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Legal Update
February 21, 2019

Testing the Waters for All? Proposed New Rule Would Expand Accommodation to All Issuers

Since the Jumpstart Our Business Startups (JOBS) Act was enacted in 2012, emerging growth companies (EGCs) have benefited from the opportunity to test the waters with investors and gauge interest in a potential offering. Title I of the JOBS Act amended Section 5 of the Securities Act of 1933 (the Securities Act) in order to provide that certain communications made by EGCs or persons acting on their behalf with institutional accredited investors and qualified institutional buyers (QIBs), either prior to or following the filing of a registration statement, would not constitute "gun jumping."

Now, the US Securities and Exchange Commission (Commission) has proposed a new rule[1] under the Securities Act that would extend the ability to test the waters to all issuers. This has been highly anticipated. In prior sessions of Congress, legislation had been proposed to do exactly this. Although most of the issuers that have undertaken IPOs in recent years are EGCs and already benefit from the ability to communicate with institutional investors, the notion of extending this communications safe harbor to other issuers has been viewed as providing greater flexibility without raising any investor protection concerns. The Commission has proposed Rule 163B. The rule would allow all issuers to engage in test the waters communications with potential investors that are reasonably believed to be institutional accredited investors or QIBs either prior to or following the date of filing of a registration statement relating to the offering. The proposed rule would provide an exemption from the registration requirements of Section 5 of the Securities Act. The communications could be oral or written, would not be required to be filed with the Commission, and would not be required to bear any legends. Since written communications will be permitted, the Commission also proposes to amend Rule 405 in order to exclude written test the waters communications from the definition of "free writing prospectus." Of course, information shared in any test the waters communication must not conflict with material information included in the registration statement for the offering. The Commission notes that issuers subject to Regulation FD would need to consider whether such communications trigger any Regulation FD obligations. Presumably, an issuer could obtain a confidentiality undertaking. This is interesting in that a significant percentage of follow-on offerings are undertaken on a "wall-crossed" or confidential basis with investors that have undertaken to keep information confidential. It will be interesting to consider whether this will change market practice for such transactions.

The proposed rule would be available to be relied upon by reporting and non-reporting companies, and also would be available to investment companies, such as closed-end funds and business development companies. The legislative proposals that had addressed extending the test the waters provisions to all issuers had not addressed investment companies. The Commission is required to propose amendments to the securities offering and the communications rules applicable to business development companies and closed-end funds by the

spring, so it may have decided to include investment companies for that reason.

The Commission notes that this proposed rule would be non-exclusive. For certain issuers, for example, well-known seasoned issuers (WKSIs), other communications safe harbors already may be available, such as Rule 163. There are some references in the proposing release that suggest the Commission may consider further revisions to the communications safe harbors, which would be welcome given that the last significant changes were made in connection with The Commision's 2005 securities offering reform. Much has changed since.

The proposed rule is subject to a 60-day comment period.

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Endnotes

[1] *Available at:* https://www.sec.gov/rules/proposed/2019/33-10607.pdf.