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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-91089; File No. SR-NASDAQ-2021-007]

Self-Regulatory Organizations; The Nasdaq Stock Market LLC; Notice of Filing of Proposed Rule Change to Adopt Additional Initial Listing Criteria for Companies Primarily Operating in Jurisdictions That Do Not Provide the PCAOB with the Ability to Inspect Public Accounting Firms

February 9, 2021.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on February 1, 2021, The Nasdaq Stock Market LLC (“Nasdaq” or “Exchange”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I and II below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

The Exchange proposes to adopt additional initial listing criteria for companies primarily operating in jurisdictions that do not currently provide the PCAOB with the ability to inspect public accounting firms.

The text of the proposed rule change is available on the Exchange’s Website at <https://listingcenter.nasdaq.com/rulebook/nasdaq/rules>, at the principal office of the Exchange, and at the Commission’s Public Reference Room.

II. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the Exchange included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

Item IV below. The Exchange has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

As described below, Nasdaq proposes to adopt additional initial listing criteria for companies primarily operating in jurisdictions that do not currently provide the Public Company Accounting Oversight Board (“PCAOB”) with the ability to inspect public accounting firms.<sup>3</sup>

Nasdaq rules<sup>4</sup> and federal securities laws<sup>5</sup> require a company’s financial statements included in its initial registration statement or annual report to be audited by an independent public accountant that is registered with the PCAOB. Company management is responsible for preparing the company’s financial statements and for establishing and maintaining disclosure controls and procedures and internal control over financial reporting. The company’s auditor, based on its independent audit of the evidence supporting the amounts and disclosures in the financial statements, expresses an opinion on whether the financial statements present fairly, in all material respects, the company’s financial position, results of operations and cash flows. “To form an appropriate basis for expressing an opinion on the financial statements, the auditor must

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<sup>3</sup> Nasdaq proposed a similar rule change in May 2020, which was withdrawn by Nasdaq on February, 1, 2021. Securities Exchange Act Release No. 89027 (June 8, 2020), 85 FR 35962 (June 12, 2020) (SR-Nasdaq-2020-027). The Commission issued an Order Instituting Proceedings to Determine Whether to Approve or Disapprove this proposal. Securities Exchange Act Release No. 89799 (September 9, 2020), 85 FR 57282 (September 15, 2020). This revised proposal addresses the concerns raised by the Commission in its Order.

<sup>4</sup> See Rule 5210(b) (“Each Company applying for initial listing must be audited by an independent public accountant that is registered as a public accounting firm with the Public Company Accounting Oversight Board, as provided for in Section 102 of the Sarbanes-Oxley Act of 2002 [15 U.S.C. 7212].”) and Rule 5250(c)(3) (“Each listed Company shall be audited by an independent public accountant that is registered as a public accounting firm with the Public Company Accounting Oversight Board, as provided for in Section 102 of the Sarbanes-Oxley Act of 2002 [15 U.S.C. 7212].”).

<sup>5</sup> See Section 4100 - Qualifications of Accountants, SEC Financial Reporting Manual (June 30, 2009), available at <https://www.sec.gov/corpfin/cf-manual/topic-4/>.

plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement due to error or fraud.”<sup>6</sup>

The auditor, in turn, is normally subject to inspection by the PCAOB, which assesses compliance with PCAOB and SEC rules and professional standards in connection with the auditor’s performance of audits. According to the PCAOB,

PCAOB inspections may result in the identification of deficiencies in one or more of an audit firm’s audits of issuers and/or in its quality control procedures which, in turn, can result in an audit firm carrying out additional procedures that should have been performed already at the time of the audit. Those procedures have sometimes led to the audited public company having to revise and refile its financial statements or its assessment of the effectiveness of its internal control over financial reporting. In addition, through the quality control remediation portion of the inspection process, inspected firms identify and implement practices and procedures to improve future audit quality.<sup>7</sup>

Nasdaq and investors rely on the work of auditors to provide reasonable assurances that the financial statements provided by a company are free of material misstatements. Nasdaq and investors further rely on the PCAOB’s critical role in overseeing the quality of the auditor’s work. The Chairman and the Chief Accountant of the Commission, along with the Chairman of the PCAOB, have raised concerns that national barriers on access to information can impede effective regulatory oversight of U.S.-listed companies with operations in certain countries, including the PCAOB’s inability to inspect the audit work and practices of auditors in those

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<sup>6</sup> See PCAOB Auditing Standard 1101.03 – Audit Risk, available at <https://pcaobus.org/Standards/Auditing/Pages/AS1101.aspx>.

