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SEC Issues Guidance on JOBS Act Research Provisions

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The staff of the **Securities and Exchange Commission's Division of Trading and Markets (Staff)** recently issued frequently asked questions (FAQs) providing guidance about provisions in Title I of the **Jumpstart Our Business Startups Act (JOBS Act)** related to research analyst conduct and publication of research reports with respect to the securities of an **emerging growth company (EGC)**.[1]

Many of the FAQs are either generally consistent with positions espoused by the staff of the Securities and Exchange Commission (SEC) at conferences since the JOBS Act's enactment or reflect interpretations that were expected. Thus, the FAQs may not have a great impact on current market practice, especially for those firms party to the Global Research Settlement. However, banks and analysts should review the FAQs to ensure their practices and procedures conform to the Staff guidance and monitor the FAQs as they may be updated periodically.

This client alert briefly summarizes the FAQs.

Impact of JOBS Act on Global Research Settlement

The Staff confirmed that the JOBS Act does not amend or modify the Global Research Settlement between certain large investment banks and the SEC, self-regulatory organizations (SROs) and other regulators. As a result, banks party to the Global Research Settlement remain subject to its restrictions despite certain JOBS Act provisions that would remove such restrictions for banks that are not subject to the Global Research Settlement.

Interplay Between "Test the Waters" Communications and Exchange Act Rule 15c2-8(e)

The JOBS Act amended the **Securities Act of 1933 (Securities Act)** to permit an EGC or any person authorized to act on its behalf to engage in oral or written communications with potential investors that are "qualified institutional buyers" or institutions that are "accredited investors" (as

defined in Securities Act Rules 144A and 501(a)) either prior to or after the filing of a registration statement with respect to such securities. The JOBS Act did not amend Rule 15c2-8(e) under the Securities Exchange Act of 1934, which requires a broker or dealer participating in a distribution of securities to make available a preliminary prospectus to its associated persons who are expected to solicit customers' orders after the filing of a registration statement and prior to any sales efforts by the associated persons.

The Staff confirmed its belief that the "test the waters" activities permitted by the JOBS Act can occur without such activities being deemed solicitations of customers' orders under Rule 15c2-8(e). Thus, absent other factors, an underwriter may test the waters by asking its customers for a non-binding indication of interest without being deemed "soliciting customers' orders" and triggering Rule 15c2-8(e)'s prospectus delivery requirement. The non-binding indication of interest may include the amount of shares the customer may purchase in the potential offering at particular price levels, but an underwriter may not ask the customer for a commitment to purchase the securities. Ultimately, the determination of whether an activity constitutes "soliciting customers' orders" is based on the relevant facts and circumstances. Without this guidance, the ability of EGCs and their underwriters to test the waters before the filing of a registration statement would have been practically eliminated as there would not be a preliminary prospectus available to satisfy Rule 15c2-8(e).

As the Staff noted that the JOBS Act did not change the meaning of "solicit customers' orders" under Rule 15c2-8, underwriters should be able to rely on this guidance for registered securities offerings by non-EGCs. However, underwriters will need to consider all relevant facts and circumstances when determining whether an activity is considered soliciting customers' orders.

As Rule 15c2-8 only applies where a registration statement has been filed with the SEC, submitting a confidential registration statement pursuant to the JOBS Act would not constitute a filing of a registration statement triggering the rule.

Arranging Communications Between Research Analysts and Potential Investors

The JOBS Act prohibits the SEC and any registered national securities association, in connection with an EGC IPO, from restricting investment banking personnel from arranging communications between a research analyst and potential investors. The Staff confirmed that neither the SEC nor the SROs have a rule that directly prohibits such "arranging" activities so that, unless accompanied by additional activities, SRO rules[2] would not prohibit the following activities:

- an investment banker forwarding a list of clients to a research analyst that the analyst could contact at his or her discretion and with appropriate controls;
- a research analyst forwarding a list of potential clients it intends to communicate with to investment banking personnel to facilitate scheduling; or
- investment bankers arranging, but not participating in, calls between research analysts and clients.

The Staff noted that the JOBS Act did not change other SEC and SRO rules applicable to research analysts, such as the requirement that customer communications related to an investment banking services transaction be fair, balanced and not misleading based on the overall context in which the communication was made. Moreover, the Staff cautioned firms subject to the Global Research Settlement to be mindful of the requirements of the settlement, including the obligation to create and enforce firewalls between research and investment banking personnel reasonably designed to prohibit all communications between the two except as expressly permitted by the settlement. As a

result, the Staff reminded firms that they need to have appropriate policies and procedures to ensure compliance with the federal securities laws and SRO rules.

