

SEC Adopts New Rule to Allow All Issuers to “Test-the-Waters”

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In connection with its efforts to modernize the regulatory framework, the SEC announced a new rule that provides all issuers with the flexibility provided by the JOBS Act to use “test-the-waters” communications with institutional investors about potential IPOs and other registered offerings to better gauge market interest. Previously, test-the-waters communications were only available to emerging growth companies.

Securities Act Rule 163B will permit any issuer to engage in oral or written communications with potential investors that are, or that they reasonably believed to be, qualified institutional buyers (“QIBs”) and institutional accredited investors (“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.

A QIB generally is a specified institution that, acting for its own account or the accounts of other QIBs, in the aggregate, owns and invests on a discretionary basis at least \$100 million in securities of unaffiliated issuers. An IAI is any institutional investor that is also an accredited investor, as defined in paragraph (a) of Rule 501 of Regulation D.

The staff intentionally does not specify the steps that an issuer could or must take to establish a reasonable belief that the intended recipients of test-the-water communications are QIBs or IAIs, with the stated goal of providing 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. In the adopting release, the staff states that issuers should continue to rely on the methods that they currently use to establish a reasonable belief with respect to an investor’s status as a QIB or IAI pursuant to Rule 144A and Rule 501(a) of the Securities Act.

Under the rule:

- There are no filing or legending requirements. A written communication would not

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constitute a free writing prospectus, which is subject to filing requirements.

- The communications are deemed “offers” subject to Section 12(a)(2) liability in addition to the anti-fraud provisions of the federal securities laws. The information provided must not conflict with material information in the related registration statement, and furthermore, the staff may request that the issuer furnish any test-the-waters communication.
- Issuers subject to Regulation FD will 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. Regulation FD requires public disclosure of any material nonpublic information that has been selectively disclosed to certain securities market professionals or shareholders.
- Where an issuer wishes to pursue a private placement in lieu of a registered offering immediately after engaging in test-the-waters communications, the issuer should consider whether the test-the-waters communication was conducted in such a way as to constitute a general solicitation that could disqualify the issuer from completing a private placement

The staff noted that limiting communications to financially sophisticated investors, the applicability of anti-fraud provisions and Regulation FD, and the investors' ultimate receipt of a prospectus will mitigate investor protection concerns.

The rule will become effective 60 days after publication in the Federal Register.