Council of Institutional Investors®
The voice of corporate governance

Via Email

April 16, 2020

Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

Re: File Number SR-NYSE-2019-67

Dear Madam Secretary:

I am writing on behalf of the Council of Institutional Investors (CII), a nonprofit, nonpartisan association of U.S. public, corporate and union employee benefit funds, other employee benefit plans, state and local entities charged with investing public assets, and foundations and endowments with combined assets under management of approximately $4 trillion. Our member funds include major long-term shareowners with a duty to protect the retirement savings of millions of workers and their families, including public pension funds with more than 15 million participants – true "Main Street" investors through their pension funds. Our associate members include non-U.S. asset owners with about $4 trillion in assets, and a range of asset managers with more than $35 trillion in assets under management.[1]

The purpose of this letter is to respond to the Securities and Exchange Commission (SEC or Commission) request for comments (SEC Order) in response to a New York Stock Exchange LLC (NYSE or Exchange) "proposed rule change to amend Chapter One of the Listed Company Manual . . . to modify the provisions related to direct listings (NYSE Proposal)."[2] The NYSE Proposal would expand the use of direct listings by permitting a company to "sell shares itself in the opening auction on the first day of trading on the Exchange in addition to, or instead of, facilitating sales by selling shareholders . . ."[3] As indicated in our letter of January 16, 2020 (January Letter) and discussed further in this letter, CII believes the SEC should disapprove the NYSE Proposal.[4]

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[1] For more information about the Council of Institutional Investors ("CII"), including its board and members, please visit CII's website at http://www.cii.org.
[2] Self-Regulatory Organizations; New York Stock Exchange LLC; Order Instituting Proceedings to Determine Whether to Approve or Disapprove a Proposed Rule Change, as Modified by Amendment No.1, To Amend Chapter One of the Listed Company Manual To Modify the Provisions Relating to Direct Listings, Exchange Act Release No. 88,485, 85 Fed. Reg. 18,292, 18,292 (Mar. 26, 2020), *available at* https://www.federalregister.gov/documents/2020/04/01/2020-06732/self-regulatory-organizations-new-york-stock-exchange-llc-order-instituting-proceedings-to-determine.
[3] *Id.*
[4] *See* Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors to Secretary, Securities and Exchange Commission 3 (Jan. 16, 2020), https://www.sec.gov/comments/sr-nyse-2019-67/srnyse201967-6660338-

SEC Does Not Have A Sufficient Basis to Make an Affirmative Finding

The SEC Order indicates that the NYSE Proposal must be disapproved if the SEC does not have "a sufficient basis to make an affirmative finding that a proposed rule change is consistent with the . . . [Securities and Exchange Act of 1934 (Exchange Act)] and the applicable rules and regulations."[5] More specifically, the SEC Order states that the NYSE Proposal must be consistent with:

> Section 6(b)(5) of the Exchange Act, which requires, among other things, that the rules of a national securities exchange be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, *to protect investors and the public interest*; and are not designed to permit unfair discrimination between customers, issuers, brokers, or dealers.[6]

CII believes the NYSE Proposal to expand direct listings may lessen investor protections in a number of ways, including the following:[7]

<u>Investors may have fewer legal protections</u>.

As described in detail in the January Letter, investors that purchase shares from issuers that have conducted direct listings may have fewer legal protections from damages caused by untrue statements of fact or material omissions of fact.[8] More specifically, investors in direct listings may not be able to: (1) directly trace their shares to a registration statement; and (2) determine the amount of damages because there is no offering price.[9]

203855.pdf ("SEC approval of the Proposed Rule before fixing our system of share ownership would follow the same disordered approach that the Commission has taken to fixing problems in proxy plumbing.").

[5] 85 Fed. Reg. at 18,296.

[6] *Id.* at 18,295 (emphasis added).

[7] We note that investor protections in direct listings may be particularly vulnerable during a down or volatile market. *See* Crystal Tee & Katie Roof, *Direct Listings Fall From Favor With Tech Cash Crunch Deepening*, Yahoo! Fin., Mar. 25, 2020, https://finance.yahoo.com/news/direct-listings-fall-favor-tech-040100439.html (Commenting that "the lack of visibility on the supply of shares on the first trading day, the absence of a target price range and the loose framework make it difficult to guide investors in an unstable market."); Cromwell Schubarth, *The Funded: Direct listings, 'blank check' IPOs look less likely in age of COVID-19*, Silicon Valley Bus. J., Mar. 25, 2020, https://www.bizjournals.com/sanjose/news/2020/03/25/the-funded-direct-listings-blank-check-ipos-look.html ("current market volatility makes it too hard to guide investors on the proper pricing and valuation of companies that skip traditional investor road shows before they trade").

