SEC Approves NYSE’s Plan for Primary Direct Listings, Then Stays Order to Consider the Changes

Article By:

Clinton Hansford Smith

On August 26, 2020, the Securities and Exchange Commission (SEC) issued an order approving a proposal from the New York Stock Exchange (NYSE) that would allow companies going public to raise capital through a primary direct listing.

These changes are not yet in effect, however, because the SEC stayed the approval order. On August 31, the Council of Institutional Investors (CII) submitted a petition to review the SEC’s approval order, and the SEC granted that stay. The NYSE petitioned the SEC to lift the stay, but on September 25, the SEC denied that petition, citing CII’s argument that the proposed rule change makes changes to the initial public offering (IPO) market that are “so significant that the Commission should maintain the stay” while it considers “the adequacy of investor protections” and other policy issues under the proposed rule change.

It is unclear how long the SEC will take to conduct its review, but if the proposal is ultimately effective, the changes will allow companies to raise capital through a primary direct listing as well as a secondary direct listing. The major aspects of the proposed changes are discussed below.

Direct Listings and Traditional Underwritten Public Offerings

Direct listings have emerged in recent years as an alternative to traditional IPOs, with large companies such as Spotify, Slack, and Palantir opting to use a direct listing when going public. A direct listing allows a company to list its equity securities without an underwritten offering and, historically, without the listing company raising capital. With a direct listing, no new shares are created and a company registers and lists only issued and outstanding shares, similar to a secondary offering. This process is different from a traditional IPO, in which a company historically issued new shares to the public as part of a capital-raising transaction in connection with a listing.

Under the NYSE’s current rules, direct listings are not available to companies seeking to issue new shares in a primary offering. Instead, direct listings are only available to companies seeking to provide liquidity to preexisting shareholders in a secondary offering, now known as a “Selling Shareholder Direct Floor Listing.”

Primary Direct Floor Listing

The NYSE’s new rules provide for a new “Primary Direct Floor Listing,” in which a company can sell newly issued primary shares on its own behalf to raise capital in the opening auction without a traditional underwritten public offering and with the IPO price determined by the opening trade auction.

Primary Direct Floor Listings set forth requirements in order for companies to qualify. A company can qualify for a Primary Direct Floor Listing in two ways:

- The company must sell at least $100 million in market value of shares in the opening auction on the first day of trading on the NYSE; or
- The company must have at the time of listing a market value of freely tradeable shares of at least $250 million, calculated using a price per share that is equal to the lowest price in the price range set by the company in the Securities Act registration statement.

With either of the above methods of qualification, the company must also meet all other applicable listing requirements, including having at least 400 security holders holding round lots, at least 1.1 million publicly held shares outstanding at the time of listing, and a price per share of at least $4.00.

Issuer Direct Offering Order

The new rule also includes additional changes relating to the mechanics of establishing an opening price and initiating trading in a Primary Direct Floor Listing. Specifically, the new rule introduces a new limit order, called an Issuer Direct Offering Order (IDO Order), which is to be traded only in a Primary Direct Floor Listing. The IDO Order will have the following requirements:

- Only one IDO Order may be entered on behalf of the issuer and only by one member organization.
- The limit price of the IDO Order must be equal to the lowest price in the price range established by the issuer in its effective registration statement (the price range is defined as the “Primary Direct Floor Listing Auction Price Range”).
- The IDO Order must be for the quantity of shares offered by the issuer, as disclosed in the prospectus of the effective registration statement.
- An IDO Order may not be cancelled or modified.
- An IDO Order must be executed in full in the issuer’s Direct Listing Auction.[1]

The new rule also establishes that a Designated Market Maker (DMM) will effectuate a Direct Listing Auction manually and be responsible for determining the auction price. The DMM will be responsible for determining whether a Direct Listing Auction will proceed, and the DMM cannot conduct a Direct Listing Auction for a Primary Direct Floor Listing if either of the following is true:

- The auction price would be below the lowest price or above the highest price of the Primary Direct Floor Listing Auction Price Range.

- There is insufficient buy interest to satisfy both the IDO Order and all better-priced sell orders in full.[2]

If there is insufficient buy interest and the DMM cannot price the auction and satisfy the IDO Order as required, the Direct Listing Auction would not proceed and such security would not begin trading. In such a situation, the NYSE would notify market participants via a Trader Update[3] that the listing has been cancelled.

Nasdaq Follows Suit

The Nasdaq is also seeking rule changes that would allow companies to raise primary capital by direct listings on the Nasdaq Global Select Market. On August 24, 2020, the Nasdaq filed with the SEC a proposed rule change that has many similarities to the NYSE's proposed rule change. Like the NYSE rule, the Nasdaq's rule would also permit primary direct listings for certain companies that meet specific requirements regarding their initial trading price and market value. For the Nasdaq's proposal, however, the company's initial trading price must be greater than or equal to 20% below the lowest price in the price range disclosed by the issuer in its registration statement; furthermore, the company's publicly held shares before the listing, together with the market value of the shares to be sold in the direct listing, must have a market value of at least $110 million (or $100 million if the company has stockholders' equity of at least $110 million). In addition, the Nasdaq's proposal calculates market value by using a price per share equal to 20% below the lowest price in the price range established by the issuer in the registration statement.

---

[1] *See* NYSE Rule 7.35(a) for relevant definitions. NYSE Rule 7.35(a)(1) defines "Auction" as the process for opening, reopening, or closing of trading of Auction-Eligible Securities on the NYSE, which can result in either a trade or a quote. NYSE Rule 7.35(a)(1)(E) defines "Direct Listing Auction" as the Core Open Auction for the first day of trading on the NYSE of a security that is a direct listing. NYSE Rule 7.35(a)(1)(C) defines "Core Open Auction" as the Auction that opens trading at the beginning of the Core Trading Session.

[2] A buy (sell) order is "better-priced" if it is priced higher (lower) than the auction price. *See* NYSE Rule 7.35(a)(5)(A) and proposed Rule 7.35A(g)(2).

[3] Trader Updates can be found at https://www.nyse.com/trader-update/history.

National Law Review, Volumess X, Number 287