INVESTMENT COMPANY INSTITUTE®

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April 29, 2019

Ms. Vanessa Countryman
Acting Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: *Solicitations of Interest Prior to a Registered Public Offering* (File No. S7-01-19)

Dear Ms. Countryman:

The Investment Company Institute[1] supports the Securities and Exchange Commission's proposal that would allow issuers, including registered investment companies, to gauge investor interest in a contemplated securities offering by providing "test-the-waters" communications to certain sophisticated investors.[2] Permitting issuers to test the waters is intended to provide a cost-effective means for evaluating market interest before incurring the costs associated with a new public offering. Issuers being able to test the waters may encourage additional companies, more generally, to publicly offer their securities, which in turn, would provide more investment opportunities for registered investment companies and other investors.

Registered investment companies and business development companies ("BDCs")[3] are uniquely positioned to evaluate this proposal, given that funds can provide dual viewpoints: both as investors and issuers with their own shareholders.

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[1] The Investment Company Institute ("ICI") is the leading association representing regulated funds globally, including mutual funds, exchange-traded funds ("ETFs"), closed-end funds, and unit investment trusts ("UITs") in the United States, and similar funds offered to investors in jurisdictions worldwide. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. ICI's members manage total assets of US$22.4 trillion in the United States, serving more than 100 million US shareholders, and US$6.6 trillion in assets in other jurisdictions. ICI carries out its international work through ICI Global, with offices in London, Hong Kong, and Washington, DC.

[2] *See* Securities Act Release No. 10607 (Feb. 19, 2019) (proposing Rule 163B under the Securities Act of 1933) ("Proposing Release"), *available at* https://www.sec.gov/rules/proposed/2019/33-10607.pdf.

[3] Throughout this letter, we refer to "funds" to include mutual funds, ETFs, closed-end investment companies, and BDCs and their investment advisers.

As investors, funds would use test-the-waters communications to assess the nature and quality of potential future investment opportunities. Funds receiving test-the-waters communications would have more lead time to evaluate an offering before deciding whether to invest. If this new communication tool prompts more issuers to engage in public offerings, it may increase the pool of liquid securities available for fund investment.

As issuers, closed-end funds and BDCs may benefit from the rule. In contrast, open-end funds will see little or no benefit if, as is proposed, they are required to register under the Investment Company Act of 1940 before being eligible to use test-the-waters communications. To enable more funds to use these communications with a greater pool of professional financial advisers, we recommend that the final rule:

- permit funds to rely on the rule prior to registering as investment companies under Investment Company Act; and

- permit funds to use test-the-waters communications with *all* SEC-registered investment advisers, in addition to Qualified Institutional Buyers ("QIBs") and Institutional Accredited Investors ("IAIs").

In addition, we recommend that the Commission require fund performance information in a test-the-waters communications to be presented in a standardized manner, in accordance with current requirements.

I. Funds as Investors

A. Broaden Category of Eligible Issuers

As way of background, we note that issuers relying on any new rule would be exempt from the federal securities laws "gun-jumping" restrictions on the "offer" of a security.[4] As the Commission recognizes, it would be granting operating companies greater flexibility to engage with sophisticated investors earlier in the offering process, allowing issuers:

> to better assess the demand for and valuation of their securities and to discern which terms and structural components of the offering may be most important

[4] "Gun-jumping" generally refers to violations of the communications restrictions under the Securities Act. For example, Section 5(c) of the Securities Act prohibits any written or oral offers prior to the filing of a registration statement. In addition, Section 5(b)(1) limits written offers to a "statutory prospectus" that conforms to the requirements of Section 10 of the Securities Act.

> to investors. This in turn could enhance the ability of issuers to conduct successful offerings and lower their cost of capital.[5]

Funds and their investors stand to benefit from these developments, and we therefore support this aspect of the proposal. We particularly support the notion that all issuers, including non-reporting issuers, emerging growth companies, non-emerging growth companies, and well-known seasoned issuers could use test-the-waters communications.

B. Eliminate Legends and Filing Requirement

The proposed rule would not require test-the-waters communications to include any specified legends or be filed with the Commission. The proposed communications, however, would be subject to Section 12(a)(2) liability and the antifraud provisions of the federal securities laws. Further, the proposed rule would require that any communications pursuant to the proposed rule be consistent with material in the issuer's related registration statement when filed. The Commission requests comment on whether legends should be required and whether these communications should be required to be filed with the Commission.