Participation by Analysts in Meetings with EGC Management and Road Shows

The JOBS Act prohibits the SEC and any registered national securities association, in connection with an EGC IPO, from restricting a research analyst from participating in any communications with an EGC's management when non-analyst investment banking personnel are present. The Staff interprets this JOBS Act provision as primarily reflecting Congress' intent to allow analysts to participate in EGC management presentations with sales force personnel to avoid the "ministerial burdens" of making separate and duplicative presentations to analysts at a time when senior management resources are limited. However, the JOBS Act does not affect SRO rules that prohibit analysts from participating in roadshows or otherwise engaging in communications with customers about an investment banking transaction in the presence of investment bankers or company management.[3]

The Staff also noted that analysts of non-Global Research Settlement firms may attend pitch meetings in connection with an EGC IPO if they do not otherwise engage in prohibited conduct in the meetings. Thus, before an underwriter is formally retained to underwrite an EGC IPO, analysts at non-Global Research Settlement firms may attend meetings with EGC management and investment banking personnel and introduce themselves, outline their research program and the types of factors considered in their analysis, and ask follow-up questions to better understand management's factual statements. After an underwriter is formally retained to underwrite an EGC IPO, analysts at non-Global Research Settlement firms may participate in EGC management presentations to educate the firm's sales force about the issuer and discuss industry trends, provide information obtained from investing customers and communicate their views. The Staff notes that these examples are not exhaustive of the types of activities permitted under the JOBS Act.

Despite the foregoing, the Staff emphasizes that the JOBS Act does not impact the Global Research Settlement, the anti-fraud provisions of the federal securities laws and other SEC and SRO rules regarding analyst conflicts of interest. For example, the Global Research Settlement still requires firewalls between analysts and investment banking personnel that are reasonably designed to prohibit communications between the two except as expressly permitted by the settlement. Thus, banks and analysts should be mindful of these other restrictions and institute and enforce appropriate controls to ensure analysts are not engaging in prohibited conduct should they choose to take advantage of the JOBS Act's meeting accommodation.

Quiet Periods

The JOBS Act prohibits any registered national securities association from restricting the publication of any research report or the making of a public appearance by an investment bank with respect to an EGC's securities at any time after an EGC's IPO date or prior to the expiration date of any lock-up agreements entered into in connection with an EGC's IPO. The JOBS Act does not explicitly address SRO rules imposing quiet periods in these additional situations:

- prior to the termination or waiver (as opposed to expiration) of a lock-up agreement entered into connection with an EGC IPO;
- after the expiration (as opposed to prior), termination or waiver of a lock-up agreement entered into in connection with an EGC IPO; or
- after a secondary offering (as opposed to an IPO) of an EGC's securities.

The Staff believes that Congress intended to eliminate the quiet period prior to the termination or waiver of the lock-up agreement. Moreover, the Staff believes that the policies underlying the elimination of quiet periods after an EGC's IPO date and prior to the end of EGC IPO lock-up agreements apply equally to quiet periods after the end of EGC IPO lock-up agreements and after EGC secondary offerings. The Staff indicated its understanding that FINRA is considering filing with the SEC a proposal to eliminate these remaining quiet periods related to an EGC and its securities not addressed by the JOBS Act.

Unaffected SEC and SRO Rules

The Staff confirmed that the JOBS Act does not impact:

- the applicability of Regulation AC, including the types of communications that constitute a research report for purposes of Regulation AC;
- the applicability of SRO rules regarding the supervision, compensation or evaluation of research analysts;
- the applicability of SRO rules regarding pre-publication review of research reports by non-research personnel or an EGC;
- the applicability of SRO rules prohibiting promises of favorable research, specific ratings or specific price targets or threats to change research, a rating or price target in exchange for the business of, or compensation from, an EGC; or
- the applicability of SRO rules governing communications with the public.

Staff Recommendations

The Staff recommended that firms considering engaging in the activities now permitted under Title I of the JOBS Act:

- review and update their policies, procedures and educational and training efforts; and
- make corresponding changes to promote compliance with SEC and SRO rules designed to minimize conflicts of interest and facilitate the objectivity and reliability of research.

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1. See SEC Div. of Trading & Mkts., Jumpstart Our Business Startups Act Frequently Asked Questions About Research Analysts and Underwriters (Aug. 22, 2012), available at http://sec.gov/divisions/marketreg/tmjobsact-researchanalystsfaq.htm.

2. The specific SRO rules cited were NASD Rule 2711(c)(6) and New York Stock Exchange (NYSE) Rule 472(b)(6)(ii). See Question 3.

3. The SRO rules specified were NASD Rules 2711(c)(5)(A) and (B) and NYSE Rules 472(b)(6)(i)(a) and (b). See Question 5.

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