

Nasdaq Proposes to Adopt and Amend Rules Applicable to Companies Operating in Restrictive Markets

I. Overview

The Nasdaq Stock Market LLC (“Nasdaq”) recently filed with the Securities and Exchange Commission (the “SEC”) three proposals or “releases” to adopt new Listing Rules and amend certain existing Listing Rules that impose more stringent listing standards when a company’s business is principally administered in a jurisdiction that Nasdaq determines to have secrecy laws, blocking statutes, national security laws, or other laws or regulations restricting access to information by regulators of U.S.-listed companies in such jurisdiction (such a jurisdiction, a “Restrictive Market” and such company, a “Restrictive Market Company”). In sum:

- The First Release¹ sets forth various factors related to the qualifications of a company’s auditor that Nasdaq may consider in determining whether a stricter standard should apply and clarifies that Nasdaq has broad discretion to apply stricter standards, particularly with respect to Restrictive Market Companies.
- The Second Release² generally focuses on ensuring liquidity of shares of Restrictive Market Companies by proposing to establish minimum offering size and public float requirements (in the case of an initial public offering) and minimum market value requirements for publicly held shares (in the case of a business combination).
- The Third Release³ sets forth certain minimum qualifications that would be required for the senior management or the directors of a Restrictive Market Company.

¹ For the full text of the proposal and the related SEC release, *see* Securities and Exchange Commission, Self-Regulatory Organizations; The Nasdaq Stock Market LLC; Notice of Filing of Proposed Rule Change to Amend IM-5101-1 (Use of Discretionary Authority) to Deny Listing or Continued Listing or to Apply Additional and More Stringent Criteria to an Applicant or Listed Company Based on Considerations Related to the Company’s Auditor or When a Company’s Business is Principally Administered in a Jurisdiction That is a Restrictive Market, SEC Release No. 34-88987; File No. SR-NASDAQ-2020-028, available at <https://www.sec.gov/rules/sro/nasdaq/2020/34-88987.pdf> (June 2, 2020) [hereinafter, the “First Release”].

² For the full text of the proposal and the related SEC release, *see* Securities and Exchange Commission, Self-Regulatory Organizations; The Nasdaq Stock Market LLC; Notice of Filing of Proposed Rule Change to Apply Additional Initial Listing Criteria for Companies Primarily Operating in Restrictive Markets, SEC Release No. 34-89027; File No. SR-NASDAQ-2020-027, available at <https://www.sec.gov/rules/sro/nasdaq/2020/34-89027.pdf> (June 8, 2020) [hereinafter, the “Second Release”].

³ For the full text of the proposal and the related SEC release, *see* Securities and Exchange Commission, Self-Regulatory Organizations; The Nasdaq Stock Market LLC; Notice of Filing of Proposed Rule Change to Adopt a New Requirement Related to the Qualification of Management for Companies From Restrictive Markets, SEC Release No. 34-89028; File No. SR-NASDAQ-2020-026, available at <https://www.sec.gov/rules/sro/nasdaq/2020/34-89028.pdf> (June 8, 2020) [hereinafter, the “Third Release”]. Unless otherwise specified, quoted statements in this memorandum are taken from the Releases, as the context suggests.

II. Nasdaq Proposals

a. Auditor Requirements

Nasdaq currently has broad authority under the Listing Rules to deny initial or continued listing or apply additional criteria under specified circumstances, including, among other things, when the auditor of an applicant or a listed company has not been subject to an inspection by the Public Company Accounting Oversight Board (the “PCAOB”). Because the PCAOB generally is prevented from inspecting the audit work of PCAOB-registered auditors in Belgium, France, China, and Hong Kong, Nasdaq may exercise its broad authority generally with respect to such jurisdictions. In addition to such broad authority, the First Release would amend IM-5101-1 to add provisions that would codify the factors relating to auditors that Nasdaq may consider in determining whether a more stringent standard should apply, including the following:

- whether the auditor has been subject to a PCAOB inspection, including where (i) the auditor is newly formed and has therefore not yet undergone a PCAOB inspection or (ii) the auditor is in a jurisdiction that limits the PCAOB’s ability to inspect the auditor;
- if the company’s auditor has been inspected by the PCAOB, whether the results of that inspection indicate that the auditor has failed to respond to the PCAOB or that the inspection has uncovered significant deficiencies in other audits or in its quality controls;
- whether the auditor can demonstrate that it has adequate personnel in the offices participating in the audit with expertise in applying U.S. GAAP, GAAS or IFRS, as applicable, in the company’s industry;
- whether the auditor’s training program for personnel participating in the company’s audit is adequate;
- for non-U.S. auditors, whether the auditor is part of a global network or other affiliation of individual auditors where the auditors draw on globally common technologies, tools, methodologies, training and quality assurance monitoring; and
- whether the auditor can demonstrate sufficient resources, geographic reach or experience as it relates to the company’s audit.

