, or following, the filing of a registration statement relating to a public offering. However, as indicated in a footnote accompanying the proposed rule, Section 3(c)(1) requires that an issuer "is not making and does not presently propose to make a public offering of its securities, " and Section 3(c)(7) requires that an issuer "is not making and does not at [the time of acquisition of its securities by qualified purchasers] propose to make a public offering of its securities."

Comment Period

Interested stakeholders may submit comments to the SEC on the rulemaking proposal during the 60-day public comment period.

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