

Policy Council<sup>14</sup> recommended that in the interest of facilitating small business capital raising, these issuers be permitted to "test the waters" in advance of undertaking a registered IPO.

Experience under Regulation A suggests that the "test the waters" initiative provides issuers of small offerings a useful and cost-effective means of assessing whether there is sufficient potential interest in the company as an investment to proceed with a Regulation A offering. To date, these solicitations do not appear to have raised significant investor protection concerns. Accordingly, the Commission today is soliciting comment on the appropriateness of providing a similar "test the waters" option for registered IPOs.<sup>15</sup>

In considering whether to provide a "test the waters" process for registered IPO's, the Commission is committed to assuring that the interests of investors are not compromised. The release solicits comment on a number of limitations or conditions that go beyond those currently required in connection with Regulation A offerings. These comments are intended to provide a basis for the Commission to assess the need for any or all of these provisions to assure that investors have the full opportunity to review and consider the information mandated by the Securities Act in making their investment decision, and that the solicitation of interest communications are not such as to cause investors to overlook the mandated disclosures.<sup>16</sup>

The IPO market is one of the great strengths of the U.S. capital markets, and its breadth and depth is unique.<sup>17</sup>

In the first five years of the 1990's, \$114.8 billion have been raised in the common equity IPO market.<sup>18</sup> Continued investor confidence is key to maintaining the strength and vitality of this market, and any "test the waters" process implemented by the Commission will have to be consistent with maintaining this confidence.

## II. Proposals

### A. Description of proposed Rule 135d

Under the proposal, an eligible issuer considering a registered IPO would be permitted to solicit indications of interest prior to filing a registration statement under the Securities Act, subject to the conditions and limitations of proposed new Rule 135d. While assuring that investors receive information mandated by the Securities Act before making an investment, the proposed rule would allow companies to gauge investor interest before incurring the significant expense required in the preparation of IPO disclosure documents. If market interest is not reflected by the response to the solicitation, companies may turn to other capital-raising plans.<sup>19</sup>

Under the current system, this would only be determined after preparation of all required compliance materials, which may involve significant expense. The efficiency of the capital markets, and the fiscal health of developing enterprises, is not benefited by issuers' finding out later rather than sooner that the public markets are not the most appropriate forums for their capital raising. On the contrary, the efficiency of the capital raising process is enhanced when issuers that spend the large sums required for an IPO have some indication as to how an offering will be received. The proposal would allow issuers to structure their offerings with consideration for their particular needs as well as the needs of investors, since issuers would be able to receive indications from potential investors concerning what offering structure may be of interest, and could then use that information in structuring their offerings.

<sup>18</sup> Securities Data Company. This includes foreign companies' first common equity offerings in the U.S.; it does not include asset-backed securities.

<sup>19</sup> Limitations on general solicitation under Regulation D [17 CFR 230.501-230.508] and case law under Section 4(2) of the Securities Act [15 U.S.C. 77d(2)] may limit companies' flexibility in pursuing such alternatives. Comment is requested in the discussion hereinafter as to what steps the Commission should take to address these issues. In a companion release published today, the Commission is soliciting comment on various possible approaches to allowing general solicitations in some form in Regulation D offerings. See Release No. 33-7185.

Communications meeting the requirements of the proposed rule would not be deemed to offer any security for sale<sup>20</sup> for purposes of Section 5 of the Securities Act.<sup>21</sup> As proposed, those eligible to use the new rule would include any issuer not reporting under Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (the "Exchange Act"),<sup>22</sup> but not:<sup>23</sup>

- (a) Issuers of asset-backed offerings;<sup>24</sup>
- (b) Partnerships, limited liability companies and other direct participation investment programs;<sup>25</sup>
- (c) Investment companies registered or required to be registered under the Investment Company Act of 1940;<sup>26</sup> or
- (d) Blank check or penny stock issuers.<sup>27</sup>

The first three exclusions apply to those issuers that appear unsuited to a "test the waters" concept, given the complex and contractual nature of the issuer. Blank check and penny stock issuers are excluded because of the substantial abuses that have arisen in such offerings. Comment is requested as to the appropriateness of the proposed exclusions. Are there any issuers proposed to be excluded that should be provided the benefits of the "test the waters" process? Are there additional classes of issuers that should be excluded either because of the nature of the investment vehicle or potential for abuse? Should any of the exclusions in the NASAA draft policy statement be specifically incorporated into the proposal?<sup>28</sup> Should the rule be limited to small business issuers?<sup>29</sup>

As in the case of Regulation A, the proposed IPO "test the waters" solicitation may include both oral and written solicitations, provided that a written solicitation document is submitted to the Commission at or prior to the time the solicitation is first

<sup>20</sup> Proposed Rule 135d(a). This provision would be similar to that contained in Rule 135 [17 CFR 230.135].

<sup>21</sup> 15 U.S.C. 77e.

<sup>22</sup> 15 U.S.C. 78m(a) and 15 U.S.C. 78o(d).

<sup>23</sup> Proposed Rule 135d(a)(1).

<sup>24</sup> "Asset-backed securities" is defined in General Instruction I.B.5 of Form S-3 [17 CFR 239.13].

<sup>25</sup> "Direct participation investment program" would be defined in a proposed amendment to Rule 100. Comment is requested as to whether the scope of the proposed definition is appropriate or whether an alternative definition would meet the goals of the exclusion.

<sup>26</sup> 15 U.S.C. 80a-1 *et seq.*

<sup>27</sup> A "blank check" company is defined at Securities Act Rule 419(a)(2) [17 CFR 230.419(a)(2)]; and "penny stock" is defined at Exchange Act Rule 3a51-1 [17 CFR 240.3a51-1].

<sup>28</sup> See Section 1 of NASAA Statement in the Appendix to this release.

<sup>29</sup> "Small business issuer" is defined in Securities Act Rule 405 [17 CFR 230.405].

<sup>14</sup> See Forthcoming Report to be used by the Subcouncil on Capital Allocation of the Competitiveness Policy Council, March 31, 1995.

<sup>15</sup> The Commission has established the Advisory Committee on the Capital Formation and Regulatory Processes (the "Advisory Committee"), chaired by Commissioner Steven M.H. Wallman. The Advisory Committee is considering fundamental issues relating to the regulatory framework governing the capital formation process, including whether the current system of registering securities offerings should be replaced with a company registration system. The recommendations of the Advisory Committee may result in rule proposals or legislative recommendations that, if implemented, may also address the matters discussed in this release. While some of the company registration models under consideration generally would not change the requirements by which a company that was not filing reports with the SEC conducts an IPO, certain company registration models could facilitate solicitations of interest by registered companies with respect to repeat offerings, by eliminating the requirement for registering each public offering of securities.

<sup>16</sup> A discussion of the legal basis for the proposed rule is in Section C of the release; comment is specifically solicited on this issue.

<sup>17</sup> See, e.g., *Foreign Firms Flock to U.S. for IPOs*, Wall Street Journal, June 23, 1995, at C1.