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SEC Extends the "Test-the-Waters" Accommodation to All Issuers

On September 26, the U.S. Securities and Exchange Commission (the "SEC") announced that it has adopted a new rule under the U.S. Securities Act of 1933 (the "Securities Act") extending a "test-the-waters" accommodation, currently available only to emerging growth companies ("EGCs"), to all issuers. The goal of new Rule 163B is to encourage more issuers to enter the U.S. public equity markets, while continuing to maintain appropriate investor protections, by leveling the playing field among issuers, increasing their flexibility to tailor the size and other terms of an offering, and reducing core costs of going public.

Under new Rule 163B, all issuers (whether domestic or foreign, reporting or non-reporting, EGCs or non-EGCs, and including well-known seasoned issuers and investment companies) will be allowed to gauge market interest in a possible initial public offering or other registered securities offering through oral or written communications with certain institutional investors prior to, or following, the filing of a registration statement. The text of final Rule 163B and its adopting release is available here. The new rule will become effective 60 days after the publication in the *Federal Register*.

Background

Section 5(c) of the Securities Act prohibits any written or oral offers prior to the filing of a registration statement. In 2012, the U.S. Congress passed the Jumpstart Our Business Startups Act that created, *inter alia*, a "test-the-waters" accommodation for EGCs (Section 5(d) of the Securities Act). The accommodation permits EGCs, or any persons acting on their behalf, to engage in oral or written communications with potential investors that are, or are reasonably believed to be, qualified institutional buyers ("QIBs") or institutional accredited investors ("IAIs"), either before or after filing of a registration statement, in order to ascertain such investors' interest in a contemplated securities offering.

Summary of Rule 163B

Rule 163B makes the test-the-waters accommodation available to any issuer, or person authorized to act on behalf of such issuer, including an underwriter, by allowing such persons to gauge the interest, in a contemplated offering, of any potential investor that is, or that the issuer reasonably believes to be, a QIB or IAI. Rule 163B does not specify the steps an issuer should take to establish a reasonable belief when determining or verifying a potential investor's status. In doing so, the 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. The SEC notes that, if an issuer has taken

reasonable steps to prevent test-the-waters communications from being shared with non-QIBs and non-IAIs and such communications are nonetheless shared (*e.g.*, in violation of a confidentiality agreement), such circumstances, in and of themselves, would not give rise to Section 5 liability for the issuer or trigger a cooling-off period.

As noted in the SEC adopting release, there are several aspects of Rule 163B that adequately ensure that investors' protections are maintained:

- Rule 163B is limited to communications only with investors that are financially sophisticated (namely, QIBs and IAIs);
- communications made under Rule 163B are deemed "offers" under Section 2(a)(10), meaning that they are subject to Section 12(a)(2) liability;
- the continued application of Regulation FD[1] to certain issuers requires consideration as to whether any information in a test-the-waters communication would trigger disclosure obligations under Regulation FD, or whether an exception to Regulation FD would apply; and
- a registration statement is required to be filed and declared effective if an issuer decides to proceed with a contemplated public offering.

No legends or disclaimers are required to be provided in Rule 163B communications. Test-the-waters communications also do not need to be filed with the SEC, although SEC staff in the Division of Corporation Finance anticipates potentially requesting, in connection with its review of a registration statement, that any test-the-waters communications used in connection with the offers are furnished for review (this is the current practice with EGCs). The SEC notes that although some of the information in the test-the-waters communication may differ from the information in a registration statement due to the lag between the time a Rule 163B communication is used and the time the registration statement is filed, issuers should keep in mind that statements made in Rule 163B communications and in the related registration statement must not contain material misstatements or omissions at the time they are made.

The SEC did not propose to require any different filing, legending or content requirements for fund issuers in connection with test-the-waters communications under Rule 163B, and none were adopted in the final rule. The SEC also decided not to impose a standardized performance requirement, or a specific requirement to identify non-standardized performance, for funds' test-the-waters communications given that (i) current standardized performance requirements generally would not be relevant at the time a fund tests the waters; (ii) any performance presentation in a test-the-waters communication would be subject to

[1] Regulation FD requires public disclosure of any material nonpublic information that has been selectively disclosed to certain securities market professionals or shareholders if an issuer has securities listed or admitted to trading on a regulated market.

anti-fraud provisions and (iii) these communications are limited to QIBs and IAIs, which are financially sophisticated investors that would have the bargaining power to request the information they need to asses fund performance.

Rule 163B is non-exclusive and an issuer may rely on other Securities Act communications rules or exemptions when determining how, when, and what, to communicate about a contemplated securities offering.

Rule 163B and general solicitation

As regards the potential treatment of Rule 163B communications as general solicitations, the SEC is of the view that whether a test-the-waters communication would constitute a general solicitation depends on the facts and circumstances concerning the manner in which the communication is effected. An issuer that engages in a test-the-waters communication pursuant to Rule 163B concurrently with communications related to a private offering can conduct such communications in a manner that preserves the availability of both Rule 163B and any offering exemption upon which the issuer might otherwise rely. The SEC has noted that, if, immediately after engaging in a Rule 163B communication, an issuer pursues a private placement instead of a registered public offering, the issuer should consider whether the test-the-waters communication was conducted in such way as to constitute a general solicitation. If it was, then the issuer would need to consider whether the private placement exemption it is relying upon allows general solicitation and if not, whether the investors in the private placement were solicited by means of the test-the-waters communication or through some other means that otherwise would not foreclose the availability of the exemption.

Amendment to Rule 405

In connection with the adoption of Rule 163B, the SEC has amended the definition of "free writing prospectus" to clarify that Rule 163B and Section 5(d) communications are not treated as free writing prospectuses.

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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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