We agree with the Commission that neither legending nor filing of the communications are necessary. Legending and filing are unwarranted, as the class of investors to whom the communications would be directed are sophisticated with the ability to assess investment opportunities and fend for themselves. Therefore, they do not need the additional safeguards provided through the legending and filing requirements. In addition, the antifraud protections under the securities laws and the proposed requirement that any communications be consistent with those in any filed registration statement offer sufficient protection. Therefore, the costs associated with legending and filing outweigh their benefits.

C. Preserve Other Communications Options

The proposed rule would be non-exclusive, meaning that an issuer could rely on other communications safe harbors or exemptions when determining how, when, and what to communicate in a contemplated offering. The Commission requests comment on whether this is appropriate. We believe it is. The approach permits issuers the flexibility to determine how to communicate with potential investors in accordance with safeguards the Commission has determined are appropriate for each type of communication.

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[5] Proposing Release at page 9.

II. Funds as Issuers

A. Do Not Require Investment Company Act Registration

Funds currently rely on Rule 482 under the Securities Act to engage in a broad range of communications with prospective investors (without being required to accompany or precede the Rule 482 communication with a statutory prospectus). Rule 482 communications must be filed with the Commission or the Financial Industry Regulatory Authority ("FINRA"), contain specific legends, and contain certain additional disclosures when performance information is included.[6] However, a fund may rely on Rule 482 only *after* it has filed its registration statement under the Investment Company Act.

The proposed rule would provide closed-end funds and BDCs greater flexibility to communicate prior to filing a Securities Act registration statement. Although closed-end funds and BDCs already discuss underwriting and other offering terms with entities involved in the offering process, the ability to rely on the proposed rule's pre-filing exemption would provide additional comfort during the underwriting process.

The Commission explains that all funds, including ETFs and mutual funds, could use the pre-filing communications to test whether a potential new fund's investment objectives and strategies would be desirable to investors. In turn, investors would be able to provide feedback on the feasibility of key terms of the offering. Therefore, funds could gauge interest from QIBs and IAIs prior to expending time and resources on preparing and filing a Securities Act registration statement. In describing these goals, the Commission requests comment on whether there are any restrictions that would impede the ability of fund sponsors or others to engage in test-the-waters communications.

While the Commission's goals are laudable, and ones that we support, as explained below, funds that are required to register as investment companies are unlikely to use the new

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[6] Rule 34b-1 under the Investment Company Act also conditionally permits funds' "sales literature" addressed to or intended for distribution to prospective investors to include certain performance information. "Sales literature" typically consists of every written communication that issuers and underwriters use with the intention of "inducing or procuring, or facilitating the inducement or procurement" of any sale of open-end fund, UIT or face-amount certificate securities. *See* Proposing Release at note 59 (citing Investment Company Act Release No. 89 (March 13, 1941)). In addition, Section 24(b) of the Investment Company Act requires open-end funds, UITs, and face-amount certificate companies or any underwriter of any such fund to file "sales literature" that they intend to distribute to prospective investors in connection with a public offering of a fund's securities.

communication type. This is because these funds only could use test-the-waters communications *after* registering under the Investment Company Act.[7]

Funds required to register as investment companies, including ETFs and mutual funds, typically file a single registration statement to register simultaneously under both the Investment Company Act and Securities Act. The funds, therefore, would have the Hobson's choice of incurring more time and expense preparing two separate registration statements (one under the Investment Company Act and a subsequent one under both the Investment Company Act and Securities Act) or forego using test-the-waters communications. Given this choice, most funds, including mutual funds and ETFs, likely would choose not to take advantage of the pre-filing benefits of the rule.

We therefore recommend that the Commission consider expanding the scope of the rule to permit funds to rely on the rule prior to registering under *either* the Securities Act or the Investment Company Act.

B. Extend Relief to Registered Investment Advisers

The proposed rule also would permit funds to communicate with QIBs and IAIs after the fund's registration statement is effective (the post-filing aspect of the rule). The new communication type, however, is very similar to institutional communications funds already are permitted to use under FINRA rules.[8] One difference is that test-the-waters communications would not have to include legends, unlike current communication types.[9] Eliminating this disclosure possibly will simplify the communication but provide only minimal cost savings for funds. We doubt that funds will exercise this new communication option when they already use, and are familiar with, institutional communications.

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[7] Proposing Release at pages 23-24. Because BDCs are not required to register under the Investment Company Act, they may be more likely to use the proposed rule to engage in pre-filing communications. *See*, *e.g.*, Proposing Release at note 57.

