September 15, 2020

The Honorable Jay Clayton
Chairman
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549

Re: Self-Regulatory Organizations; New York Stock Exchange LLC; Staff Order Approving a Proposed Rule Change, as Modified by Amendment No. 2, to Amend Chapter One of the Listed Company Manual to Modify the Provisions Relating to Direct Listings (Release No. 34-89684; File No. SR-NYSE-2019-67)

Dear Chairman Clayton:

The American Securities Association (ASA)[1] writes to express our deep concern related to the Securities and Exchange Commission's (SEC or Commission) August 26th staff order approving a proposal from the New York Stock Exchange (NYSE) for the use of direct listings in primary offerings (Staff Order). As stated in previous ASA comments to the Commission and attached to this letter, we believe direct listings undermine critical investor protections and are an end-run around the initial public offering (IPO) process that has served our capital markets and American investors well for decades.

Our membership has been active in the capital markets and involved in capital raising, research, and support of growth companies for many years. We share your concern about the long-term decline in U.S. public companies and support innovative ways to promote capital formation. However, we believe the Staff Order undercuts the fundamental tenets of the securities offering process, and more importantly, the rights of investors. As a result, the ASA supports the forthcoming petition from the Council of Institutional Investors (CII)[2] for the Commission to conduct a full review of the NYSE proposal, and we thank the SEC for temporarily staying the Staff Order.

<u>General Concerns</u>.

Underwriters involved in an IPO serve a critical function that identifies red flags and systemic problems within companies *before* they list on a public exchange. This process has become even more important in recent years, as many "unicorn" companies have sought to sell shares to the

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[2] https://www.wsj.com/articles/nyse-direct-listings-hit-snag-as-investor-group-raises-concerns-11599000009

public at inflated valuations (e.g. WeWork). Underwriters must also hold regulatory capital in the event of a lawsuit associated with an issue in the IPO process so that investors who are wronged can seek redress.

We remind the Commission that the SEC and its regulation of broker-dealers was born out of the Great Depression, a significant moment in our country's financial history. To prevent mom-and-pop investors from being defrauded and create confidence in our markets, Congress created the SEC and required broker-dealers to comply with detailed rules, be subject to liability for false statements, and to hold regulatory capital. This supervision and regulation of the securities offering process is precisely what gives investors confidence in our regulatory architecture and our equity capital markets.

Unfortunately, the Staff Order seeks to eviscerate these longstanding securities laws and regulations so that certain special interests can cash out at the top of the market while mom-and-pop investors catch the falling knife as the bubble bursts. In short, our main concern is that the Staff Order seems to purposefully tilt the scales against the very investors who the SEC is statutorily mandated to protect.

Raises New Concerns About Chinese Companies Access to U.S. Markets.

Could the Staff Order be exploited by companies in countries that have weak audit, financial reporting, and corporate governance controls, like China[3]? We are concerned that it might. It is highly probable that the Staff Order would allow Chinese companies to come to our markets without any due diligence or any validated financial statements and use a "financial advisor" whose qualifications for that important role are undefined. This has the potential to defraud millions of American investors and retirement savers.

As the Commission knows, Chinese companies do not follow our rules today,[4] and the Staff Order effectively creates a new loophole they can use to avoid the diligence process of the current securities offering process. The SEC itself has repeatedly warned investors about the risks inherently involved with Chinese companies and the Staff Order would only amplify those risks.[5]

Questions for SEC to Contemplate.

As the Commission conducts its review, we believe that the following questions must be taken into consideration:

[3] Senior U.S. government officials have repeatedly warned that Chinese companies may defraud investors. Many are involved in human rights abuses and/or pose threats to our national security. The Labor Department says that twelve of these corporations actually use child- or slave-labor making investors in them effectively slave owners.

