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SEC Issues FAQs on JOBS Act Provisions Relating to Research Analysts and Underwriters

Last week, the Securities and Exchange Commission ("SEC") issued a set of FAQs clarifying a number of questions and ambiguities regarding the activities of underwriters and research analysts in connection with offerings by Emerging Growth Companies ("EGCs") under the Jumpstart Our Business Startups Act (the "JOBS Act").[1] We summarize and analyze the key points below.

Testing the Waters

The FAQs address a technical concern that "testing the waters" under the JOBS Act might violate the requirements of Rule 15c2-8(e) under the Securities Exchange Act of 1934, as amended. Testing the waters is the process whereby an EGC, or a person authorized to act on its behalf, engages in oral or written communications with Qualified Institutional Buyers[2] or institutions that are Accredited Investors[3] to determine their interest in a contemplated securities offering. Rule 15c2-8(e) makes it a deceptive act or practice for a broker or dealer to participate in a distribution of securities once a registration statement has been filed, unless (among other things) the broker or dealer takes reasonable steps to provide a preliminary prospectus to each of the broker's or dealer's associated persons who are expected to "solicit customers' orders" for securities. The FAQs clarify that customary testing the waters activities under the JOBS Act would be unlikely to constitute soliciting activities under Rule 15c2-8(e). The FAQs also note that Rule 15c2-8(e) would only apply in any event once a registration statement has been filed publicly with the SEC and not when it has only been submitted confidentially.

The FAQs also include statements about the types of interactions that EGCs and underwriters may have with potential investors as part of testing the waters activities. The FAQs provide an example of an underwriter seeking non-binding indications of interest that includes asking how many shares a potential investor might purchase at various price levels. This guidance should settle concerns among some investment banks that questions of this type might go further than what is permitted under the JOBS Act or otherwise be inadvisable.

1 The complete SEC FAQ release is available at http://www.sec.gov/divisions/marketreg/tmjobsact-researchanalystsfaq.htm.

2 Within the meaning of Rule 144A under the Securities Act of 1933, as amended (the "Securities Act").

3 Within the meaning of Rule 501(a) under the Securities Act.

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Although not addressed in the FAQs, it should be noted that in IPOs by EGCs, the SEC has been issuing a standard comment requesting copies of all materials provided to potential investors in connection with testing the waters activities. This enables the SEC to police indirectly the content of these communications, for example, by requiring issuers to include in their registration statements disclosure that appears in the testing the waters communications.

Global Settlement

The FAQs reiterate that the JOBS Act does not amend or modify the Global Settlement entered into in 2003, and amended in 2010, among the SEC, self-regulatory organizations ("SROs"), other regulators, and a dozen major investment banks to address conflicts of interest between the banks' research and investment banking functions (the "Global Settlement"). The Global Settlement may be amended or modified with the approval of the court or if the SEC adopts a rule (or approves an SRO rule) "with the stated intent to supersede" one or more of its provisions.

Communications Between Investment Bankers and Analysts

The FAQs confirm that an investment banker may forward a list of potential investors to an analyst for that analyst to contact at his or her discretion. An analyst may also forward a list of potential investors that he or she plans to contact to an investment banker for scheduling purposes. These largely ministerial acts will not be considered violations of NASD Rule 2711(c)(6) or NYSE Rule 472(b)(6)(ii), which prohibit investment bankers from directing analysts to engage in sales or marketing efforts. It should be noted, however, that the investment banks subject to the Global Settlement must continue to create and enforce firewalls between research and investment banking personnel designed to prohibit all communications between the two except where specified in the Global Settlement. In addition, all other legal and regulatory requirements remain intact, including the requirement that communications with current and prospective investors related to an investment banking services transaction be fair, balanced, and not misleading, taking into consideration the overall context in which the communications were made.

Analyst Participation in Communications With Management

The FAQs take a narrow view of the JOBS Act provisions that permit research analysts to participate in communications with the management of an EGC that are also attended by non-research investment banking personnel.

