



Securities Law ADVISORY ■

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SEC Issues Final Rule Allowing All Issuers to “Test the Waters”

On September 26, 2019, the Securities and Exchange Commission (SEC) adopted new [Rule 163B](#) under the Securities Act of 1933 (Securities Act) allowing all issuers to “test the waters” by gauging market interest for a potential registered securities offering before filing a registration statement. Previously, only emerging growth companies (EGCs) were permitted to use the test-the-waters accommodation. The SEC believes this new rule may encourage more issuers to enter the public equity markets and raise capital through registered securities offerings.

Under the newly finalized Rule 163B of the Securities Act:

- There are no filing or legending requirements.
- Communications between issuers and investors are considered “offers.”
- Issuers subject to Regulation FD will still need to consider whether information in a test-the-waters communication will require public disclosure under Regulation FD.

Background

In 2012, Congress passed the Jumpstart Our Business Startups Act (JOBS Act), permitting EGCs to communicate with institutional investors and buyers to gauge interest in a securities offering before or after filing a registration statement. This allowed issuers a cost-effective method of evaluating the market’s interest in an offering before expending the costs of a public offering.

Given the significant use of test-the-water communications in EGC initial public offerings (IPOs), issuers have called on the SEC to expand the application of the rule to all issuers. In July 2018, the House of Representatives passed the JOBS and Investor Confidence Act (JOBS Act 3.0), which contained reforms to grow the IPO market, including the expansion of test-the-water communications to all issuers. While the Senate has yet to vote on the JOBS Act 3.0, the SEC proactively adopted Rule 163B.

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Highlights of the Final Rule

Scope of eligibility: All issuers (including registered investment companies), or any person acting on the issuer's behalf, are eligible to make test-the-water communications under Rule 163B either before or after the date of filing a registration statement relating to the offering without violating the Securities Act's "gun jumping" rules. Communications must be limited to qualified institutional buyers and institutional accredited investors.

Reasonable belief standard: Issuers are not required to verify investor status if they "reasonably believe" the investor meets the rule's requirements. The final rule did not include specific steps an issuer must take to establish a reasonable belief. However, we anticipate that issuers should conduct reasonable inquiries into a potential investor's status to ensure the investor meets the requirements.

Nonexclusivity: Rule 163B remains nonexclusive, and issuers may still rely on other securities laws and regulations when determining what communications to have in preparation for a securities offering.

No filing or legending requirement: Issuers do not need to file or include these communications with a specific legend before or after filing a registration statement.

Regulation FD: Issuers subject to Regulation FD still need to consider whether their test-the-water communications must be disclosed under Regulation FD requirements. Regulation FD requires the public disclosure of any material nonpublic information that had previously been disclosed to other market professionals or shareholders if the security is registered under Section 12 or 15(d) of the Securities Exchange Act of 1934 (Exchange Act).

Changes from the Proposed Rule

The SEC first proposed expanding the test-the-waters rule on February 19, 2019. Following the public comment period, the SEC implemented a few changes to the final rule. First, the final rule does not include an anti-evasion provision that barred communications, otherwise in compliance with the rule, that were part of a plan to evade requirements of Section 5 of the Securities Act. Commenters raised concerns that this provision would create uncertainty and may limit the efficacy of the rule. The SEC noted communications under the rule are still subject to anti-fraud laws and removed the anti-evasion provision to avoid confusion.

The SEC also removed the filing requirement for test-the-waters communications from the final rule. The SEC agreed with commenters that many of these communications have a limited benefit to the public and are often "oral in nature" and would not be included in a filing anyway.

Finally, the SEC clarified in the final rule that its statement "information in a Rule 163B communication must not conflict with material information in the related registration statement" was included to provide guidance on federal security law requirements and is not an obligatory condition to the rule.

Next Steps

This rule becomes effective 60 days after publication in the *Federal Register*.

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