[4] https://www.foxbusiness.com/markets/trump-orders-federal-retirement-money-invested-in-chinese-equities-to-be-pulled

[5] Statement from Chairman Clayton, PCAOB Chair Duhnke, SEC Chief Accountant Sagar Teotia, Division of Corporation Finance Director Bill Hinman, Division of Investment Management Director Dalia Blass: Emerging Market Investments Entail Significant Disclosure, Financial Reporting and Other Risks; Remedies are Limited (April 21, 2020).

1) What specific market failures associated with the existing IPO process has the SEC identified internally, or through the public notice and comment process under the Administrative Procedure Act that warrant approval of the NYSE proposal?
2) What entities involved in a primary offering direct listing would be subject to underwriter liability under Sections 11 and 12 of the Exchange Act?
3) If an independent third-party valuation of a company turned out to be based upon flawed assumptions and grossly overstated, what recourse would mom-and-pop investors or the SEC have to hold that third-party accountable?
4) What qualifications must a "financial advisor" have in order to conduct a roadshow with investors to *solicit* feedback on the company and its valuation as part of the direct listing process for a primary capital raise?
5) Can a "financial advisor" conduct a roadshow with institutional investors, and if so, then must a "financial advisor" also be a registered broker-dealer?
6) Can the "financial advisor" organize meetings not considered roadshows with prospective buyers and avoid underwriter liability?
7) How will the SEC treat the conflict of interest a firm will face to provide inflated company valuations because of the pressure imposed on them by venture capital firms, selling shareholders or financial advisors whose repeat business they seek to procure?
8) Would any specific entities be prohibited from acting as an independent third party to conduct a valuation analysis for a company looking to complete a direct offering?
9) In instances where the valuation of a direct listing is wildly off-base, what if any liabilities would attach to broker-dealers who make recommendations related to that direct listing, provide research based on the valuation, or execute buy orders on behalf of their retail investor clients?
10) What is the scope of who can be a "financial advisor"? Can entities other than broker-dealers be "financial advisors"? Are individuals registered under the 40 Act eligible to be "financial advisors" on a direct listing for primary capital?
11) Are "financial advisors" required to hold regulatory capital and can they be sued by retail and institutional investors who purchase shares in a direct listing?
12) The Staff Order creates ambiguity about who is and who is not a statutory underwriter in a securities offering. Is that intentional? If so, what is the legal reason for this ambiguity given that such ambiguity will encourage litigation?
13) Are firms and their employees who assist in the direct listing of a company no longer required to register as broker-dealers if they act as "financial advisors"?
14) Under what circumstances will a financial advisor who "assists" the company and the exchange in the direct listing process not be deemed to be solicitating the sale of the securities of a company raising primary capital?
15) Has the SEC evaluated whether retail brokerage firms that have had no involvement in or with the preparation of the direct listing, but facilitate submission of orders on behalf of their retail or institutional accounts on an *unsolicited basis,* would have underwriting liability with respect to such orders?

16) Has the SEC evaluated whether retail brokerage firms that have had no involvement with the preparation of the direct listing, but facilitate submission of orders on behalf of their accounts on a *solicited basis or after discussing the potential merits and risks* of an investment in the issuer with their clients would have underwriting liability with respect to such orders?
17) Does liability attach to accounting firms, valuation agents that offer independent pricing services such as Bloomberg, IHS Markit, and others who may provide a valuation to support the pricing of a direct listing? If not, the public should understand this.
18) What is the statutory justification the SEC is relying on to approve the Staff Order allowing the vertical integration of the securities offering process?
19) Does evidence exist that is informing the staff's decision to alter the current securities offering process and justify the approval of the NYSE Proposal? If it does exist, then has any of it ever been made available for the public to comment on?
20) What type of economic analysis – taking into account potential risks to investors from direct offerings – is necessary to ensure that the benefits of the NYSE proposal outweigh the costs and harm to investors, especially where the company argues it is not liable to investors under the current securities laws (i.e. Slack argument in the 9th Circuit)[6]?
21) Has the SEC decided that controversial issues that change our securities laws, in the way the Staff Order does, do not need to be subject to a thorough cost-benefit analysis and receive public input under the Administrative Procedure Act?

