RULE 139 OF THE US SECURITIES ACT
RESEARCH REPORTS

Peter Castellon of Proskauer Rose (UK) LLP and Mark Bergman of Paul, Weiss, Rifkind, Wharton & Garrison LLP discuss research reports and the safe harbour under Rule 139 of the US Securities Act.

As anyone familiar with the registration requirements of the US Securities Act of 1933 (Securities Act) knows, issuers and others involved in securities offerings with a US component need to be mindful of the restrictions on publicity at or around the time of the offering. These concerns flow from broad interpretations by the US Securities and Exchange Commission (SEC) of the types of communications and other offering activities in, or directed to, the US that might constitute offers.

If these communications or offering activities do constitute offers, they might be considered impermissible "gun-jumping" in the context of a public offering (that is, an offer that is made before the filing of a registration statement), or impermissible general solicitation and general advertising in the context of certain private placements, under Section 5 of the Securities Act.

This article focuses on the safe harbour in Rule 139 under the Securities Act (Rule 139) for research reports covering an issuer, its securities or the issuer's industry that are published by investment banks participating in a distribution of the issuer's securities and cover securities subject to the offering (*see box "What are research reports?"*). For ease of reference, since the terminology used in the relevant regulations is US-centric, this article refers to the financial institution publishing a research report as an investment bank.

HISTORY OF RULE 139

Rule 139 was introduced to offset the broad application of the Securities Act's gun-jumping prohibitions by providing certain safe harbours for communications conducted around the time of a registered public offering (*see box "Safe harbours"*).

In 1995, the SEC adopted amendments to Rule 139 that clarified that the safe harbour protections would be available for initial public offerings (IPOs) by sizable foreign private issuers that satisfy the alternative offshore trading history test; that is, the issuer's securities must have been traded for at least 12 months on a designated offshore market.

In 2005, as part of reforms of the offering process, the SEC adopted further amendments to Rule 139. These amendments expanded the class of non-SEC reporting foreign private issuers with respect to which the Rule 139 provisions would be applicable to include non-SEC reporting foreign private issuers whose equity securities have traded on a designated offshore securities market for at least 12 months or that have a worldwide float of at least $700 million. The amendments also confirmed that in

What are research reports?

In addition to providing underwriting services for offerings, investment banks provide ongoing research about an issuer's securities in the form of research reports. These reports track the issuer's performance in the market and give investors information that they can use to decide whether to buy, sell or hold the issuer's securities. In this way, research reports help to increase the liquidity of an issuer's securities. However, issuers need to be wary of gun-jumping issues; that is, violating the publicity restrictions that the US Securities and Exchange Commission imposes during the offering process.

Rule 139 under the US Securities Act of 1933 defines research reports as any written communication that includes information, opinions or recommendations with respect to, or analyses of, securities or issuers, whether or not the information is reasonably sufficient on which to base an investment decision. The US Jumpstart Our Business Startups Act of 2012 includes oral as well as written communications in the definition of a research report.

unregistered offerings conducted under Rule 144A under the Securities Act (Rule 144A), research reports meeting the conditions of Rule 139 would not be considered general solicitation or general advertising, and would not be considered directed selling efforts for the purposes of Regulation S under the Securities Act (Regulation S) (*see "Rule 144A and Regulation S" below*).

KEY ELEMENTS OF RULE 139

Rule 139 permits an investment bank participating in a distribution of securities of a well-known seasoned issuer (WKSI), a seasoned issuer or certain foreign private issuers to publish issuer-specific or industry-related research reports concerning the issuer or any class of its securities, if the research is included in a publication distributed in the regular course of its business. Industry-related research reports may also cover reporting issuers; that is, issuers that are required to file periodic reports with the SEC under the US Securities Exchange Act of 1934 (Exchange Act).

A WKSI is an issuer that:

- Is eligible to use SEC Form S-3 or Form F-3 for the registration of a primary offering of securities; that is, the issuer has a class of securities registered pursuant to Section 12(b) of the Exchange Act or is otherwise required to file reports under Section 15(d) of the Exchange Act.
- Has a worldwide public float of at least $700 million or has sold at least $1 billion in aggregate principal amount of registered, non-convertible securities (other than common equity) in primary offerings for cash.

The term "seasoned issuer" is not expressly defined in the relevant rules but is generally understood to meet the requirements of a WKSI except for the $700 million public float requirement. All other issuers with SEC filing obligations would simply be reporting issuers.