Where Nasdaq is concerned that a company’s auditor does not satisfy the criteria above, that its shares do not provide sufficient liquidity or that material misstatements have been detected by its auditors but not disclosed, Nasdaq may seek additional comfort by, among other things, imposing a higher standard of financial listing criteria or additional liquidity measures, requiring an offering to be underwritten, or imposing lock-up restrictions on officers and directors.

b. Broad Discretion with Respect to Restrictive Market Companies

Under the First Release, the Listing Rules would also be amended to add provisions clarifying that Nasdaq may use its discretionary authority to impose additional or more stringent criteria in other circumstances, including with respect to Restrictive Market Companies. Under each of the Releases, in determining whether a company is a Restrictive Market Company, Nasdaq may consider the geographic locations of the company’s “(a) principal

business segments, operations or assets; (b) board and shareholders' meetings; (c) headquarters or principal executive offices; (d) senior management and employees; and (e) books and records." Under these factors, both foreign private issuers based in Restrictive Markets and companies based in the U.S. or another jurisdiction that principally administer their businesses in Restrictive Markets may be deemed Restrictive Market Companies.

c. Requirements Intended to Ensure Liquidity

Under the Second Release, a new Listing Rule would impose additional requirements intended to ensure liquidity of Restrictive Market Company securities in the market. Specifically, the new provisions would require a Restrictive Market Company listing equity securities in its initial public offering ("IPO"), to offer a minimum amount of securities in a firm commitment offering in the United States to Public Holders⁴ that will (i) yield gross proceeds of \$25 million or more or (ii) represent at least 25% of the post-offering market value of the Restrictive Market Company's securities listed on Nasdaq or another national securities exchange, whichever is lower. Similarly, in the context of a business combination involving a Restrictive Market Company, a new Listing Rule would require a listed company to have a minimum market value of unrestricted publicly held shares, on a post-closing basis, equal to (i) \$25 million or (ii) 25% of the post-business combination entity's market value of the securities listed on Nasdaq or another national securities exchange, whichever is lower. Nasdaq believes that these requirements would assure increased investor interest and liquidity.

d. Limits on Direct Listings

Under the Second Release, a new Listing Rule would provide that, although a Restrictive Market Company would be permitted to list on the Nasdaq Global Select Market or Nasdaq Global Market in a direct listing (provided that all applicable listing requirements for the Nasdaq Global Select Market or Nasdaq Global Market, as applicable, and the additional requirements of IM-5315-1 or IM-5405-1, as applicable, are met), it would be not be permitted to list on the Nasdaq Capital Market in connection a direct listing. Given that the public float and market value requirements of the Nasdaq Capital Market are lower than those of the Nasdaq Global Select Market and Nasdaq Global Market, Nasdaq believes that precluding a Restrictive Market Company from listing through a direct listing on the Nasdaq Capital Market would help ensure sufficient public float, investor base, trading interest, and liquidity.

e. Senior Management and Director Requirements

Under the Third Release, a new Listing Rule would require that listing applicants from Restrictive Market countries (i) have at least one senior management member or director with experience at a U.S.-listed public company, or other experience, training or background resulting in his or her general familiarity with related regulatory and reporting requirements under Nasdaq's rules and the U.S. federal securities laws and (ii) certify to Nasdaq that they will continue to have such senior management member or director. A company could also satisfy these requirements by retaining an advisor acceptable to Nasdaq that will provide ongoing guidance regarding such regulatory and reporting requirements. Once a company becomes listed, it would become subject to a new Listing Rule which would impose continuing obligations to maintain at least one such senior management member, director, or advisor. Under the amended Listing Rule, a Restricted Market Company that failed to main compliance would be required to submit a compliance plan to Nasdaq, which may grant up to 180 days to regain compliance.

⁴ "Public Holders" means holders of a security that includes both beneficial holders and holders of record, but does not include any holder who is, either directly or indirectly, an Executive Officer, director, or the beneficial holder of more than 10% of the total shares outstanding. See Listing Rule 5005(a)(36).

III. Conclusion

The Releases are particularly noteworthy in light of the U.S. Senate's recent passage of the Holding Foreign Companies Accountable Act on May 21, 2020, which would, among other things, require certain issuers identified by the SEC as having failed to allow the PCAOB to conduct an audit of the reports prepared by their accounting firms due to a position taken by an authority in a foreign jurisdiction, to allow the PCAOB to conduct an audit of the reports within three years from the time of identification, or face prohibition on trading of securities over-the-counter or on any U.S. securities exchange.

The comment period for the First Release will close on June 29, 2020, and the comment period for the Second Release and the Third Release will close on July 6, 2020.

* * *

If you have any questions about the issues addressed in this memorandum, or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email authors Geoffrey E. Liebmann at 212.701.3313 or gliebmann@cahill.com; or Joseph E. Cho at 212.701.3589 or jcho@cahill.com; or email publications@cahill.com.