<sup>7</sup> See Public Company Accounting Oversight Board, Public Companies that are Audit Clients of PCAOB-Registered Firms from Non-U.S. Jurisdictions where the PCAOB is Denied Access to Conduct Inspections (October 1, 2020), available at <https://pcaobus.org/oversight/international/denied-access-to-inspections>.

countries.<sup>8</sup> Similar concerns have been expressed by Members of Congress,<sup>9</sup> the State Department<sup>10</sup> and the President’s Working Group on Financial Markets.<sup>11</sup> In particular, the PCAOB is currently prevented from inspecting the audit work and practices of PCAOB-registered auditors in Belgium, France, China and Hong Kong (to the extent their audit clients have operations in mainland China).<sup>12</sup>

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<sup>8</sup> See SEC Chairman Jay Clayton, SEC Chief Accountant Wes Bricker and PCAOB Chairman William D. Duhnke III, Statement on the Vital Role of Audit Quality and Regulatory Access to Audit and Other Information Internationally—Discussion of Current Information Access Challenges with Respect to U.S.-listed Companies with Significant Operations in China (December 7, 2018), available at <https://www.sec.gov/news/public-statement/statement-vital-role-audit-quality-and-regulatory-access-audit-and-other> (“Positions taken by some foreign authorities currently prevent or significantly impair the PCAOB’s ability to inspect non-U.S. audit firms in certain countries, even though these firms are registered with the PCAOB.”). On April 21, 2020, these concerns were reiterated by the Chairman and the Chief Accountant of the Commission, along with the Chairman of the PCAOB and the Directors of the SEC Divisions of Corporation Finance and Investment Management. See SEC Chairman Jay Clayton, PCAOB Chairman William D. Duhnke III, SEC Chief Accountant Sagar Teotia, SEC Division of Corporation Finance Director William Hinman, SEC Division of Investment Management Director Dalia Blass, Emerging Market Investments Entail Significant Disclosure, Financial Reporting and Other Risks; Remedies are Limited (April 21, 2020), available at <https://www.sec.gov/news/public-statement/emerging-market-investments-disclosure-reporting>. See also Chairman Jay Clayton’s Statement at the SEC’s Emerging Markets Roundtable (July 9, 2020), available at <https://www.sec.gov/news/public-statement/clayton-emerging-markets-roundtable-2020-07-09>.

<sup>9</sup> See Congress Passes Legislation to De-List Chinese Companies Unless U.S. Has Access to Audit Workpapers (December 2, 2020), available at <https://sherman.house.gov/media-center/press-releases/congress-passes-legislation-to-de-list-chinese-companies-unless-us-has>; see also SEC Chairman Jay Clayton, Statement after the Enactment of the Holding Foreign Companies Accountable Act (December 18, 2020), available at [https://www.sec.gov/news/public-statement/clayton-hfcaa-2020-12#\\_ftn5](https://www.sec.gov/news/public-statement/clayton-hfcaa-2020-12#_ftn5).

<sup>10</sup> See Press Statement of Michael R. Pompeo, Secretary of State, New Nasdaq Restrictions Affecting Listing of Chinese Companies (June 4, 2020), available at <https://www.state.gov/new-nasdaq-restrictions-affecting-listing-of-chinese-companies/>.

<sup>11</sup> See President’s Working Group on Financial Markets: Report on Protecting United States Investors from Significant Risks from Chinese Companies (July 24, 2020), available at <https://home.treasury.gov/system/files/136/PWG-Report-on-Protecting-United-States-Investors-from-Significant-Risks-from-Chinese-Companies.pdf>.