[8] Proposed Rule 163B would not require filing of test-the-waters communications. Funds typically distribute their communications through registered broker-dealers, which are FINRA members. Broker-dealers are permitted to use institutional communications under FINRA Rule 2210(a)(3). That rule defines "institutional communication" as "any written (including electronic) communication that is distributed or made available only to institutional investors." FINRA Rule 2210(c)(7)(K) effectively exempts "institutional communications" from filing with FINRA or the Commission. Therefore, the ability to use test-the-waters communications without filing them would not incent funds to use post-filing communications when they already use, and are familiar with, institutional communications.

[9] Given the sophistication of QIBs and IAIs, they should be able to understand the communication without these additional protections.

The proposed rule would permit issuers to provide these communications to investors that are, or the issuer reasonably believes to be, QIBs and IAIs.[10] We agree that these two categories of investor are sophisticated enough to receive and evaluate test-the-water communications. We recommend that any final rule also permit *any* SEC-registered investment adviser to receive these communications. The Commission should do so, recognizing that, because investing is an adviser's business, any adviser should be considered sophisticated enough to fend for itself.[11] Further, doing so would be consistent with FINRA Rule 2210, which treats any registered investment adviser as an institutional investor.[12]

For many funds, perhaps the most important way to ensure a successful distribution is using the professional advice sales channel, which includes a broad range of professionals, including registered investment advisers that would not meet the QIB ownership thresholds. Yet, to get a better sense of the expected viability of a fund, feedback from this group is exceptionally valuable.

Accordingly, we recommend that the Commission permit issuers to provide test-the-waters communications to broker-dealers and SEC-registered investment advisers to the same extent.

C. Require Standardized Performance Information

The proposed rule would not impose any content restrictions on the communications provided, including on fund performance information. This would permit funds flexibility to illustrate performance in varying ways, so long as the information is not misleading or inconsistent with information in their related registration statements. In contrast, Rule 482 and Rule 34b-1 require funds to present performance information in a standardized format.

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[10] As the Proposing Release explains, QIBs are specified institutions that, acting for their own account or the accounts of other QIBs, in the aggregate, own and invest on a discretionary basis at least $100 million in securities of unaffiliated issuers. *See* Rule 144A(a)(1)(i) under the Securities Act. IAIs are institutional investors that also are accredited investors that meets the criteria of Rule 501(a)(1), (a)(2), (a)(3), (a)(7) or (a)(8). *See*, *e.g.*, Proposing Release at text surrounding notes 36 and 37.

[11] SEC-registered investment advisers may conduct research and due diligence on all types of investments. *See*, *e.g.*, Investment Advisers Act Release No. 4889 (April 18, 2018) (discussing an investment adviser's fiduciary duty to clients).

[12] Under the proposal, only registered investment advisers that in the aggregate own and invest on a discretionary basis at least $100 million in securities of issuers that are not affiliated with the adviser would be eligible to receive test-the-waters communications, while any broker-dealer would be eligible. This is because any broker-dealer qualifies as an IAI and as such is not required to own or invest any particular amount of securities.

We recommend that the Commission require funds to include performance information in a standardized manner in their test-the-waters communications.[13] This would enable QIBs, IAIs, (and potentially other registered investment advisers) to compare fund performance on an "apples-to-apples" basis and level the playing field for funds. It would not be burdensome for funds because this is how they present their performance today.

If the SEC does not require funds to provide standardized performance, we urge that the SEC require funds to provide clear and prominent disclosure whenever nonstandardized fund performance is presented. This would clearly alert all investors that the presented performance varies from the standardized performance that investors are accustomed to seeing – in accordance with requirements that have been in place for over thirty years.

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We appreciate the opportunity to comment on the SEC's proposed test-the-waters rulemaking. If you have any questions or require further information, please contact me (202-326-5813 or solson@ici.org), Dorothy Donohue, Deputy General Counsel (202-218-3563 or ddonohue@ici.org), or Kenneth C. Fang, Assistant General Counsel (202-371-5430 or kenneth.fang@ici.org).

Sincerely,

/s/ Susan Olson

Susan Olson
General Counsel

cc: The Honorable Jay Clayton
The Honorable Robert J. Jackson Jr.
The Honorable Hester M. Peirce
The Honorable Elad L. Roisman

Dalia O. Blass
Director, Division of Investment Management

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[13] *See also* Letter from Susan Olson, General Counsel, ICI, to Brent Fields, Secretary, SEC, dated July 9, 2018 (providing comments on the SEC's proposed rule on covered investment fund research reports), *available at* https://www.sec.gov/comments/s7-11-18/s71118-4017690-167320.pdf. For open-end funds, this would require compliance with the applicable requirements in Rule 482 under the Securities Act. For closed-end funds, this would require compliance with the applicable requirements of Form N-2.