MEMO# 10511

November 25, 1998

SEC PROPOSALS REGARDING THE REGULATION OF SECURITIES OFFERINGS AND TAKEOVERS (""AIRCRAFT CARRIER RULES"")

1 Securities Act Release No. 33-7606A, November 13, 1998 (File No. S7-30-98). 2 Securities Act Release No. 33-7607, November 3, 1998 (File No. S7-28-98). 3 The proposals can be found on the SEC’s web site at www.sec.gov/rules/propridx.htm. If you wish to obtain a copy of the proposals referred to in this memorandum, please call the Institute's Library Services Division at (202) 326-8304. [10511] November 25, 1998 TO: CLOSED-END INVESTMENT COMPANY COMMITTEE No. 26-98 INVESTMENT ADVISERS COMMITTEE No. 38-98 SEC RULES COMMITTEE No. 121-98 UNIT INVESTMENT TRUST COMMITTEE No. 37-98 EQUITY MARKETS TASK FORCE MUNICIPAL SECURITIES TASK FORCE SECURITIES OFFERINGS RULES TASK FORCE RE: SEC PROPOSALS REGARDING THE REGULATION OF SECURITIES OFFERINGS AND TAKEOVERS ("AIRCRAFT CARRIER RULES") ____ The Securities and Exchange Commission ("SEC") recently published for comment proposed amendments to the Securities Act of 1933.1 The rule proposals, also known as the "aircraft carrier rules," would modernize and clarify the regulatory structure for securities offerings. The SEC also published for comment a companion rule proposal2 that would update and simplify the rules and regulations applicable to takeover transactions (including tender offers, mergers, and acquisitions).3 The rule proposals address several different areas of the securities laws including the securities offering process, communications, periodic reporting, mergers and acquisitions, and the proxy rules. The proposals are expected to be published in the Federal Register this week. There will be a 120-day comment period following publication in the Federal Register. Significant aspects of the proposals are summarized below. The Institute has established a Securities Offerings Rules Task Force to review the rule proposals, examine the extent to which the proposals affect investment companies both as purchasers and issuers, and assist in the preparation of its comment letter to the SEC. If you are interested in joining the Task Force or have any comments on the proposals that you would like the Institute to consider including in its letter, please contact the undersigned at (202) 371-5408 or by e-mail at aburstein@ici.org. - 2 - 4 Under the proposals, a "seasoned" issuer means a reporting issuer with at least a one-year reporting history that has filed at least one annual report. 5 Under the proposals, a large issuer would be an issuer with either (1) a public float of $250 million or more or (2) a public float of $75 million or more and an average daily trading volume of $1 million or more. - 3 - A. REGULATION OF SECURITIES OFFERINGS The proposal to update and modernize the Securities Act would implement major changes to the securities offering process and the

