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SEC/CORPORATE

New SEC Rule Expands "Test-the-Waters" to All Issuers

On September 26, the Securities and Exchange Commission adopted a new rule to allow all issuers, not just emerging growth companies, to utilize "test-the-waters" communications in connection with an initial public offering or other securities offering.

The rule implements the proposal put forth by the SEC in February 2019, discussed in the March 1, 2019 edition of *Corporate & Financial Weekly Digest*.

Since 2012, the JOBS Act has allowed emerging growth companies to engage in "test-the-waters" meetings with institutional investors prior to or following the filing of a registration statement. These meetings have proved popular with issuers looking to gauge investor interest in a potential offering prior to a formal roadshow and, in some cases, prior to devoting significant financial and other resources to the registration process. The SEC's new rule expands this accommodation, which is intended to encourage more issuers to consider entering the US public markets, to all issuers.

As a general matter, Section 5 of the Securities Act of 1933 (Securities Act) prohibits issuers from making any written or oral offers prior to filing a registration statement. Once a registration statement is filed, offers must be made pursuant to a "statutory prospectus" that conforms to the requirements of the Securities Act. "Test-the-waters" communications are exempt from these limitations, allowing these communications to occur before a registration statement is filed or before a statutory prospectus is furnished to investors.

Under this new rule any issuer, or any person authorized to act on behalf of an issuer (including an underwriter), can engage in oral or written communications about a potential offering with investors that are, or are reasonably believed to be, qualified institutional buyers or institutional accredited investors.

Importantly, though, "test-the-waters" communications are "offers" within the meaning of the securities laws and are subject to the general anti-fraud provisions of the federal securities laws, as well as to potential liability under Securities Act Section 12(a)(2) (Civil Liabilities in Connection with Prospectuses and Communications). Accordingly, issuers should take care in preparing or authorizing any "test-the-waters" materials and review the contents with legal counsel prior to holding any meetings.

Under the new rule, no special legending will be required in connection with "test-the-waters" communications, and issuers will not be required to publicly file "test-the-waters" materials. The SEC noted, however, that, as is currently the practice of the SEC staff when reviewing registration statements, the staff could request an issuer to furnish any "test-the-waters" materials to the staff in connection with their registration statement review.

The SEC also reminded public companies to consider the application of Regulation FD in connection with furnishing investors any materials. To the extent "test-the-waters" communications contain any material nonpublic information, an issuer would need to determine whether Regulation FD requires public disclosure of the information at the same or whether an exemption from Regulation FD disclosure applies.

The new rule will be codified as Rule 163B under the Securities Act, with conforming amendments to existing Rule 405, and will take effect 60 days after publication in the *Federal Register*.

The SEC's full adopting release is available here.

Institutional Investor Advocacy Group Proposes Limits to Multi-Class Voting by Delaware Companies

The Council of Institutional Investors (CII), an investor advocacy association primarily for pension funds and local governments, has put forth a proposal to amend the Delaware General Corporation Law to limit the ability of publicly-traded Delaware corporations to maintain multi-class common stock voting structures (i.e., high-vote/low-vote stock structures).

In summary, CII is proposing that a multi-class voting structure sunset no later than seven years after an IPO, a shareholder adoption or an extension vote approved by a vote of a majority of outstanding shares of each class, voting separately. CII's seven-year sunset period is intended to recognize multi-class voting could have short-term benefits in certain circumstances, without what they consider "long-lasting unaccountability."

While not new, multi-class voting structures have gained increased attention in recent years as a series of founder-led "unicorn" technology companies have gone public with high-vote/low-vote (or no-vote) structures. High-vote shares held by WeWork co-founder Adam Neumann were cited among other investor concerns around the company's now-delayed planned IPO.

CII had previously, in October 2018, petitioned the New York Stock Exchange and NASDAQ to adopt similar limitations. Whether this proposal will gain traction with other investors or Delaware lawmakers is yet to be seen.

CII's full proposal is available here.

BROKER-DEALER

FINRA Issues Regulatory Notice on Disclosure Innovations for Advertisements and Other Public Communications

On September 19, the Financial Industry Regulatory Authority (FINRA) issued Regulatory Notice 19-31 (Notice) addressing disclosure innovations in advertising and other communications with the public. The Notice responds specifically to questions that FINRA has received from member firms about how they can comply with FINRA rules when communicating with their customers. FINRA's goal in issuing the Notice is to help facilitate simplified and more effective disclosures.

