

MEMO# 18189

November 15, 2004

SEC PROPOSES SECURITIES ACT REFORM

[18189] November 15, 2004 TO: CLOSED-END INVESTMENT COMPANY MEMBERS No. 73-04 EQUITY MARKETS ADVISORY COMMITTEE No. 45-04 FIXED-INCOME ADVISORY COMMITTEE No. 13-04 SEC RULES MEMBERS No. 163-04 RE: SEC PROPOSES SECURITIES ACT REFORM

The Securities and Exchange Commission has published for comment proposed modifications to the securities registration and offering processes under the Securities Act of 1933.¹ The proposals address communications related to registered securities offerings, registration and other procedures in the offering and capital formation processes, and delivery of information to investors, including delivery through access and notice, and timeliness of that delivery. The most significant aspects of the proposals are summarized below. The proposals address several issues raised by the SEC's so-called "Aircraft Carrier" proposal.²

I. Categories of Issuers Under the proposals, the amount of flexibility granted to issuers would be contingent on the characteristics of the issuer, including the type of issuer, the issuer's reporting history, and the issuer's equity market capitalization or historical debt issuance. The proposals divide issuers into the following four categories and would grant the most flexibility to "well-known seasoned" issuers.

- Non-reporting issuer: An issuer that is not required to file reports with the SEC pursuant to Sections 13 or 15(d) of the Securities Exchange Act of 1934.
- Unseasoned issuer: An issuer that is required to file periodic reports with the SEC, but does not satisfy the requirements of Form S-3 or Form F-3 for a primary offering of its securities.

¹ Securities Act Release No. 8501 (Nov. 3, 2004) ("Release"). The Release can be found on the SEC's website at <http://www.sec.gov/rules/proposed/33-8501.pdf>. Comments on the proposals are due to the SEC no later than January 31, 2005.

² The Regulation of Securities Offerings, Release No. 33-7606A (Nov. 13, 1998).

- Seasoned issuer: An issuer that is eligible to use Form S-3 or Form F-3 to register a primary offering of securities.
- Well-known seasoned issuer: An issuer that is eligible to register a primary offering of its securities on Form S-3 or Form F-3 and has either \$700 million of public common equity float or, for limited purposes, has issued \$1 billion of registered debt in the preceding three years.

³ The Release notes that in general, registered investment companies and business development companies would not be eligible to take advantage of the proposals.

II. Proposals Relating to Issuer Communications The proposals would update and liberalize permitted offering activity and communications to allow more information to reach investors in the following ways:

- All issuers and other offering participants would be permitted to use a new type of written communication called a "free writing prospectus" after the filing of the registration statement, subject to specified conditions (including, in some cases, filing with the SEC).
- All reporting issuers would be permitted at any time to continue to publish regularly released factual business information and forward-looking information.
- Non-reporting issuers would be permitted to publish at any time regularly released factual business information to persons other than in their capacity as investors or potential investors (i.e., customers or suppliers).
- Well-known seasoned issuers would be permitted to engage at

any time in oral and written communications, including use at any time of a free writing prospectus, subject to specified conditions (including, in some cases, filing with the SEC). • Communications by issuers more than 30 days before filing a registration statement would not be considered prohibited so long as the communications do not reference a securities offering. • A broader category of routine communications regarding issuers, offerings and procedural matters, such as communications about the schedule for an offering or account-opening procedures, would be excluded from the definition of “prospectus.”

3 The Release notes that the issuers that would meet the proposed thresholds for well-known seasoned issuers are the most active issuers in the U.S. public capital markets. For instance, in 2003, those issuers, which represented approximately 30 percent of listed issuers, accounted for about 95 percent of U.S. equity market capitalization and 87 percent of the total debt raised in registered offerings over the past seven years.

4 The SEC specifically requests comment on whether registered investment companies or business development companies should be permitted to use a free-writing prospectus.

3 • The current exemptions available to broker-dealers for research reports would be expanded. The proposals would define all methods of communication, other than oral communications, as written communications for purposes of the Securities Act. The proposals would also address the treatment under the Securities Act of electronic road shows and communications on Web sites.