disclosure system that applies to publicly offered reporting companies. The proposal covers five major topics: registration system reform; communications around the time of an offering; prospectus delivery requirements; integration of private and public offerings; and periodic reporting under the Securities Exchange Act of 1934. 1. Registration System Reform The proposed amendments to the rules governing the securities offering process are designed to encourage issuers to engage in public offerings instead of offering securities in the private and Rule 144A markets by applying the timing and disclosure flexibility found in those markets to the public offering process. The SEC believes that, as a result, more offerings will be registered and therefore more information about companies will be disseminated to investors. In particular, the proposal would create a three-tiered registration system consisting of three new forms: Form A; Form B; and Form C. A different type of issuer, depending on its size and seasoned status,4 will use each form. Form A, which would replace Form S-1 as the basic registration statement form, generally would be used for offerings made by smaller or unseasoned companies. IPOs also would generally be registered on Form A. Form B generally would be used for offerings made by large,5 seasoned issuers and those made to relatively informed or sophisticated investors. Finally, Form C would be used for offerings that relate to business combinations or exchange offers. a. Contents of Prospectuses The proposals condition the extent that flexibility will be afforded issuers based on the size and seasoned status of the issuer. Larger, seasoned issuers who would use Form B for securities offerings are therefore afforded a larger measure of flexibility regarding disclosure about their offerings. The proposal asks for comment on two alternative proposals for Form B offerings. The first proposal would require all material transactional disclosure and would limit the itemized transactional disclosure. The second proposal would continue to require all itemized transactional disclosure. Under both proposals, however, the SEC would continue to require that issuers incorporate by reference the current itemized company information in their periodic reports. In addition, under both proposals, issuers and third party participants such as underwriters and auditors would continue to have the legal responsibility to ensure the quality of disclosure. - 4 - In addition to allowing more flexibility to issuers in Form B offerings, the SEC is considering the same approaches to disclosure in offerings limited to sophisticated investors and to investors with a pre-established relationship with the issuer. Smaller issuers or unseasoned issuers of any size would continue to remain subject to the itemization of transactional information in the prospectus. The proposals would, however, allow more freedom for seasoned smaller issuers to rely on their periodic reports for disclosure about their companies in an offering. b. Timing of Registration Issuers in Form B offerings would have complete control in determining when their offerings become effective. The SEC would not review these registration statements before the offering or take any action to make the registration statement effective. Under the proposals, Form B registration statements however would be screened by the SEC after receipt to determine whether the offering was eligible for registration on Form B and whether the disclosure raises any concerns under the antifraud provisions of the securities laws. The proposals would continue to require that issuers registering offerings on Form A file a registration statement before making their first offer. The SEC also would continue to review all IPOs and selectively review repeat offerings by smaller, unseasoned issuers. Under the proposals, medium-sized seasoned issuers, however, would be allowed to control when their offerings become effective. c. Underwriter Guidance In connection with the proposed registration system, the proposal would expand the Securities Act rule concerning due diligence to identify six practices that the SEC believes would enhance an underwriter’s due diligence investigation when conducting an expedited offering. That rule currently lists circumstances to consider in deciding whether a person has met the "reasonable investigation" and "reasonable ground for belief" standards that apply in defending against liability under Section 11 of the Securities Act. The proposal would cover only certain Form B offerings completed on an expedited basis. d. Small Business Issuers For purposes of registration and reporting, the proposals would revise the definition of "small business issuer" to increase the number of companies qualifying as small business issuers. This change would allow these companies to take advantage of the less stringent disclosure requirements offered to small businesses. In particular, the proposals would raise the annual revenues ceiling from $25 million to $50 million and would remove the public float limitation. In addition, to provide small businesses with greater flexibility in raising capital, the proposals also would allow small business issuers to delay payment of registration fees and would allow earlier incorporation by reference of Exchange Act periodic reports. - 5 - 2. Communications Around the Time of an Offering The Securities Act restricts the type of offering communications that a registrant may use during the time that it is in the process of a registered public offering of its securities. The level of restrictions depends on the period during which the communications occur. The proposals would significantly relax the current restrictions on communications before and during the time an issuer is "in registration" and would basically eliminate the "quiet period" for many offerings. The SEC believes that the proposals would better facilitate capital formation while providing increased information to investors on a more timely basis. The extent to which the requirements on communications by the issuer would be relaxed depends on the type of offering. For Form B offerings, the proposals would remove all restrictions on offering communications before the registration statement is filed. The antifraud provisions and civil liability provisions of the securities laws would still apply to those communications. For Form A offerings, the proposals would preserve the prohibition on offers prior to filing a registration statement. The proposals, however, would create greater certainty about the timing and scope of restrictions on communications during this time period. In particular, the proposals would create a bright-line rule that the 30 days immediately before the registration statement is filed would be the time period during which communications would be restricted because of the upcoming offering. The proposed rules also would provide that during this 30-day period, issuers could disclose factual business information and regularly released forward-looking information. Once the issuer’s prospectus is on file with the SEC, the proposals would remove restrictions on written communications for Form A offerings. 