

NYSE Proposes Letting Companies Raise Funds in a Direct Listing

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Key Takeways:

- Direct listings to date have not permitted companies to raise capital, and have required 400 holders of company stock prior to listing.
- The proposed NYSE rule would address both of these limitations.
- Underwritten IPOs are still expected to remain attractive to most private companies.

The “traditional” IPO model has received a lot of criticism recently in the media and from venture capital investors for perceived “mispricings” that result in a pop in the opening trade. Recently, the media and investors have seized upon “direct listings,” where a company is listed on an exchange without a capital raising transaction, and instead files a registration statement to facilitate a listing and permit existing shareholders to sell into the market without a formal offering. While this structure has been utilized by three companies to date (full disclosure: this firm worked on two of them), the structure has two significant infirmities that the proposed NYSE rule change would address. These proposed changes are welcome and may facilitate more direct listings, but it is unclear whether this rule change will solve all concerns with direct listings and encourage a meaningful number of private companies to abandon the traditional underwritten IPO, which continues to work well for many companies.

Two significant weaknesses for direct listings to date are that (i) the issuer cannot raise any capital and (ii) to be listed, the issuer must have 400 holders of its common stock prior to the listing (only a small number of large private companies can satisfy this requirement.)

The NYSE has filed a **proposed rule change** with the Securities and Exchange Commission that would permit companies to raise capital in a direct listing. Under the proposed rule change, an issuer would be able to sell newly issued primary shares on its own behalf directly into the opening trade, without a traditional underwritten public offering and with the IPO price determined by the opening trade auction. This change could make the direct listing route more attractive to issuers that need to raise capital, although it is an open question whether issuers will be able to achieve the desired pricing and distribution of shares in a way comparable to that done in a traditional underwritten IPO. In addition, traditional IPOs allow stable, long-term holders to buy a significant stake in a company, which may not be possible in a direct listing. We note that while there would be no underwritten IPO or underwriters, existing SEC rules do require that investment banks participate as financial advisors and accept underwriter liability, so that the basic registration and due diligence process will remain largely as it is for underwritten offerings.

The NYSE has also proposed to modify the distribution requirements to delay the requirement that an issuer have 400 round lot holders at the time of listing until 90 trading days after the listing date if (i) in the case of a primary direct listing, either the company sells at least \$250 million in market value of shares in the opening auction, or the market value of freely tradable shares prior to the listing plus the market value of shares sold by the company in the opening auction is at least \$350 million, or (ii) in the case of a secondary direct listing, the market value of freely tradable shares at the time of listing is at least \$350 million. The historical distribution requirements precluded many private companies from being eligible to pursue a direct listing because they did not have the requisite number of round lot holders. By providing a 90-day grace period coupled with a higher public float requirement, the NYSE is trying to make the direct

listing route available to more companies while balancing the need for an appropriate liquid trading market.

This proposed rule change reflects the growing interest in direct listings and is an attempt to solve two key issues related to direct listings. However, there continue to be other potential limitations to direct listings and private companies considering their options should consult with counsel and their investment banking advisors to fully understand the benefits and costs of this new model.

If the SEC approves the proposal, the rule change is not expected to take effect until at least 45 days after its publication in the Federal Register.

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