

Leveling the Playing Field: SEC Makes “Testing the Waters” Available to All Companies

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New Rule Will Allow All Pre- and Post-IPO Companies to Confidentially Pre-Market Before a Registration Statement Is Filed

Final Rule Substantially Similar to Proposed Rule

On September 26, the SEC announced a welcome, broad expansion of “testing the waters” flexibility for all companies. Under new Rule 163B, all companies, and persons authorized to act on their behalf (such as underwriters), will be able to gauge market interest in a possible offering with qualified institutional buyers (QIBs) and institutional accredited investors (IAIs) prior to or after the filing of a registration statement. The new rule is welcome relief for all non-emerging growth companies (EGCs) and for companies without a registration statement on file. The final rule largely follows the February 2019 proposal, with a couple of exceptions.

The rule will become effective 60 days after publication in the Federal Register, likely in early December 2019.

Availability to All Companies

Under the new rule, all companies, including non-reporting companies, EGCs, non-EGCs, well-known seasoned issuers (WKSIs), and investment companies (including registered investment companies and business development companies (BDCs)) will be able to test the waters (TTW) with potential sophisticated investors. Today, only EGCs and underwriters acting on their behalf are allowed to engage in pre-filing communications with sophisticated investors. This will level the playing field for non-EGCs contemplating an IPO, who until now have not been able to conduct pre-marketing until a registration statement is filed publicly, even though they have been able to confidentially submit registration statements since 2017.

Availability to Underwriters and Wall-Crossing in All Cases

Today, the ability of underwriters to test the waters for public companies is somewhat limited. For non-EGCs, underwriters can only test the waters if a registration statement covering the securities is on file. Rule 163 allows WKSIs to test the waters, but underwriters working on the transaction are not eligible under that rule. Under the new rule, underwriters will be able to communicate with potential investors prior to the filing of a registration statement, as long as they are authorized to do so by the company.

As a result, the ability to “wall-cross,” or market an offering on a confidential basis to a small number of investors prior to deciding whether to launch, will be expanded to all companies and their underwriters without needing a registration statement on file. Of course, any pre-marketing activities must be conducted in compliance with Regulation FD.

Flipping to a Private Offering Allowed

Companies will not automatically be precluded from conducting a private placement in lieu of a registered offering after testing the waters pursuant to Rule 163B. The SEC noted that a company should consider the facts and circumstances to determine whether the TTW communication was a general solicitation that might foreclose the availability of a private placement exemption. That said, the SEC stated that where the company has taken reasonable steps to ensure that the TTW communications are not shared with non-QIBs and non-IAs, no cooling-off period would be required. Most helpfully, the SEC did *not* include a

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provision from the proposal that would have made the rule unavailable for any communication that was part of a plan to evade the registration requirements of the Securities Act.

No Filing Requirement and No Free Writing

TTW communications under Rule 163B will not be required to be filed. The SEC does anticipate, however, that the staff will ask to see any TTW communications in connection with its review of a registration statement, consistent with its practice for EGC TTW materials.

Use by Investment Companies

Consistent with the proposal, Rule 163B will apply to registered investment companies and BDCs. In addition to pre-filing communications, funds will be permitted to engage in TTW communications with QIBs and IAs after filing a registration statement. No further filings with the SEC or legending or content requirements will be needed for funds' communications pursuant to Rule 163B.

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