These questions should be thoroughly examined by the full Commission prior to any final decision on the NYSE proposal. Due process must not be skirted in this instance, and given the depth and complexity of the issues raised in this matter, we strongly recommend that the Commission vote to adopt a proposal to put this Order out for public comment. Staff orders should not be permitted to create loopholes in our financial regulation that could harm millions of mom-and-pop investors, incentivize fraudulent company listings, and undercut confidence in our equity capital markets.

The ASA looks forward to continuing to engage with the SEC on this important investor protection issue.

[6] As reported by the Wall Street Journal in January, "[Slack] says it shouldn't be held liable under Section 11 of the Securities Act of 1933, a provision that underpins many shareholder suits. That is because when Slack went public, investors bought a mix of shares, Slack said in a November court filing. Some were covered by the company's registration statement filed with the SEC and other shares hadn't been registered because they were sold by Slack insiders rather the company itself. Because the investors suing Slack can't directly trace their shares to the registration statement, the suit should be dismissed, the company argued. Slack also said the plaintiffs can't seek damages because there was no offering price in its direct listing, which would determine how much money the plaintiffs had lost." https://www.wsj.com/articles/investor-advocates-see-risks-in-silicon-valleys-favorite-ipo-alternative-11578047400

Sincerely,

Christopher A. Iacovella

Christopher A. Iacovella
Chief Executive Officer American
Securities Association

Cc:

Commissioner Hester Peirce
Commissioner Elad Roisman
Commissioner Allison Lee
Commissioner Caroline Crenshaw

EXHIBIT A

March 4, 2020

The Honorable Jay Clayton
Chairman
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: New York Stock Exchange Notice of Filing of 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; Release No. 34-87821; File No. SR-NYSE-2019-67

Dear Chairman Clayton:

This letter is a follow-up to the American Securities Association (ASA)[1] letter dated December 12, 2019 regarding a proposal by the New York Stock Exchange (NYSE) to expand the use of direct listings to include primary offerings to the general public[2] (NYSE Proposal). We support innovative ideas to promote capital formation for businesses across America so long as they have the appropriate investor protections that have surrounded the initial public offering (IPO) process for over eight decades. The ASA continues to be concerned that if the NYSE Proposal were adopted in its current form by the Securities and Exchange Commission (SEC), then those protections would be significantly undermined.

The Securities Act of 1933 and Securities Exchange Act of 1934 established regulatory oversight for the offering and trading of securities, which up until that point had been virtually nonexistent. Widespread fraud and self-dealing related to the public trading of stocks directly led to the 1929 market crash and shattered the public's trust in our financial markets. The passage of the securities laws and creation of the SEC helped restore the faith of the American people in our capital markets because its mandate was to hold market participants liable for any wrongdoing they may perpetrate. This system has worked remarkably well, and it has made America's capital markets the envy of the world.

A core component of the securities laws – and an indispensable tool necessary to protect investors – is the imposition of liability of on issuers and underwriters under Sections 11 and 12

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[2] https://www.nyse.com/publicdocs/nyse/markets/nyse/rule-filings/filings/2019/SR-NYSE-2019-67,%20Re-file.pdf

of the Securities Act for any material misrepresentations or omissions they make related to an IPO. Interestingly, it remains unclear under the NYSE Proposal whether issuers that pursue a direct listing, or the financial advisors that assist them, would retain liability under Sections 11 and 12. This question is critical to maintain investor trust and confidence in the markets and it is one that the SEC must address before allowing the expanded use of direct listings.

The ASA echoes many of the concerns raised by the Council of Institutional Investors (CII) in its January 16th, 2020 comment letter.[3] The CII letter points out that certain shareholder legal rights under Section 11 could be weakened under direct listings and cites ongoing litigation in California regarding Slack's direct listing in June 2019.