FINRA's Rules 2210 through 2220 focus on communications and are based on the principles of ensuring fair and balanced communications from member firms that do not mislead the investing public. In the Notice, FINRA recognizes that there are many different approaches for achieving this goal in member communications. FINRA addresses the following topics in its responses to member questions:

- innovative design techniques in member communications;
- multiple means of required information disclosures, and that electronic media and design innovations may open new possibilities;
- disclosures limited to the content of what the communication promotes;
- disclosure within the marketing message itself; and
- non-promotional communications (i.e., educational materials or reference resources).

The Notice, with the questions and answers, is available here.

BREXIT/UK DEVELOPMENTS

Revised JMLSG Sectoral Guidance Approved by HM Treasury

On September 25, the Joint Money Laundering Steering Group (JMLSG) announced on its website that HM Treasury has approved revisions to three chapters in Part II of the JMLSG's anti-money laundering and counter-terrorist financing sectoral guidance.

The amended guidance relates to credit unions (section 4), asset finance (section 12) and brokerage services to funds (sector 20).

The announcement is available here.

FCA Publishes Findings From Review of MiFID II Research Unbundling Rules

On September 19, the UK Financial Conduct Authority (FCA) published its findings from its review of unbundling of third-party research under the revised Markets in Financial Instruments Directive (MiFID II).

MiFID II, and the FCA's related implementing rules, requires asset managers to pay for third-party research explicitly and brokers to price and provide services separately. In order to assess the implementation of such rules, the FCA undertook a review between July 2018 and March 2019 of 40 buy-side firms and conducted 10 visits to buy-side and sell-side firms.

The FCA identified changes in firm behavior in response to the MiFID II reforms, which suggests that the market has moved towards the intended outcomes of accountability and price transparency. However, the FCA also noted that research valuation and pricing are still evolving.

Overall, the FCA found that:

- most buy-side firms have chosen to absorb research costs themselves, resulting in savings for investors;
- most buy-side firms also can still access the research they need with no material reduction in research coverage, including for listed small and medium enterprises;
- asset managers' research valuation models have different levels of sophistication, particularly in evaluating the quality of research. The FCA stated that it expects firms to refine their models to ensure they are acting in the best interests of their clients;
- there is a wide range of sell-side research pricing levels, which the FCA attributes to an ongoing process of price discovery. It will monitor this for potential competition concerns and will act if necessary; and
- some firms were uncertain about the application of the new rules to various activities such as attending trade association events, marketing research services or making contributions to consensus forecasts. The FCA has provided clarification of its expectations on these areas in its report.

The FCA intends to undertake further work in 2020/21 to assess the impact of the new rules, given that firms are still developing their arrangements and a market for separately priced research is still emerging.

The findings are available here.

FCA Updates Directions Under the Temporary Transitional Power

On September 26, the UK Financial Conduct Authority (FCA) published updated draft directions under its Temporary Transitional Power (TTP). The TTP is designed to give the FCA flexibility in applying post-Brexit requirements to firms that are transitioning to the new UK regulatory framework following the UK's departure from the EU. The draft directions would only come into effect on exit day if the UK leaves the EU without an implementation period.

The draft directions are an update to directions previously issued on March 28. The FCA also updated its accompanying explanatory note providing guidance on the use of the TTP. The FCA states that the draft directions are being published now in order to give firms time to consider any changes that may apply to them prior to finalization.

The main updates relate to the following areas:

- extending the proposed duration of the directions issued under the TTP from June 30, 2020 to December 31, 2020;
- updating provisions relating to prudential requirements to reflect new HM Treasury legislation and FCA exit instruments published after March 29;
- revoking certain directions in relation to payment services provided by European Economic Area (EEA) credit institutions, as these are no longer needed because of legislative amendments made by the UK Government; and
- applying a standstill direction to allow EEA Central Banks and the European Central Bank to continue to rely on their status as exempt persons until December 31, 2020.

The FCA does not expect to make significant changes to the updated draft directions prior to exit day.

The updated draft directions and explanatory note are available here.

For additional coverage on financial and regulatory news, visit *Bridging the Week*, authored by Katten's Gary DeWaal.

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