<sup>12</sup> See *supra* note 7. The PCAOB notes that “[t]he position taken by authorities in mainland China may in some circumstances cause a registered firm located in another jurisdiction to attempt to resist PCAOB inspection of public company audit work that the firm has performed relating to the company’s operations in mainland China. Only in mainland China and Hong Kong, however, is the position of the Chinese authorities effectively an

Nasdaq shares these concerns and believes that accurate financial statement disclosure is critical for investors to make informed investment decisions. Nasdaq believes the lack of transparency from certain markets raises concerns about the accuracy of disclosures, accountability, and access to information, particularly when a company is based in a jurisdiction that does not provide the PCAOB with access to conduct inspections of public accounting firms that audit Nasdaq-listed companies (a “Restrictive Market”).

Nasdaq’s listing requirements include a number of criteria which, in the aggregate, are designed to ensure that a security listed on Nasdaq has sufficient liquidity and public interest to support a listing on a U.S. national securities exchange. These requirements are intended to ensure that there are sufficient shares available for trading to facilitate proper price discovery in the secondary market. Nasdaq believes that concerns about the accuracy of disclosures, accountability, and access to information can be compounded when a company from a Restrictive Market lists on Nasdaq through an initial public offering (“IPO”) or business combination with a small offering size or a low public float percentage because such companies may not attract market attention and develop sufficient public float, investor base, and trading interest to provide the depth and liquidity necessary to promote fair and orderly trading. As a result, the securities may trade infrequently, in a more volatile manner and with a wider bid-ask spread, all of which may result in trading at a price that may not reflect their true market value. In addition, foreign issuers are more likely to issue a portion of an offering to investors in their home country, which raises concerns that such investors will not contribute to the liquidity of the security in the U.S. secondary market.

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obstacle to inspection of all, or nearly all, registered firms in the jurisdiction.” In addition, the PCAOB’s cooperative arrangement with the French audit authority expired in December 2019, preventing inspections of registered firms in France until a new arrangement is concluded. According to the PCAOB, it expects to enter into bilateral cooperative arrangements soon “that will permit the PCAOB to commence inspections in Belgium and resume inspections in France.”

Less liquid securities may be more susceptible to price manipulation, as a relatively small amount of trading activity can have an inordinate effect on market prices. The risk of price manipulation due to insider trading is more acute when a company principally administers its business in a Restrictive Market (a “Restrictive Market Company”), particularly if a company’s financial statements contain undetected material misstatements due to error or fraud and the PCAOB is unable to inspect the company’s auditor to determine if it complied with PCAOB and SEC rules and professional standards in connection with its performance of audits. The risk to investors in such cases may be compounded because regulatory investigations into price manipulation, insider trading and compliance concerns may be impeded and investor protections and remedies may be limited in such cases due to obstacles encountered by U.S. authorities in bringing or enforcing actions against the companies and insiders.<sup>13</sup>

Currently, Nasdaq may rely upon its discretionary authority provided under Rule 5101<sup>14</sup> to deny initial listing or to apply additional and more stringent criteria when Nasdaq is concerned that a small offering size for an IPO may not reflect the company’s initial valuation or ensure sufficient liquidity to support trading in the secondary market. Nasdaq is proposing to adopt new

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<sup>13</sup> See SEC Chairman Jay Clayton, PCAOB Chairman William D. Duhnke III, SEC Chief Accountant Sagar Teotia, SEC Division of Corporation Finance Director William Hinman, SEC Division of Investment Management Director Dalia Blass, Emerging Market Investments Entail Significant Disclosure, Financial Reporting and Other Risks; Remedies are Limited (April 21, 2020), available at <https://www.sec.gov/news/public-statement/emerging-market-investments-disclosure-reporting>; see also SEC Division of Corporation Finance, CF Disclosure Guidance: Topic No. 10: Disclosure Considerations for China-Based Issuers (November 23, 2020), available at <https://www.sec.gov/corpfin/disclosure-considerations-china-based-issuers>.

<sup>14</sup> Listing Rule 5101 provides Nasdaq with broad discretionary authority over the initial and continued listing of securities in Nasdaq in order to maintain the quality of and public confidence in its market, to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and to protect investors and the public interest. Nasdaq may use such discretion to deny initial listing, apply additional or more stringent criteria for the initial or continued listing of particular securities, or suspend or delist particular securities based on any event, condition, or circumstance that exists or occurs that makes initial or continued listing of the securities on Nasdaq inadvisable or unwarranted in the opinion of Nasdaq, even though the securities meet all enumerated criteria for initial or continued listing on Nasdaq.