These research reports are deemed not to constitute an offer for sale or offer to sell for the purposes of Sections 2(a)(10) and 5(c) of the Securities Act if certain requirements are met. The Rule 139 safe harbour is not available if the issuer is, or any predecessor of the issuer was during the preceding three years, a blank check company, a shell company (other than a business combination-related shell company) or a penny stock issuer.

Issuer-specific reports

Reports about a specific issuer can cover only:

- Reporting issuers with at least a one-year reporting history that are current in their Exchange Act periodic reports and are eligible to register a primary offering of securities on Forms S-3 or F-3, based on the $75 million minimum public float or investment grade securities provisions of those forms.
- Certain non-SEC reporting foreign private issuers that satisfy the requirements of Rule 139(a)(1)(i)(B).

Accordingly, an investment bank publishing research on non-SEC reporting foreign private issuers may take advantage of Rule 139 for issuer-specific reports provided that the issuers meet the following requirements:

- The eligibility requirements of Form F-3; that is, they have not defaulted under debt securities.
- They have either $75 million in worldwide common equity public float or are issuing non-convertible investment grade securities (*see box "Fallen angels"*).
- They have had equity securities trading on a designated offshore securities market for at least 12 months or have $700 million in worldwide common equity public float (*see box "Designated offshore securities markets"*). The SEC assumes that those issuers will have home country reporting obligations even though they are not SEC reporting companies.

The investment bank must publish or distribute the research report in the regular

Fallen angels

Regardless of the exchange on which a foreign private issuer has listed its equity securities, it must have a free float of at least $75 million to be eligible for Rule 139 under the US Securities Act of 1933 (Rule 139). Questions may arise as to what to do if the free float temporarily falls below $75 million. As long as this is triggered by events affecting the wider market, the issuer is otherwise Rule 139-compliant and it continues to have broad research coverage, an investment bank may from time to time feel comfortable continuing research coverage as if Rule 139 continued to be available. The research would not strictly fall within the safe harbour, but investment banks have concluded that this would not constitute general solicitation or directed selling efforts.

course of its business and must, at the time of use, also have distributed or published at least one research report about the issuer or its securities, or have distributed or published at least one such research report following any discontinuation of coverage. Rule 139 does not impose a minimum time period to have distributed or published research reports about the issuer and does not require that the previously published or distributed research report cover the same securities that are the subject of the current offering.

Industry-related reports

Industry-related research reports can cover any reporting issuer or non-reporting foreign private issuer that satisfies the conditions of Rule 139(a)(1)(i)(B) (*see above*). Investment banks are not precluded from making more favourable recommendations than the one made in the last publication and the report does not need to include any previous recommendations.

However, the following conditions must be met to comply with Rule 139:

- The investment bank must publish or distribute industry research reports in the regular course of its business.
- At the time of the publication or distribution of the industry research report, the report must include a similar type of information about the issuer or its securities as is contained in similar reports.
- The industry research report must include similar information with respect to a substantial number of issuers in the relevant issuer's industry or sub-industry, or contain a comprehensive list of securities currently recommended by the investment bank.
- The analysis regarding the issuer or its securities must not be given materially greater space or prominence in the publication than that given to other issuers or securities.

In addition, if projections are provided in an industry report, the investment bank must:

- Have previously published or distributed projections on a regular basis in order to satisfy the "regular course of business" condition.
- At the time of publishing or disseminating the industry research report, be publishing or distributing projections with respect to that issuer.
- Include projections covering the same or similar periods with respect to either a substantial number of the issuers in the issuer's industry or sub-industry, or substantially all issuers represented in the comprehensive list of securities contained in the industry research report.

Safe harbours

Research reports prepared and distributed by investment banks during a public offering are the type of communications that could potentially be treated as offers to sell securities in violation of the US Securities Act of 1933 (Securities Act) if they are published before the filing of a registration statement, known as gun-jumping.

Rules 137, 138 and 139 under the Securities Act provide safe harbours to allow investment banks to publish and distribute research reports without the reports being treated as offers, as long as certain conditions are met:

- Rule 137 provides that an investment bank that is not an offering participant in a registered offering but publishes or distributes research in the regular course of business will not be considered to be engaging in a distribution of the issuer's securities and, therefore, will not be treated as an underwriter for the purposes of the offering.
- Rule 138 permits an investment bank participating in a distribution of the securities of a reporting issuer or a foreign private issuer to publish or distribute research that is limited to that issuer's securities other than the offered securities.
- Rule 139 deals with research reports about an issuer, that issuer's securities and the industry, which are published by investment banks participating in a distribution of a qualifying issuer's securities and cover the securities that are the subject of the offering.

