



December 12, 2019

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

**Re: Investor Protection Concerns Related to Direct Listings**

Dear Chairman Clayton:

For almost nine decades, our nation's capital markets have been governed by a set of securities laws designed to promote transparency and accountability amongst market participants. Prior to the passage of the Securities Act in 1933 (Securities Act), oversight of trading in stocks and bonds was virtually nonexistent, which led to widespread fraud, contributed to the 1929 market crash, and prolonged the Great Depression that followed. The Securities Act, as well as the subsequent passage of the Securities Exchange Act which created the Securities and Exchange Commission (SEC or Commission), have helped make America's capital markets the most reliable and trusted in the world.

The Securities Act requires all broker-dealers offering securities to the public to register with the SEC, to hold a specific amount of capital, and to submit to explicit liability as an underwriter of every security sold to retail investors through an initial public offering (IPO). Underwriters serve a critical function that protects investors and keeps our markets functioning in the most efficient and effective manner possible. In a traditional IPO, registered broker-dealers act as underwriters and work with the company and its counsel during the registration process to market the deal to institutional and retail investors. Underwriters also gauge investor demand, determine the clearing price, underwrite the offering, allocate shares, and utilize the over-allotment option to help protect and stabilize the offering. Following the public offering, underwriting brokers provide critical aftermarket support to the issuer which includes market making, equity research, and non-deal investor outreach.

Notwithstanding the fact that the current regulatory regime has worked remarkably well for investors, some market participants are now seeking to expand the use of direct listings. Currently, only selling shareholders can use a direct listing to exit their initial positions, but an expanded use would go beyond that and allow companies to raise *primary* capital from retail investors in our public markets. This would be a complete end run around the traditional underwriting process and it would create a massive loophole in the regulatory regime that governs the offerings of securities to the public.

Recent direct listing proposals filed by the exchanges attempt to do just that. For the first time, companies would be allowed to raise capital and sell new shares in the primary market using a



direct listing. If the new rule proposals were approved by the SEC, they would fundamentally alter the IPO market, likely increase the number of companies that forego the traditional IPO process, and significantly increase the risks for America’s retail investors. While direct listings to raise primary capital may sound good in theory, the reality is that the practice circumvents the diligence process, many of the most important investor protections set forth in the Securities Act, and the very reason the SEC was formed: to protect America’s retail investors against fraud.

The primary advocates of direct listings are private investors in highly valued “unicorns” that stand to benefit the most from selling their shares directly to the general public. But two high-profile direct listings— Spotify and Slack— haven’t worked out particularly well for retail investors. Spotify continues to trade at or below its April 2018 direct listing price, while Slack is down roughly 45% since its direct listing in June 2019. Given that many of America’s retail investors ended up buying these stocks at high valuations from large institutional holders, the SEC must examine potential investor harm associated with direct listings. A robust underwriting process would have uncovered more of the company’s vulnerabilities before they were offered to the public in the same way it did for WeWork.

Sections 11 and 12 of the Securities Act impose liability on underwriters for material misrepresentations or omissions related to an IPO. It is at best unclear whether the financial advisors, exchanges, control shareholders, and directors involved with a direct listing would incur this liability. 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.

A rigorous underwriting process promotes accountability for all those involved with a public listing and it gives hardworking American retail investors the confidence and trust to participate in our capital markets. The SEC must proceed with caution if it intends to weaken investor protections through the expanded use of direct listings. Otherwise fallen unicorns, like Theranos or WeWork, would have been able to use this process to access public capital while massively defrauding America’s retail investors.<sup>1</sup>

Our concerns on this matter are urgent given the recent rule proposals filed by the exchanges. To be clear, the decline of publicly listed companies in the United States has serious economic ramifications for all Americans and should be a top concern for the SEC and Congress. But, diminishing critical and longstanding investor protections is not the way to go about addressing it and expanding direct listings to include primary capital raising will do little to encourage legitimate small businesses to enter our public markets.

We look forward to discussing this matter with you further.

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<sup>1</sup> <https://www.sec.gov/news/press-release/2018-41>



Sincerely,

*Christopher A. Iacovella*

Christopher A. Iacovella  
Chief Executive Officer

Cc:

Commissioner Hester Peirce  
Commissioner Robert Jackson  
Commissioner Elad Roisman  
Commissioner Allison Lee  
Director Brett Redfearn  
Director William Hinman  
Rick Fleming