Rules 5210(k)(i) and (ii) that would require a minimum offering size or public float for Restrictive Market Companies listing on Nasdaq in connection with an IPO or a business combination (as described in Rule 5110(a) or IM-5101-2). Nasdaq is also proposing to adopt a new Rule 5210(k)(iii) to provide that Restrictive Market Companies would be permitted to list on the Nasdaq Global Select or Nasdaq Global Markets if they are listing in connection with a Direct Listing (as defined in IM-5315-1), but would not be permitted to list on the Nasdaq Capital Market, which has lower requirements for Unrestricted Publicly Held Shares, in connection with a Direct Listing.

I. Definition of Restrictive Market

Nasdaq proposes to adopt a new definition of Restrictive Market in Rule 5005(a)(37) to define a Restrictive Market as a jurisdiction that does not provide the PCAOB with access to conduct inspections of public accounting firms that audit Nasdaq-listed companies. This is similar to the President’s Working Group on Financial Markets definition of “Non-Cooperating Jurisdictions,” which observed that:

Certain jurisdictions, however, do not currently provide the PCAOB with the ability to inspect public accounting firms, including sufficient access to conduct inspections and investigations of audits of public companies, or otherwise do not cooperate with U.S. regulators (“Non-Cooperating Jurisdictions,” or “NCJs”). The PCAOB has been unable to fulfill its statutory mandate under Sarbanes-Oxley to inspect audit firms in NCJs, including those in China, potentially exposing investors in U.S. capital markets to significant risks. The PCAOB has been unable to fulfill this mandate meaningfully with respect to audit firms based in China for more than a decade.<sup>15</sup>

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<sup>15</sup> See supra note 11 at 2.

The PCAOB maintains a map of where it can and cannot conduct oversight activities on its website.<sup>16</sup> In addition, the PCAOB publishes a list identifying the public companies for which a PCAOB-registered public accounting firm signed and issued an audit report and is located in a jurisdiction where obstacles to PCAOB inspections exist.<sup>17</sup>

Nasdaq will consider a company's business to be principally administered in a Restrictive Market if: (i) the company's books and records are located in that jurisdiction; (ii) at least 50% of the company's assets are located in such jurisdiction; or (iii) at least 50% of the company's revenues are derived from such jurisdiction. Nasdaq also proposes to renumber the remainder of Rule 5005(a) to ensure consistency in its rulebook.

For example, Company X's books and records could be located in Country Y, which is not a Restrictive Market, while 90% of its revenues are derived from operations in Country Z, which is a Restrictive Market. If Company X applies to list its Primary Equity Security on Nasdaq in connection with an IPO, Nasdaq would consider Company X's business to be principally administered in Country Z, and Company X would therefore be subject to the proposed additional requirements applicable to a Restrictive Market Company. Conversely, Company A's books and records could be located in Country B, which is a Restrictive Market, but 90% of its revenues are derived from Country C, which is not a Restrictive Market. Nasdaq would consider Company A's business to be principally administered in Country B, and Company A would therefore be subject to the proposed additional requirements applicable to a Restrictive Market Company.

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<sup>16</sup> See Public Company Accounting Oversight Board, Oversight: International (last accessed January 29, 2020), available at <https://pcaobus.org/oversight/international>.

<sup>17</sup> See supra note 7.

## II. Minimum Offering Size or Public Float Percentage for an IPO

As proposed, Rule 5210(k)(i) would require a company that is listing its Primary Equity Security<sup>18</sup> on Nasdaq in connection with its IPO, and that principally administers its business in a Restrictive Market, to offer a minimum amount of securities in a Firm Commitment Offering<sup>19</sup> in the U.S. to Public Holders<sup>20</sup> that: (a) will result in gross proceeds to the company of at least \$25 million; or (b) will represent at least 25% of the company's post-offering Market Value<sup>21</sup> of Listed Securities,<sup>22</sup> whichever is lower. For example, Company X is applying to list on Nasdaq Global Market. Company X principally administers its business in a Restrictive Market and its post-offering Market Value of Listed Securities is expected to be \$75,000,000. Since 25% of \$75,000,000 is \$18,750,000, which is lower than \$25,000,000, it would be eligible to list under the proposed rule based on a Firm Commitment Offering in the U.S. to Public Holders of at least \$18,750,000. However, Company X would also need to comply with the other applicable listing requirements of the Nasdaq Global Market, including a Market Value of Unrestricted Publicly Held Shares<sup>23</sup> of at least \$8 million.<sup>24</sup>