[8] *See* Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors to Secretary, Securities and Exchange Commission at 2 ("investors in direct listing companies may have fewer legal protections than investors in IPOs").

[9] *See, e.g.*, Alexander Osipovich, *Investor Advocates See Risks in Silicon Valley's Favorite IPO Alternative,* Wall St. J., Jan. 3, 2020, https://www.wsj.com/articles/investor-advocates-see-risks-in-silicon-valleys-favorite-ipo-alternative11578047400 (describing the two arguments in the context of litigation involving shareholders of Slack).

The NYSE dismisses our concern claiming that "it should have no bearing on the Commission's decision as to whether the [NYSE] Proposal is consistent with the Exchange Act."[10] The NYSE appears to support the absence of traceable shares in a direct listing as an appropriate defense to investor losses caused by public companies' untrue statements of fact or material omissions of fact.[11] We respectfully disagree.

As we concluded in the January Letter:

> Critical shareholder litigation rights . . . depend in some cases, particularly Section 11 claims, on a better system to prove provenance of shares. SEC approval of the [NYSE Proposal] . . . before fixing our system of share ownership would follow the same disordered approach that the Commission has taken to fixing problems in proxy plumbing.
>
> If . . . public companies are successful in limiting their liability to investors for damages caused by untrue statements of fact or material omissions of fact within registration statements associated with direct listings, we cannot support direct listings as an alternative to IPOs.[12]

<u>Investors may be subject to greater risk because of the small number of required shareholders.</u>

NYSE listing standards generally require issuers to have at least 400 round lot holders and 1.1 million publicly held shares.[13] Under the NYSE Proposal, however, direct listings would be granted an exemption or grace period of up to 90 days to comply with those requirements as long as they meet one of three market value tests.[14] We reiterate the following concerns expressed in the January

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[10] Letter from Elizabeth K. King, Chief Regulatory Officer, ICE, General Counsel & Corporate Secretary, NYSE to Ms. Vanessa Countryman, Secretary, Securities and Exchange Commission 4 (Mar. 16, 2020) https://www.sec.gov/comments/sr-nyse-2019-67/srnyse201967-6960395-212779.pdf.

[11] *See id.* at 4-5 ("The methods used by a plaintiff to establish Securities Act liability for offering participants may well vary depending upon the facts of the specific transaction, and securities law liability has always distinguished between investors who purchase in the market and investors who purchase directly from underwriters.").

[12] Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors to Secretary, Securities and Exchange Commission at 3 (footnotes omitted).

[13] *See* 85 Fed. Reg. at 18,293 n.20 ("Section 102.01A requires a company to have 400 holders of 100 shares or more (or of a unit of trading if less than 100 shares) and 1,100,000 publicly-held shares.").

[14] *Id.* at 18,293 ("In each of the following cases, the Exchange has proposed to grant the company a grace period of up to 90 trading days from the date of initial listing (''Distribution Standard Compliance Period'') to comply with the applicable initial listing distribution requirements: (i) A company listing in connection with a Primary Direct Floor Listing in which it sells at least $250 million in market value of shares in the Exchange's opening auction on the first day of trading on the Exchange; (ii) a company listing in connection with a Primary Direct Floor Listing in which the aggregate amount of the market value of shares sold by the company in the opening auction and the market value of publicly-held shares demonstrated by the company immediately prior to the time of initial listing (in the manner set forth in Section 102.01B, Footnote (E) of the Manual) is at least $350 million; and (iii) a company listing in connection with a Selling Shareholder Direct Floor Listing in which it demonstrates at the time of initial listing (in the manner set forth in Section 102.01B, Footnote (E) of the Manual) that it has at least $350 million in aggregate market value of publicly held shares.").

