

Client Alert

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

On September 26, 2019, the Securities and Exchange Commission (the **SEC** or the **Commission**) adopted Rule 163B under the Securities Act of 1933, as amended (the **Securities Act**) to permit all issuers, regardless of size or filing status, to engage in oral or written communications (**test-the-waters**) with potential investors that are qualified institutional buyers (**QIBs**) under Rule 144A or institutional accredited investors (**IAIs**) under Rule 501, both before and after filing a registration statement, to determine whether such investors might have an interest in a contemplated registered securities offering. The newly adopted Rule 163B, which largely conforms to its [proposed form](#), extends the popular test-the-waters accommodation under the Jumpstart Our Business Startups Act (the **JOBS Act**) for emerging growth companies (**EGCs**) under Rule 405 to all issuers and becomes effective 60 days after publication in the Federal Register.

The JOBS Act, enacted in 2012, amended Section 5 of the Securities Act to permit EGCs, or persons authorized to act on their behalf, to make test-the-waters communications prior to or after filing a registration statement. Under the test-the-waters accommodation, issuers that qualify as an EGC can engage in oral or written communications to solicit nonbinding indications of interest from potential investors that are QIBs or IAIs. Rule 163B, which likewise has been adopted under the Securities Act, extends the test-the-waters exemption to all issuers, regardless of size or status.

By allowing all issuers to gauge market demand before incurring the costs associated with an offering, Rule 163B offers significant flexibility to issuers in the offering process by permitting them greater flexibility to communicate with potential investors. The discussion below provides a high-level overview of key takeaways under the rule. For a more in-depth discussion of Rule 163B, please see the [adopting release](#) issued by the SEC.

High-Level Takeaways

1. All issuers are eligible under Rule 163B to engage in test-the-waters communications.

The newly adopted Rule 163B allows all issuers, including well-known seasoned issuers, nonreporting issuers, non-EGCs and investment companies to communicate more freely in all types of registered offerings. In other words, the rule allows all issuers, regardless of size or filing status, to engage with QIBs and IAIs before filing a registration statement to gauge interest and feedback for an anticipated offering.

Rule 163B also applies to investment companies, including closed-end funds and business development companies. Under the rule, investment companies may engage with QIBs and IAIs pre-filing, as well as in the time period after a registration statement has been filed while the fund considers a registered offering before the registration statement becomes effective.

2. *Test-the-waters communications can only take place with an investor the issuer reasonably believes qualifies as a QIB or IAI.*

Under 163B, test-the-waters communications may only be communicated to an investor the issuer reasonably believes is a QIB or IAI. The “reasonable belief” standard adopted by the Commission is a flexible standard that does not require any specific method to establish a reasonable belief or that an issuer verify an investor’s status. Rather, the reasonable belief standard is satisfied so long as an issuer takes into consideration the specific facts and circumstances of the offering and each potential investor. The adopting release rejected one commenter’s call for a more stringent verification standard and explained that issuers should continue to rely on existing methods of establishing a reasonable belief of an investor’s status in other contexts.

3. *No filing requirements exist under Rule 163B.*

The newly adopted rule does not require issuers to file test-the-waters communications with the SEC, nor does it require issuers to use any disclaimers or restrictive legends. The adopting release notes, however, that in continuing with the current practice conducted by EGCs, Commission staff anticipates requesting, in connection with its review of a registration statement, any test-the-waters communications used in connection with the offering.

4. *Test-the-waters communications constitute “offers” subject to Section 12(a)(2) liability.*

Consistent with the proposed rule, under Rule 163B(b)(2), test-the-waters communications constitute “offers” as defined in Section 2(a)(3) of the Securities Act, and are thereby subject to liability under Section 12(a)(2) of the Securities Act for material misstatements and omissions, as well as the other antifraud provisions of the federal securities laws.

In that context, the Commission clarified that the proposing release’s statement that “information in a Rule 163B communication must not conflict with material information in the related registration statement” is not a prerequisite to utilizing Rule 163B, but merely guidance that such communications, while not subject to Section 5 of the Securities Act, must still comply with the other provisions of federal securities laws. The adopting release explains that test-the-waters communications must not contain a material misstatement or omission at the time the statements were made, but noted that the Commission recognizes that information such as changes to capital-raising strategy or offering terms may change depending on the circumstances and investor feedback. Nonetheless, issuers should ensure that test-the-waters communications that relate to material information regarding financial condition, business operations and strategy, management, and other operational information are generally consistent with the information presented in the filing statement to avoid liability under the federal securities laws.

The adopting release also addressed liability concerns regarding implications of a QIB or IAI passing test-the-waters material to a nonqualified party. Pursuant to the adopting release, an issuer that takes reasonable steps to prevent test-the-waters communications from being shared to a nonqualified party is not subject to Section 5 liability or the need for a cooling-off period. As such, liability is limited to circumstances where an issuer fails to take reasonable steps to prevent dissemination of test-the-waters materials to nonqualified investors.

5. *Rule 163B is nonexclusive.*

Rule 163B is nonexclusive, meaning an issuer may rely on the rule concurrently with other rules and exemptions when determining the content and timing of the communications related to a contemplated securities offering. An issuer that relies on any other exemption, however, must still comply with the conditions of the applicable exemption. Though not explicitly addressed in the adopting release, new Rule

163B may afford issuers greater flexibility as to the information discussed when engaging in nondeal roadshows so long as the audience for such communications is limited to QIBs and IAs.

6. *Engaging in test-the-waters communications does not prevent simultaneous communications related to a private placement.*

To alleviate concerns on the proposed rules' effect on private placement exemptions, the adopting release permits an issuer to engage in test-the-waters communications simultaneous to communications related to a private offering, while preserving the availability of both Rule 163B and a valid private placement exception. The adopting release cautions, however, that an issuer that decides to pursue a private placement in lieu of a registered offering immediately after engaging in test-the-waters communications must consider whether such communications constitute a general solicitation, thereby precluding the availability of some private placement exemptions.

7. *Rule 163B does not exempt test-the-waters communications from Regulation FD.*

Issuers subject to Regulation FD must publicly disclose any nonmaterial public information that has been selectively disclosed to certain securities market professionals or shareholders. Test-the-waters communications made under Rule 163B are not exempt from Regulation FD. Issuers subject to Regulation FD should therefore consider whether any information disclosed in a test-the-waters communication triggers a Regulation FD obligation, and if so, whether an exception to Regulations FD applies.

Many seasoned issuers already rely on the confidentially marketed public offering, also known as a wall-crossed offering, for equity follow-on offerings, particularly during periods of market volatility. As part of such an offering, underwriters contact select institutional investors and, after securing a confidentiality and standstill agreement from interested parties, provide those investors with limited nonpublic information about the issuer and the offering in an effort to gauge market demand for a new issuance. In order to comply with Section 5, this technique is usually limited to issuers with effective shelf registration statements and is typically marketed off a base prospectus and preexisting investor presentations, obviating the need to produce additional written disclosure documents or any free writing prospectuses. Rule 163B expands the potential use of wall-crossed offerings to all issuers. In these situations, we expect issuers and their underwriters to observe many of the procedures currently utilized in the existing market for wall-crossed offerings.

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