RULE 144A AND REGULATION S

Rule 139 safe harbours historically have not been available for research reports that are published and distributed around the time of offerings carried out under Rule 144A and Regulation S. Rule 144A is a non-exclusive safe harbour from the registration requirements of the Securities Act for sales of securities to qualified institutional buyers (QIBs). Regulation S provides a non-exclusive safe harbour for offerings made outside the US by both US and foreign issuers.

However, recognising the value of research in creating an efficient market, the SEC clarified, as part of its securities offering reform in 2005, that research reports meeting the conditions of Rule 139 would not be considered offers under Section 5 of the Securities Act or general solicitation and general advertising in connection with offerings made in reliance on Rule 144A. These research reports would also not constitute directed selling efforts or be inconsistent with the offshore transaction requirements for the purposes of Regulation S.

However, as is the case with registered offerings generally and offerings conducted by emerging growth companies (EGCs) (*see "Emerging growth companies" below*), the flexibility provided for Rule 144A offerings has been affected by the provisions of the global research settlement (*see box "Global research settlement"*), as well as liability concerns.

In addition, it is widely accepted that an investment bank that publishes Rule 139-compliant research would not engage in general solicitation in connection with an offering to QIBs that is structured to comply with "Section 4(1½)" or Section 4(a)(2) of the Securities Act (*see feature article "US private placements: when Rule 144A is unavailable", www.practicallaw.com/7-615-3385*).

REGULATION M

Regulation M of the Exchange Act may also have implications for the publication and

Designated offshore securities markets

Rule 902(b) of Regulation S under the US Securities Act of 1933 defines "designated offshore securities markets" and lists the following exchanges which met the definition at the time the rule was published:

- Alberta Stock Exchange.
- Australian Stock Exchange Limited.
- Bermuda Stock Exchange.
- Copenhagen Stock Exchange.
- Euronext Amsterdam.
- Euronext Brussels.
- Euronext Paris.
- Frankfurt Stock Exchange.
- Helsinki Stock Exchange.
- The Stock Exchange of Hong Kong.
- Irish Stock Exchange.
- Istanbul Stock Exchange.
- Johannesburg Stock Exchange.
- London Stock Exchange.
- Bourse de Luxembourg.
- Mexico Stock Exchange.
- Milan Stock Exchange.
- Montreal Stock Exchange.
- Oslo Stock Exchange.
- Stock Exchange of Singapore.
- Stockholm Stock Exchange.
- SWX Swiss Exchange.
- Tokyo Stock Exchange.
- Toronto Stock Exchange.
- Vancouver Stock Exchange.
- Warsaw Stock Exchange.

Since then, the following exchanges have been added to the list:

- Aequitas Neo Exchange.
- Athens Exchange.
- Bahamas International Securities Exchange.
- Channel Islands Stock Exchange.
- CNSX Markets.
- Egyptian Exchange.
- Korea Exchange.
- Kuala Lumpur Stock Exchange.
- Madrid Stock Exchange.
- Malta Stock Exchange.
- Panama Stock Exchange.
- Prague Stock Exchange.
- Taiwan Stock Exchange.
- Tel Aviv Stock Exchange.
- Vienna Stock Exchange.

distribution of research reports. It contains certain restrictions in connection with sales and purchases of securities in order to prevent market manipulation by an issuer, its affiliates and broker dealers.

The publication of a research report could constitute a prohibited attempt to induce someone to bid for or purchase a security being offered in a distribution if it is made during the applicable restricted period. Regulation M provides an exception for research reports that meet the conditions of Rule 139. In addition, the restrictions imposed by Regulation M do not apply to distributions of:

- Actively traded securities.
- Investment grade, non-convertible and non-convertible preferred debt securities.
- Investment grade, asset-backed securities.

WHEN RULE 139 IS NOT AVAILABLE

If Rule 139 is not available, an investment bank participating as an underwriter in an offering has various options, including postponing the publication of the research report, prevailing on the issuer to postpone the offering, or withdrawing as an underwriter

Global research settlement

On 28 April 2003, certain enforcement actions initiated by the US Securities and Exchange Commission (SEC), self-regulatory organisations and other regulators against a number of investment banks to address conflicts of interest between their research and investment banking functions were settled. This is known as the global research settlement.

The global research settlement required investment banks to modify several of their practices, including separating their research and investment banking departments, and prohibiting any communication between those departments.

The SEC has confirmed that the enactment of the US Jumpstart Our Business Startups Act of 2012 does not affect the global settlement agreement. Therefore, any restrictions applicable to an investment bank because of the global settlement agreement, including the need to create and enforce firewalls between research and investment banking personnel, will continue to apply unless the bank procures a court order amending the terms of the global research settlement in respect of that bank.