Letter about the lack of any data to support a conclusion that the exemption is consistent with the protection of investors:

> The NYSE argues that the exemption from this liquidity requirement "is consistent with the protection of investors because the enhanced public float requirement[] . . . would make it probable that there would be a quick development of a liquid trading market and that the company would comply with the initial listing distribution standards within the [proposed 90 day grace period] . . . ." The NYSE, however, provides no data to support its argument other than the statement that the "$350 million public float requirement that would be required under this proposal . . . is far higher than [the $100 million public float that] . . . a newly-listed company would have to demonstrate under other circumstances." And without evidence, the $350 million threshold appears arbitrary.[15]

Similarly, we share the Commission's observation in the SEC Order that the NYSE Proposal "has not explained why potentially listing an issuer with a very small number of holders, and allowing it to trade for many [at least 3] months, would not risk undermining . . . the protection of investors, or otherwise would be consistent with Section 6(b)(5) and other relevant provisions of the Exchange Act."[16]

Finally, we also share the Commission's observation in the SEC Order that by providing a 90 day grace period from the requirement of having at least 400 round lot holders and 1.1 million publicly held shares, the NYSE Proposal "would appear to be increasing the risk of delisting companies relatively soon after their listing, and the Exchange has not offered any assessment of this risk or the impact such delisting's may have on investors in those securities . . . ."[17]

<u>Investors may be subject to greater risk because of the potentially low aggregate market value of publicly held shares at the time of listing.</u>

NYSE listing standards generally require issuers to demonstrate an aggregate market value of publicly-held shares of $100 million on the first day of trading.[18] Under the NYSE Proposal, however, it is unclear whether this listing standard will be met. As the SEC Order explains:

> The Exchange has proposed that . . . a company will be deemed to have met the applicable $100 million aggregate market value of publicly-held shares requirement if the company sells at least $100 million in market value of shares in the . . . opening

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[15] Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors to Secretary, Securities and Exchange Commission at 4 (footnotes omitted).
[16] 85 Fed. Reg. at 18,295.
[17] *Id.*
[18] *See* NYSE Listed Company Manual § 102.01B (Nov. 9, 2018), https://nyseguide.srorules.com/listed-company-manual/document?treeNodeId=csh-da-filter!WKUS-TAL-DOCS-PHC-%7B0588BF4A-D3B5-4B91-94EA-BE9F17057DF0%7D--WKUS_TAL_5667%23teid-4 ("A Company must demonstrate an aggregate market value of publicly-held shares of $40,000,000 for companies that list either at the time of their initial public offerings . . . (C) or as a result of spin-offs or under the Affiliated Company standard or, for companies that list at the time of their Initial Firm Commitment Underwritten Public Offering (C), and $100,000,000 for other companies (D)(E).").

> auction on the first day of trading. The Exchange has not explained, however, how it would be assured that a company listing under this provision will actually sell shares valued at $100 million or more at the time the company is approved for listing, which necessarily will be in advance of the Exchanges opening auction. If the company is unable to sell shares with the requisite valuation in the opening auction, then it may not in fact have met the initial listing standards prior to listing and trading.[19]

We share the Commission's observation in the SEC Order that the potential failure of a direct listing company under the NYSE Proposal to meet the listing standard requiring a $100 million aggregate market value of publicly-held shares on the first day of trading, presents an "immediate compliance issue, and the potential for delisting, [that] would appear to raise . . . investor protection, and other issues . . . [and the] Exchange has not explained how this would be consistent with Section 6(b)(5) and other relevant provisions of the Exchange Act."[20]

<u>Investors may be subject to greater risk because of the company could be the only seller in the opening auction.</u>

Finally, the SEC Order notes that the NYSE Proposal "for the first time, would permit the Exchange to conduct [a direct listing] . . . where the company being listed . . . could be the only seller (or the dominant seller) participating in the opening auction" of its own shares on the first day of trading.[21] We share the Commission's observation in the SEC Order that under those circumstances the company conducting the direct listing "could be in a position to uniquely influence the price discovery process [in a manner that may fail to] . . . protect investors . . . ."[22]

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For all the above reasons, we respectfully request that the Commission disapprove the NYSE Proposal. Thank you for considering our views on this matter. Please contact me with any questions.

Sincerely,

Jeff Mahoney

Jeffrey P. Mahoney
General Counsel

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[19] 85 Fed. Reg. at 18,295.
[20] *Id.* at 18,295-96.
[21] *Id.* at 18,296.
[22] *Id.*