3. Prospectus Delivery Requirements Under the proposals, there would be no prospectus delivery requirements for Form B offerings. The proposals only would require delivery of a "securities term sheet" outlining the key features of the securities before the investor makes an investment decision. In Form A offerings by unseasoned issuers, underwriters and dealers participating in the offering would be required to deliver a preliminary prospectus at least 7 days before the securities are priced. In all other Form A offerings, issuers, underwriters and dealers would be required to deliver a preliminary prospectus at least 3 days before the securities are priced. Information about any material change that has occurred since delivery of the prospectus would be required to be provided to investors no later than 24 hours before the securities are priced. Under the proposals, there also would be no delivery requirement for final prospectuses in most offerings. Final prospectuses would still have to be filed with the SEC but the proposals would exempt most issuers from delivering a final prospectus to investors if a preliminary prospectus had been delivered. The proposals also would require that issuers tell investors where they can acquire the information that constitutes the final prospectus free of charge. 6 According to the Proposing Release, the proposal would allow a small private company to "test the waters" for a public offering of its securities. This would not prevent the small issuer from selling privately if it finds too few investors to make it worthwhile to become a public company. Similarly, small issuers that find more investor interest than expected could change from a private offering to a registered public offering. - 6 - 4. Integration of Public and Private Offering Flexibility The proposals also consider whether the distinction between public and private offerings remain necessary. The proposals would provide flexibility for issuers that have difficulty assessing the extent of market interest in a planned offering. In particular, the proposals would remove most of the barriers created to prevent companies from changing the type of offering chosen (i.e., from a private offering to a public offering or from a public offering to a private offering) once the offering process has begun.6 5. Periodic Reporting The proposals would make several changes to Exchange Act disclosure requirements. In particular, these changes would require, among other things, more prompt disclosure by issuers of annual and quarterly financial results and more prompt reporting of certain events on Form 8-K, depending on the importance of the event. The proposals also would expand the events that trigger a Form 8-K filing. In addition, the changes would add certification requirements for persons signing Exchange Act filings. If the proposed registration system is adopted, the SEC also would place much more significance on the review of Exchange Act filings and would shift resources from the review of registration statements to accommodate this increased review. 6. Investment Company Issuers The SEC specifically requests comments on how any aspect of the proposals affects investment companies and how the proposals should be modified to reflect the circumstances of investment companies. In particular, the Proposing Release requests comments on whether the proposals adequately address delivery obligations with respect to investment company securities, particularly the securities of closed-end investment companies and whether certain safe harbors for communications contained in the proposals should apply to investment companies. B. REGULATION OF TAKEOVERS The second proposal updates and simplifies the rules and regulations applicable to takeover transactions, including tender offers, mergers and acquisitions, and shareholder communications, to accommodate the current environment for takeover activity. The goal underlying this proposal is the same as that for the securities offerings reform proposal, i.e., that it is important for companies to have increased flexibility in conducting business operations, particularly the flexibility to announce and discuss a proposed acquisition. Unlike the securities offerings reform proposal, which conditions the extent to which communications will - 7 - be allowed on the size and seasoned status of the issuer, this proposal provides flexibility regardless of the size and seasoned status of the acquiror. 1. Restrictions on Communications The proposals would relax many of the current restrictions on communications with security holders regarding business combinations involving the registered offerings of securities. In particular, the proposals would allow free communication before the filing of a registration statement in connection with either an exchange offer or a stock merger transaction and before the filing of a proxy statement (whether or not a takeover transaction is involved). The proposals also would permit free communication about a planned tender offer without triggering the "commencement" of the offer. 2. Regulation of Exchange Offers Currently, exchange offers generally cannot begin until the Securities Act registration statement for the securities being offered becomes effective. This time period can be very lengthy if the SEC decides to review and comment during the waiting period. Cash offers, however, may begin as soon as the required information is filed with the SEC and disseminated to security holders. In response to these differences in the regulatory treatment between exchange offers and cash tender offers, the proposals would permit exchange offers to begin on a similar time frame to cash tender offers, specifically, upon the filing of a Securities Act registration statement. The proposals are designed to allow bidders that offer securities in takeover transactions a chance to be competitive in acquiring targets with cash bidders, especially when the value of the stock offered is equal to or greater than the value of the cash offered in a competing offer. 3. Costs of Compliance with Multiple Regulatory Schemes The Proposing Release states that because many takeover transactions involve a combination of tender offer, proxy solicitation and Securities Act registration issues, participants in a merger or acquisition may be required to comply with several regulatory schemes. The application of multiple regulatory regimes to a single transaction can significantly increase the participants' burdens and costs of compliance. The proposals, therefore, would simplify the regulatory structure for takeovers by integrating the disclosure requirements for tender offers, going-private transactions, and other extraordinary transactions by using combined forms and uniform disclosure regulation. The proposals also would require a "plain English" summary term sheet in all cash tender offer, cash merger and going-private transactions and would update the financial statement requirements for takeover transactions. Ari Burstein Assistant Counsel

---