In the Slack case, shareholders are alleging that Slack – whose stock price remains roughly 30% below its direct listing in June – failed to disclose certain risks to its business. Slack is making the remarkable argument that it should not be held liable because investors bought a mix of shares when the company listed publicly. They argue that in this mix of shares some were covered by the company's registration statement, while others that were sold by insiders of Slack are not covered because they are not registered with the SEC.

Slack is effectively taking the position that it should not be held liable under Section 11 for false or omitted statements regarding shares that are sold through a direct listing. This alarming argument can't be what the SEC or the broader investing public had in mind when the Slack direct listing was approved.

As reported by the Wall Street Journal in December, the SEC is currently probing some of the trading surrounding Slack's first day of trading. The investigation is part of a larger probe into the communications and practices of certain hedge funds involved in "unicorn" IPOs. The SEC probe into trading activity underscores some of the risks associated with foregoing the traditional underwriting process.

Rather than offering an alternative path forward for more businesses to go public, the Slack offering is a serious warning sign for investors. If the company is successful in its California lawsuit, then investors will have diminished and uneven rights for claims against issuers.

Given that Slack – along with Spotify – is one of the two high-profile companies that have added momentum to the call for direct listings in the U.S., it behooves the SEC to refrain from any further regulatory changes until the California litigation and SEC probe are concluded.

We would also like highlight Professor John Coffee of Columbia University, who posed a number of important questions regarding investor protections if direct listings were approved as an end-run around the IPO process in the United States.[4] In particular, Prof. Coffee questions whether financial advisors to a direct listing can or should be held liable under Sections 11 and

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[3] https://www.sec.gov/comments/sr-nyse-2019-67/srnyse201967-6660338-203855.pdf
[4] https://clsbluesky.law.columbia.edu/2018/01/16/the-spotify-listing-can-an-underwriter-less-ipo-attract-other-unicorns/

12 as an underwriter would in a traditional IPO. Prof. Coffee also raises concerns over short-sellers exploiting pricing uncertainties at the time of a direct listing. In a traditional IPO, underwriters typically act as a stabilizer against "bear raids" in the period immediately following the listing – a practice that does not exist in a direct listing.

The wild fluctuations in "unicorn" valuations over the last several years should give the SEC pause as it considers approving direct listings. Certain companies, such as WeWork, demonstrate the real risks companies would pose to Main Street investors if they were permitted to sell shares at unvetted valuations. In other words, direct listings without the appropriate protections could provide a strong incentive and an easier path for company insiders to cash out at inflated valuations, leaving "Mr. and Mrs. 401k" holding the bag.

The NYSE Proposal is not consistent with the Commission's overarching mission of (1) protecting investors and (2) maintaining fair, orderly and efficient markets and (3) facilitating capital formation. Investors would be exposed to companies with unsustainable valuations and have little legal recourse if an issuer engages in wrongdoing. Short sellers could exploit price inefficiencies associated with direct listings, and confidence in our public markets would likely be eroded as investors get burned by the absence of lock-ups, due diligence, and liability for issuers and underwriters.

Ferdinand Pecora, the lawyer who led the Senate's investigation into the financial abuses that contributed to the 1929 market crash and Great Depression, stated that his investigation uncovered a "shocking disclosure of low standards in high places." The SEC should not encourage the lowering of standards for IPOs because this will put investors at risk and increase the chances of fraud in our markets.

We reiterate the position in our December letter: at a minimum, the SEC should make clear that financial advisors, exchanges, control shareholders, and directors involved in a direct listing automatically incur statutory underwriter liability under the 1933 Securities Act and be required to hold the regulatory capital necessary to act as a de facto underwriter.

Sincerely,

Christopher A. Iacovella

Christopher A. Iacovella
Chief Executive Officer
American Securities Association