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BLOG

SEC Approves NYSE Rule Change to Allow Capital Raise with Direct Listings

DECEMBER 30, 2020

NYSE

On December 22, 2020, the Securities and Exchange Commission (the SEC) approved the New York Stock Exchange's (the NYSE) proposal to allow private companies to conduct a primary registered offering as part of a direct listing on the NYSE without conducting a firm commitment underwritten offering (a Primary Direct Floor Listing). Capital Markets & Securities Law Watch previously discussed the NYSE's proposal on September 1, 2020.

A Primary Direct Floor Listing requires companies either to sell at least $100 million in market value of their shares in the NYSE's opening auction on the first day of trading on the NYSE or, if selling less than $100 million, to evidence that the aggregate market value of the shares that it will sell on that day and the shares that are publicly held immediately prior to listing is at least $250 million (which is calculated using a price per share equal to the low end of the price range established by the issuer in its registration statement for the offering). In addition, any company planning a direct listing must also meet all applicable initial listing standards at the time of listing, without the benefit of a grace period, including the NYSE's requirement that the company have a minimum of 400 round lot holders, 1.1 million publicly held shares outstanding and a price per share of at least $4.00.

Under the new direct listing process, an issuer is permitted to list its existing shares on the NYSE and raise capital by issuing new shares without first hiring an investment bank to underwrite the transaction, unlike in a "traditional" initial public offering. As a result, a Primary Direct Floor Listing may potentially be less expensive because there are no underwriting fees (although the company still retains an investment bank as a financial advisor) and the company's insiders are not subject to the standard 180-day underwriters' lockup.

The largest advantage of a direct listing may be that the price at which the stock opens is determined by the market, while, in traditional initial public offerings, the price is set by the company and the underwriters after conducting price discovery through a road show and book-building process. Issuers have pointed to the "IPO pop" as evidence that IPOs are priced to benefit professional investors, like hedge funds, that purchase shares directly from the underwriter, causing the issuer and selling stockholders to leave money on the table. Now that companies can raise money in connection with a direct listing, more companies may choose to go public through the direct listing process, since it may prove to be a cheaper alternative to traditional initial public offerings, while providing potentially higher market-based pricing for issuers.

Notably, NYSE's direct listing rules will not be available to special purpose acquisition companies (SPACs).

Nasdaq
On December 17, 2020, the SEC instituted proceedings to determine whether to approve the Nasdaq Stock Market's (Nasdaq) proposal to permit companies to list in connection with a primary offering in which the company itself will sell shares on the first day of trading on Nasdaq. Nasdaq's proposal, initially filed with the SEC on September 4, 2020, is substantially similar to the NYSE's direct listing proposal, but does not require that the opening price be within the price range set forth in the registration statement.

Instead, Nasdaq's proposal allows companies to initiate a listing at a price up to 20% below the low end of the price range in the company's registration statement and without a limit on the maximum price. In calculating whether a company satisfies Nasdaq's Market Value of Unrestricted Publicly Held Shares requirement, Nasdaq will calculate the value of the shares using the price that is 20% below the low end of the price range and will deem the test to be met if the aggregate market value of unrestricted publicly held shares immediately prior to listing, together with the value of the shares the issuer sells in the opening auction, is at least $110 million (or $100 million, if the company has stockholders' equity of at least $100 million). Additionally, unlike the NYSE direct listing process, Nasdaq's proposal allows the issuer's financial advisor, rather than a designated market maker, to be responsible for determining the opening price.

In its order, the SEC noted several areas of particular concern, including the lack of a limit on the upside of the price range, which could make it difficult for the issuer to ensure that its Securities Act registration statement covers the full amount of securities to be sold in the offering. This concern should be easily addressed by Nasdaq clarifying that issuers cannot sell more than the number of securities registered or, if an aggregate dollar amount is registered, not more than the aggregate offering amount registered. The SEC also raised some technical issues with Nasdaq's proposal to allow companies to price up to 20% below the low end of the price range disclosed in the registration statement, which Nasdaq will presumably address in an amended rule filing. Lastly, the SEC raised concerns with the discretion afforded an issuer's financial advisor to cancel an order once entered.

The SEC is soliciting additional comments from the public for 21 days as part of its continuing review of Nasdaq's proposal.

Conclusion
The newly approved NYSE direct listing rules and, once approved, the proposed Nasdaq direct listing rules provide a viable alternative for companies that are interested in raising capital in a public offering but are wary of some of the downsides to the traditional initial public offering process. The tremendous increase in the number of companies going public through mergers with SPACs has demonstrated that issuers are increasingly looking for alternatives to underwritten offerings. Now that companies can raise capital in a direct listing, an increasing number of issuers will be weighing the pros and cons of traditional IPOs, direct listings and SPAC mergers.

The Capital Markets & Securities Law Watch will continue to monitor Nasdaq's direct listing proposal as it is evaluated by the SEC and will provide updates to our readers.

4 Min Read

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