Nasdaq Permits Primary Direct Listings and Proposes Relaxation of Pricing Limits

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On May 19, 2021, the Securities and Exchange Commission (SEC) approved Nasdaq's proposal to permit companies to issue shares and raise capital in primary direct listings conducted on the Nasdaq Global Select Market without the involvement of traditional underwriters. The changes, which are effective immediately, closely align Nasdaq's direct offering framework with that of the New York Stock Exchange (NYSE), which, as discussed in our previous client alert "NYSE Direct Listing Rules Approved; Nasdaq Proposes Substantially Similar Rules," has permitted such listings since December 2020.

On May 26, 2021, shortly following the SEC's approval of the primary direct listings proposal, Nasdaq proposed additional modifications to make direct listings more attractive to issuers. Under the current rules, issuers must disclose the price range within which they expect their securities to price in the direct listing, and securities must directly list within that price range, unless an issuer files a post-effective amendment to the registration statement. If Nasdaq's proposed rules are approved, these price range requirements will be relaxed, permitting deviations of up to 20% above or below the disclosed price range in all cases, and deviations of more than 20% above the disclosed price range if certain conditions are met.

Background

Since 2018, both the NYSE and Nasdaq have permitted direct listings as an alternative route to going public in cases where companies do not issue new shares or raise capital for themselves, but instead register existing shares of previous investors through resale registration statements. Though direct listings offer certain advantages over traditional initial public offerings (IPOs), the prohibition on raising new capital has significantly limited their appeal in some cases. Since 2018, only nine companies have gone public via direct listing. Beginning in 2019, both the NYSE and Nasdaq have submitted proposals to expand the scope of direct listings by permitting issuers to raise additional capital in limited circumstances.

Nasdaq Approved Rules

Nasdaq's rules on primary direct listings are substantially similar to those of the NYSE. Key requirements of a Nasdaq primary direct listing include:

Listing on the Nasdaq Global Select Market: Issuers must satisfy the applicable Nasdaq Global Select Market initial listing requirements, including having a minimum of either 2,200 total shareholders or 450 round lot holders *(i.e.*, holders of at least 100 shares), at least 50% of whom hold at least $2,500 in securities. Issuers must also have at least 1.25 million publicly held shares (including all shares sold in the auction and all shares publicly held prior to the auction) and attain a minimum bid price of at least $4 at the time of initial listing. Issuers going public on the Nasdaq Global Market or Nasdaq Capital Market are not eligible for primary direct listings, but may continue to qualify for secondary direct listings.

The NYSE also requires that issuers in a primary direct listing meet applicable initial listing requirements, though those requirements are slightly different (400 round lot holders, 1.1 million publicly held shares and a $4 minimum bid price). Meeting the initial listing requirements of the either exchange is more challenging in a direct listing than in a traditional IPO, in which the participation of underwriters and the book-building process facilitate compliance.

Minimum Market Valuation of Securities: To meet the requirements of Nasdaq Listing Rule IM-5315-2, the aggregate market value of unrestricted publicly held shares immediately prior to listing, together with the market value of shares sold in the direct listing, must total at least $110 million (or $100 million, if stockholders' equity is at least $110 million). Market value is calculated by using the lowest price per share within the price range disclosed in the registration statement multiplied by the total number of shares outstanding immediately prior to the offering, plus the number of new shares to be issued in the direct listing. This market valuation requirement is significantly higher than the $45 million required by a company pursuing a traditional IPO on Nasdaq, but lower than the $250 million requirement Nasdaq imposes for secondary direct listings. It is also lower than the NYSE market valuation requirements. To directly list on the NYSE, issuers must meet a $250 million market valuation of publicly held shares immediately prior to listing, combined with the value of shares sold in the auction, or alternatively, must sell $100 million worth of shares in the auction.

Primary Direct Listing Auction Procedures

A Nasdaq primary direct listing will be conducted through an opening auction, with prices set via the Nasdaq Halt Cross. As a preliminary step, a company will issue a Company Direct Listing Order (CDL Order), a new type of order exclusive to direct listings. A CDL Order must be for the full number of shares subject to direct listing, as disclosed in the issuer's effective registration statement. However, the CDL Order will not include the price per share. Instead, the Nasdaq Halt Cross, in consultation with the company's financial advisor, will determine the price, which must be within the price range disclosed in the registration statement. Nasdaq will permit trading to begin only if the CDL Order will be executed in full in the opening auction, at or above the lowest price and at or below the highest price of the disclosed price range. All better-priced orders must also be executed in full. If either or both of these conditions cannot be met, Nasdaq will postpone the auction. Thus, a CDL Order will function much as a limit order, because it cannot execute at a price lower than the lowest price in the disclosed price range nor for less than the full number of shares offered in the registration statement. A CDL Order cannot be canceled or modified, and unlike in a traditional IPO, an issuer would be required to file a pre-effective amendment to the registration statement if the opening auction price was below the price range disclosed in the registration statement. After the initial auction, shares would begin freely trading on Nasdaq.

Nasdaq Proposed Rules To Permit Greater Pricing Flexibility

The current process and pricing requirements for Nasdaq direct listings are substantially similar to those imposed by the NYSE, though different terminology is used. Nasdaq's initial proposal on primary direct listings would have permitted the opening bid price to be up to 20% lower than the price range disclosed in the registration statement. Though Nasdaq initially withdrew the proposal after the SEC expressed concerns, Nasdaq reintroduced pricing flexibility in direct listings in its most recent proposed rule change.

The proposed rules would permit a direct listing to price 20% outside the price range disclosed in the effective registration statement. As is currently applicable to IPOs, Nasdaq would calculate 20% of the highest price in the disclosed price range, and would add that amount to the high end (in the case of an increase in price) or subtract it from the low end (in the case of a decrease in price) to calculate the permitted 20% variation. Additionally, direct listings could price at greater than 20% above the disclosed price range, provided that the company certify to Nasdaq that the price change would not materially change the company's disclosure in its previous registration statement. Nasdaq would issue an "industry-wide trader alert" notifying auction participants of the lowest possible price for the securities, factoring in the 20% permitted variation, and whether there was an upper pricing limit above which the auction could not proceed, based on the company's certification. The additional pricing flexibility would also impact the calculation of market value, which would be based on a price per share 20% lower than the lowest price within the price range disclosed in the registration statement.

In advocating for greater pricing flexibility, Nasdaq noted that the current price range restrictions increase the chance of a failed offer in cases of significant changes in the market or in investor confidence. Nasdaq observed that IPOs are able to price outside of the disclosed price range, and that modifying the requirements for direct listings would harmonize the requirements and make direct listings more attractive to investors, without elevating investor risk. If the rules are approved, companies could adjust the price of a direct listing using a 424(b) prospectus rather than a post-effective amendment, reducing delay and the market risk incurred by that delay.

Standard Application of Securities Law Liabilities and Safe Harbors

Existing securities law liabilities and safe harbors continue to apply in the direct listing context. While an underwriter does not participate in a direct listing, financial advisors serve a similar, but more limited role. The SEC has cautioned that existing securities regulations may result in a financial advisor being deemed a statutory underwriter, but that this assessment would be fact-specific and determined on a case-by-case basis. Company insiders, including directors, officers and 10% shareholders are also eligible to participate in a direct listing, provided their participation is in compliance with existing securities laws and applicable safe harbors.