As part of US Treasury Department's review of the US capital markets, in October 2017 it recommended a holistic review of the global research settlement and research analyst rules to determine which provisions should be retained, amended or removed, in order to harmonise a single set of rules for financial institutions (*www.treasury.gov/press-center/press-releases/Documents/A-Financial-System-Capital-Markets-FINAL-FINAL.pdf*).

for the offering. Where it has published a research report, the investment bank would generally want some period of time to elapse between publication and an offering of shares of the issuer. For example, some investment banks wait 30 to 40 days before conducting an offering to QIBs.

For post-offering publication of research, an investment bank that participated in an offering would generally want a period of time to elapse between the offering and publication of research covering the issuer. For example, many investment banks would wait 40 days after an offering to QIBs.

Since Rule 139 is a non-exclusive safe harbour, some investment banks may conclude that they are not engaging in gun-jumping, general solicitation and general advertising, or directed selling efforts, even if the conditions of Rule 139 are not strictly met.

If an investment bank has published a non-compliant research report, it could conduct the offering outside the US. In order to rely on this approach, most investment banks would go further than just structuring the transaction under Rule 903 of Regulation S. They tend to avoid US jurisdictional means by not offering securities to onshore investment advisers of offshore funds, which would otherwise be allowed under Rule 903. This assumes that the research report was not, in fact, initiated to obtain the mandate for the transaction or to condition the market for the offering.

Concerns may be raised that withholding research would alert the market that an offering is imminent. In this case, non-compliant research could be kept out of the US. This approach is sometimes used by local or regional investment banks that post or email the research to non-US customers or publish the research on a website that is only accessible by non-US customers.

Investment banks may take the position that where an issuer is covered by a sufficient number of analysts, initiating new coverage should not make a difference to investors. For example, if an issuer is covered by five institutions in the English language, initiating coverage, perhaps as part of a wider sector-based initiative or because the institution has hired a new analyst, should not be interpreted as a solicitation for an offering that takes place shortly before or after the publication of the research report. Again, this is as long as the research was not, in fact, published to obtain the mandate for the transaction or to condition the market for the transaction.

Investment banks may also take the position that they had no reasonable expectation of a mandate at the time of publication and, therefore, the publication should not be considered a solicitation. In addition, some investment banks may take the position that they have information barriers between their research teams and their bankers, and that, as long as the barriers work, the research should not be viewed as a solicitation.

While these approaches are taken by some investment banks from time to time, few investment banks would initiate research when they are mandated for an offering.

EMERGING GROWTH COMPANIES

The US Jumpstart Our Business Startups Act of 2012 (JOBS Act) created a new category of issuers known as EGCs (*see Briefing "Accessing the US markets: a warmer climate for foreign issuers", www.practicallaw.com/4-519-6311*). EGCs are defined in the Securities Act and the Exchange Act as issuers with total annual gross revenues of less than $1 billion during their most recently completed fiscal year.

Rule 139 was not amended to cover EGCs, however, the JOBS Act provides a safe harbour for EGCs by adding an exception from the definition of "offer" in Section 2(a)(3) of the Securities Act (Section 2(a)(3)) for research reports prepared by investment banks covering EGCs that are engaged in a public offering of common equity securities.

Under Section 2(a)(3), the publication or distribution of a written or oral research report about an EGC, at any time before or during a public offering of the EGC's securities (including its IPO), by an investment bank involved in the offering will not constitute an offer of securities for the purposes of Section 2(10) or Section 5(c) of the Securities Act.

The SEC and the US Financial Industry Regulatory Authority (FINRA) are prohibited from maintaining or adopting any rule restricting the publication of research on an EGC within any time period after an IPO or before the expiration of any related lock-up arrangement. Section 2(a)(3), unlike Rule 139,

is available for the initiation or re-initiation of research reports.

Investment banks preparing and distributing research reports about EGCs which avail themselves of Section 2(a)(3) should still remain mindful of certain other limitations on the distribution of research reports during offerings conducted in the US; in particular, those arising from the global research settlement and certain FINRA rules (*see box "Global research settlement"*).

Owing to general concerns about liability, in practice, investment banks may elect not to rely on Section 2(a)(3) and to continue to impose research quiet periods, which typically last until the 25th calendar day following the IPO effective date. These quiet periods prohibit the publication of any research reports by investment banks participating in the offering in an effort to ensure that investors base their investment decision mainly on the information found in the registration statement.

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