

SEC Endorses Use of Conditional Offers to Buy Shares in IPOs

December 16, 2016

The Securities and Exchange Commission (the “SEC”) recently issued a no-action letter to Morgan Stanley Smith Barney L.L.C. (“Morgan Stanley”) that will streamline the process for its wealth management clients to participate in initial public offerings (“IPOs”). The SEC said it would not object to Morgan Stanley’s proposed use of conditional offers to buy shares (“COBs”) prior to the effectiveness of IPO registration statements under specific conditions. The no-action request and the SEC’s letter confirm that COBs, if properly implemented, may be used in registered offerings, and when read together, outline detailed procedures to follow in order to use COBs.

Morgan Stanley sought to use COBs to solve a practical problem in IPOs. Section 5(a) of the Securities Act of 1933, as amended, prohibits the sale of any securities until the registration statement has been declared effective. Typically, IPO registration statements go effective after the market closes on the day of pricing and sales are promptly confirmed with investors. Under standard IPO investment procedures, individual wealth management clients of Morgan Stanley need to be available in a narrow window of time after effectiveness to confirm purchases of IPO shares. These standard procedures made it difficult and inconvenient for individual investors to participate in IPOs.

Morgan Stanley proposes to eliminate these difficulties for individual investors in IPOs by using COBs under procedures that will ensure compliance with Section 5. Each investor’s COB is a conditional offer to buy either a number or dollar amount of shares in an IPO. An investor may withdraw a COB at any time prior to effectiveness of the IPO registration statement (or at a later time under certain circumstances). A COB may not be accepted unless three conditions are satisfied: the IPO registration statement is effective, the IPO is priced within the IPO price range as set forth in the preliminary prospectus delivered to the investor and there has been no material change to the preliminary prospectus. If the three conditions are satisfied and the investor has not withdrawn the COB, then Morgan Stanley would be entitled to accept an investor’s COB to the extent shares are allocated to the investor.

Related Capabilities

- Corporate Governance & Compliance
- Capital Markets

In its no-action letter, the SEC highlighted several representations of Morgan Stanley that supported the SEC's determination:

- Morgan Stanley will distribute a summary of the COB process to inform clients of the right to withdraw COBs;
- Morgan Stanley will confirm by email receipt of COBs and remind client that they may withdraw the COB;
- Financial advisors at Morgan Stanley will be responsible for making sure clients understand their right to withdraw COBs;
- Client will be notified of effectiveness or anticipated effectiveness of the IPO registration statement and clients will have at least one hour following the notice to withdraw the COB;
- COBs would be no longer valid if there is a material change from the preliminary prospectus or the IPO prices outside the permitted price range; and
- Morgan Stanley will not collect any funds to purchase shares until it accepts a COB following effectiveness of the registration statement.

The SEC's position will not materially impact the ability of companies to raise funds but it should enhance the ability of individual client of investment banks to participate in IPOs managed by the investment banks.