III. Liability Timing Issues

The Release includes an interpretation that, for purposes of disclosure liability under Sections 12(a)(2) and 17(a)(2) of the Securities Act, the assessment of whether a material misstatement or material omission exists would be made against information conveyed to an investor at the time of its decision, and not information that is only conveyed or filed after that decision. This interpretation reflects the SEC’s view that materially accurate and complete information regarding an issuer and the securities being sold should be available to investors at the time of the contract of sale, when they make their investment decision. In an effort to address uncertainty as to issuer liability under Section 12(a)(2), the SEC is proposing a rule that would provide that an issuer in a primary offering of securities, regardless of the form of the underwriting arrangement, be considered to offer or sell the securities to the purchaser, and therefore be a seller for purposes of Section 12(a)(2) as to any communications made by or on behalf of the issuer. The proposed rule, Rule 159A, would apply, for example, to communications made by or on behalf of investment companies and business development companies in any advertisements pursuant to Securities Act Rule 482.5

IV. Registration Process

The proposals would modernize the operation of the requirements for the shelf registration process under the Securities Act. The proposals would, among other things, establish “automatic shelf registration” for offerings by well-known seasoned issuers (which would provide these issuers significant latitude in determining the types and amounts of their securities that could be offered), permit issuers to use prospectus supplements (rather than post-effective amendments) to make material changes to the plan of distribution described in the base prospectus, and permit immediate takedowns of securities off of shelf registration statements.

V. Prospectus Delivery Reforms

The proposals would change the way in which the final prospectus delivery obligations under the Securities Act are satisfied by creating an “access equals delivery” model for final prospectuses.⁶ Under this model, filing a final prospectus with the SEC and complying with

5 The SEC requests comment on whether proposed Rule 159A should apply to investment companies and whether the communications covered by the proposed rule with respect to investment company issuers (e.g., profiles provided pursuant to Rule 498, issuer information included in advertisements pursuant to Rule 482) are appropriate.

6 The proposed prospectus delivery reforms would not apply to registered investment companies or business development companies. 4 other conditions would satisfy delivery requirements. In addition, to preserve an investor’s ability to trace securities to a registered

offering, the proposals include a separate requirement to notify investors that they purchased securities in a registered offering. VI. Required Disclosure in Exchange Act Reports The proposals would extend risk factor disclosure to annual reports on Form 10-K and registration statements on Form 10. VII. Application of Proposals to Asset-Backed Securities The Release notes that asset-backed securities (“ABS”) issuers offering securities registered on Form S-1 would be non-reporting issuers and ABS issuers offering securities registered on Form S-3 would be considered seasoned issuers. The proposals would provide that no ABS issuer would be a well-known seasoned issuer. In addition, the general content of ABS registration statements under current practice and under proposed SEC rules⁷ would not change under this proposal. The SEC noted that it would anticipate that the communications proposals, if adopted, would apply to ABS offerings. For example, the proposals regarding regularly released information for reporting issuers, noted above, could apply to information conveyed to investors in outstanding ABS, such as static pool information, provided the conditions of the proposed rule are satisfied. In addition, the use of informational and computational materials for ABS issuers would be considered free writing prospectuses, and their use would be conditioned on satisfying the conditions of the proposed rules. The Release states that the proposal would address some of the concerns that were expressed by commenters, including the Institute, on the ABS Proposal regarding discrepancies between the time an investor makes an investment decision and the time of availability of a prospectus supplement. As noted above, under the proposals, information conveyed to investors by or on behalf of an issuer or other offering participant after the time of contract of sale would not be used to evaluate liability under Section 12(a)(2). Therefore, if a prospectus (including a free writing prospectus) provided prior to the time of the contract of sale failed to disclose material information about the asset pool and the omission caused the information conveyed to the investor to be misleading, then the omission could not be corrected by conveying the information subsequently, including in a subsequently available prospectus or prospectus supplement. Jane G. Heinrichs Assistant Counsel 7 Securities Act Release No. 8419 (May 3, 2004) (“ABS Proposal”). See ICI Memorandum to Fixed-Income Advisory Committee No. 7-04 and SEC Rules Members No. 81-04, dated June 3, 2004 [17574].