The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

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SEC Proposes Expanding Pre-Filing Communications with Certain Prospective Investors; Member Call Scheduled for March 5 at 2 pm (Eastern)

[31627]

February 21, 2019 TO: ICI Members
Chief Compliance Officer Committee
Closed-End Investment Company Committee
SEC Rules Committee
Small Funds Committee SUBJECTS: Compliance RE: SEC Proposes Expanding Pre-Filing Communications with Certain Prospective Investors; Member Call Scheduled for March 5 at 2 pm (Eastern)

The Securities and Exchange Commission recently proposed a new rule that would expand the ability of issuers, including investment company issuers, to gauge market interest in potential securities offerings through communications with certain investors prior to the filing of a registration statement.[1] These "test-the-waters" communications, which may be oral or in writing, would permit issuers to consider investor views about potential offerings at an earlier stage in the process than permitted today.

The SEC is proposing the new rule in response to calls to expand the "test-the-waters" accommodations to a broader range of issuers and to level the playing field with certain companies that already can take advantage of these measures.[2] It believes that the proposed rule may benefit more issuers seeking capital and may encourage additional participation in the public markets, sparking investment opportunities and market transparency and resiliency.[3] The SEC believes that certain investment companies could benefit from "test-the-waters" communications during their seeding periods, when they test investment strategies and establish performance track records without filing registration statements under the Securities Act of 1933.[4] Although it acknowledges that investment companies would use the proposed rule more sparingly than operating companies, the SEC believes that such communications could help investment companies better assess market demand for a particular investment strategy and appropriate fee structures, prior to incurring the full costs of a registered offering.[5]

We have scheduled a member call to discuss the proposal for Tuesday, March 5

at 2 pm (Eastern Time). Please contact Ruth Tadesse at rtadesse@ici.org to receive dial-in information for the call. If you have any comments on the proposal, please contact Ken Fang at kenneth.fang@ici.org. Comments on the proposal are due 60 days after publication in the Federal Register. We summarize the proposal briefly below.

Summary of Proposed Rule

Section 5(c) of the Securities Act generally restricts issuers from making written and oral offers prior to filing a registration statement under the Securities Act. Section 5(b)(1) limits written offers to "statutory prospectuses" that conform to certain information requirements set out in Section 10 of the Securities Act. Section 12(a)(2) of the Securities Act imposes liability for selling a security through a prospectus that includes an untrue statement of a material fact or omits to state a material fact necessary to make the statements therein not misleading.

The proposed rule would permit issuers and persons authorized to act on their behalf to solicit interest in a registered securities offering with potential investors that are, or are reasonably believed to be, "qualified institutional buyers" ("QIBs")[6] or "institutional accredited investors" ("IAIs"),[7] notwithstanding the Section 5 prohibitions. The communications could occur either prior to or following the filing of a registration statement for such securities and must not conflict with material information in the related registration statement.[8] Because QIBs and IAIs are considered to have the ability to assess investment opportunities, "test-the-waters" communications that comply with the proposed rule would not need to be filed with the SEC, nor would they be required to include any specified legends.[9]

The proposed rule would be non-exclusive, meaning that an issuer could rely on other Securities Act communications rules or exemptions when determining, how, when, and what to communicate regarding a contemplated securities offering.[10]

The "test-the-waters" communications, while exempt from Section 5, would nonetheless be considered "offers" and would be subject to Section 12(a)(2) liability in addition to anti-fraud provisions. While currently investment companies could make similar communications *after* the filing of a registration statement subject to rules under the Securities Act (*e.g.*, Rule 482) and the Investment Company Act (*e.g.*, Rule 34b-1), the proposed rule would permit funds to engage in permissible "test-the-waters" communications *both prior to and after* the filing a registration statement without complying with the conditions of those other rules (*e.g.*, subject to certain filing, disclosure, and legending requirements).

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endnotes

[1] *See* SEC, *Solicitations of Interest Prior to a Registered Public Offering*, Securities Act Release No. 10607 (February 19, 2019), *available at* https://www.sec.gov/rules/proposed/2019/33-10607.pdf.

[2] In 2012, Congress passed the Jumpstart Our Business Startups Act which permitted, among other things, "emerging growth companies" and any person authorized to act on

their behalf to engage in oral or written communications with potential institutional investors before or after filing a registration statement. "Emerging growth companies" are issuers that had total annual gross revenues of less than $1.07 billion during its most recently completed fiscal year and, as of December 8, 2011, had not sold common equity securities under a registration statement.

[3] In support of the proposed rule, the SEC indicates that it has not found pre-filing solicitations to be a significant cause for investor protection concerns.

[4] In addition, the SEC believes that certain investment companies could benefit from the communications after filing registration statements under the Securities Act, as they could rely on the new rule rather than existing rules that have conditions imposing associated filing, disclosure, and legending requirements. *See*, *e.g.*, Rule 482 under the Securities Act and Rule 34b-1 under the Investment Company Act of 1940.

[5] The SEC notes that, often, an investment company contemplating a registered offering at the time of its organization will file a registration statement under both the Securities Act and Investment Company Act, obviating the benefit of "test-the-waters" communications prior to the filing of a registration statement under the Securities Act.

[6] "QIBs" are defined in Rule 144A under the Securities Act and include specified institutions that, in the aggregate, own and invest on a discretionary basis at least $100 million in securities of non-affiliated issuers. Banks and other specified financial institutions also must have a net worth of at least $25 million. A registered broker-dealer qualifies as a QIB if, in the aggregate, it owns and invests on a discretionary basis at least $10 million in securities of non-affiliated issuers.

[7] An "IAI" refers to any institutional investor that is also an "accredited investor," as defined in Rule 501 of Regulation D. Certain enumerated entities with over $5 million in assets qualify as accredited investors, while others, including regulated entities such as banks and registered investment companies, are not subject to the assets test.

[8] The proposed rule would not be available for communications that are part of a plan or scheme to evade the requirements of Section 5.

[9] Issuers subject to Regulation FD also would need to consider whether any information in the "test-the-waters" communications trigger obligations under Regulation FD. Regulation FD requires public disclosure of any material non-public information that has been selectively disclosed to certain market professionals or shareholders.

[10] The conditions of any other exemption or rule relied upon must be satisfied in order to rely on the other exemption or rule.