- The FAQs limit these provisions to permitting analysts to participate in presentations by an issuer's management to sales force personnel so that the issuer's management would not need to make separate and duplicative presentations at a time when their resources are limited. It should be noted that this is a restrictive interpretation since sales force presentations occur at the very end of the IPO process at a time when management presentations to analysts are typically complete and there are no longer any duplicative presentations by management.
- Analysts of investment banks that are subject to the Global Settlement continue to be prohibited from meeting with management of an EGC in the presence of investment banking personnel unless it is in connection with a chaperoned due diligence activity or another exception set forth in the Global Settlement. One such exception does permit analysts to present to sales force personnel in the presence of management or investment banking personnel solely consisting of members of the banks' equity capital markets group and subject to complying with various additional requirements.
- The FAQs make it clear that the JOBS Act does not supersede the prohibition in NASD Rule 2711(c)(4) and NYSE Rule 472(b)(5) on analysts soliciting investment banking business. Therefore, if analysts from non-Global Settlement banks do attend pitches with investment bankers, the analysts are permitted to "introduce themselves, outline their research program and the types of factors that the analyst would consider in his or her analysis of a company, and ask follow-up questions to better understand a factual statement made by the emerging growth company's management." As a result, while the FAQs state that analysts may attend pitches for EGC IPOs, the rules that continue to circumscribe analyst activities make this a high-risk proposition since any interaction between the analysts, the investment bankers and the potential issuer client could raise questions regarding a violation of NASD Rule 2711(c)(4) and NYSE Rule 472(b)(5) unless very carefully monitored.
- Finally, since the JOBS Act does not expressly address communications where investors are present together with company management, analysts and investment banking personnel, the SEC is taking the position that the JOBS Act does not affect NYSE and NASD rules prohibiting analysts from participating in roadshows or otherwise engaging in communications with customers about an investment banking transaction in the presence of investment bankers or the company's management.[4]

4 NASD Rules 2711(c)(5)(A)-(B); NYSE Rules 472(b)(6)(i)(a)-(b).

NYSE Rules

Sections 105(b) and 105(d) of the JOBS Act, which address communications with securities analysts and the post-offering publication of research reports, explicitly address the rules of a "national securities association;" this term covers FINRA, but not the New York Stock Exchange ("NYSE"). The FAQs clarify that those sections were intended to apply to NYSE Rule 472 to the same extent as NASD Rule 2711.

Research Before and After Lock-Up Period Termination

The FAQs clarify three specific points related to research and lock-up agreements in offerings of an EGC's securities.

- First, the JOBS Act permits the publication of research during the period before a lock-up agreement expires, is terminated or is waived (even though the JOBS Act only refers to expiration).
- Second, the FAQs note the SEC's belief that the JOBS Act permits the publication of research both before *and after* the expiration, termination or waiver of a lock-up agreement (even though the JOBS Act only expressly references the period before an expiration). The FAQs also note that FINRA is considering filing with the SEC a proposal to eliminate the NASD and NYSE rules that impose quiet periods in connection with offerings of the securities of EGCs.
- Finally, the FAQs similarly note the SEC's belief that these new rules on research publication at the time a lock-up expires in connection with an IPO by an EGC were also intended to apply to secondary offerings of an EGC's securities and that FINRA is considering a proposal to eliminate the NASD's and NYSE's rules requiring quiet periods with regard to such secondary offerings. The FAQs do not expressly address follow-on offerings by an EGC itself, but presumably these would be treated in a similar manner.

To date, investment banks have not removed the "booster shot" language from lock-up provisions in connection with IPOs and other offerings by EGCs. Given the language in the FAQs, we think it is appropriate to continue including the "booster shot" language, but with appropriate carveouts for when FINRA enacts new rules eliminating the quiet periods discussed above.

Excluded Rules

The FAQs also reiterate that the JOBS Act does not affect any NYSE or NASD rules regarding the following:

- Supervision, compensation or evaluation of analysts[5]
- Pre-publication review of research reports by non-research personnel[6]
- Prohibitions on NYSE and FINRA member firms directly or indirectly offering favorable research, specific ratings, or specific price targets, or threatening to change research, ratings, or price targets to companies as consideration or inducement for the receipt of business or compensation[7]
- FINRA's requirements in respect of the content, filing and approval of communications with the public[8]

The SEC additionally takes the position that the JOBS Act does not affect Regulation Analyst Certification ("Regulation AC") in any respect. Regulation AC requires brokers, dealers and certain persons associated with a broker or dealer (i) to include analysts' certifications in research reports confirming that the views expressed accurately reflect their personal views, and (ii) to disclose analysts' compensation or other payment arrangements in connection with their recommendations or views in such reports. Broker-dealers must also obtain analysts' periodic certifications in connection with their views expressed in public appearances. Regulation AC's analysis of what constitutes a research report is also unaffected by the JOBS Act's definition of "research report." The SEC maintains that the analysis of whether a communication constitutes a "research report" for purposes of Regulation AC depends on the facts and circumstances of the communication in question.

5 NASD Rules 2711(b)(1), 2711(d); NYSE Rules 472(b)(1) and 472(h).

6 NASD Rules 2711(b)(2)-(3) and 2711(c)(1)-(2); NYSE Rules 472(b)(2)-(4).

7 NASD Rule 2711(e); NYSE Rule 472(g)(1).

8 NASD Rule 2210.

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