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<sup>18</sup> Rule 5005(a)(33) defines "Primary Equity Security" as "a Company's first class of Common Stock, Ordinary Shares, Shares or Certificates of Beneficial Interest of Trust, Limited Partnership Interests or American Depositary Receipts (ADR) or Shares (ADS)."

<sup>19</sup> Rule 5005(a)(17) defines "Firm Commitment Offering" as "an offering of securities by participants in a selling syndicate under an agreement that imposes a financial commitment on participants in such syndicate to purchase such securities."

<sup>20</sup> Rule 5005(a)(36) defines "Public Holders" as "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."

<sup>21</sup> Rule 5005(a)(23) defines "Market Value" as "the consolidated closing bid price multiplied by the measure to be valued (e.g., a Company's Market Value of Publicly Held Shares is equal to the consolidated closing bid price multiplied by a Company's Publicly Held Shares)."

<sup>22</sup> Rule 5005(a)(22) defines "Listed Securities" as "securities listed on Nasdaq or another national securities exchange."

<sup>23</sup> See Rule 5005(a)(45) (definition of "Unrestricted Publicly Held Shares"), Rule 5005(a)(46) (definition of "Unrestricted Securities"), and Rule 5005(a)(37) (definition of "Restricted Securities").

<sup>24</sup> See Rule 5405(b)(1)(C).

In contrast, Company Y, which also principally administers its business in a Restrictive Market, is applying to list on the Nasdaq Global Select Market and its post-offering Market Value of Listed Securities is expected to be \$200,000,000. Since 25% of \$200,000,000 is \$50,000,000, which is higher than \$25,000,000, it would be eligible to list under the proposed rule based on a Firm Commitment Offering in the U.S. to Public Holders that will result in gross proceeds of at least \$25,000,000. However, Company Y would also need to comply with the other applicable listing requirements of the Nasdaq Global Select Market, including a Market Value of Unrestricted Publicly Held Shares of at least \$45 million.<sup>25</sup>

The Exchange believes that the proposal to require a Restrictive Market Company conducting an IPO to offer a minimum amount of securities in the U.S. to Public Holders in a Firm Commitment Offering will provide greater support for the company's price, as determined through the offering, and will help assure that there will be sufficient liquidity, U.S. investor interest and distribution to support price discovery once a security is listed. Nasdaq believes there is a risk that substantial participation by foreign investors in an offering, combined with insiders retaining significant ownership, does not promote sufficient investor base and trading interest to support trading in the secondary market. The risk to U.S. investors is compounded when a company is located in a Restrictive Market due to restrictions on the PCAOB's ability to inspect the audit work and practices of auditors in those countries, which may be accompanied by limitations on the ability of U.S. regulators to conduct investigations or bring or enforce actions against the company and non-U.S. persons. As a result, there are increased concerns about the accuracy of disclosures, accountability and access to information.

Further, the Exchange has observed that Restrictive Market Companies listing on Nasdaq in connection with an IPO with an offering size below \$25 million or public float ratio below 25% have a high rate of compliance concerns. Nasdaq believes that these concerns may be

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<sup>25</sup> See Rule 5315(f)(2)(C).

mitigated by the company conducting a Firm Commitment Offering of at least \$25 million or 25% of the company's post-offering Market Value of Listed Securities, whichever is lower. Firm Commitment Offerings typically involve a book building process that helps to generate an investor base and trading interest that promotes sufficient depth and liquidity to help support fair and orderly trading on the Exchange. Such offerings also typically involve more due diligence by the broker-dealer than would be done in connection with a best-efforts offering, which helps to ensure that third parties subject to U.S. regulatory oversight are conducting significant due diligence on the company, its registration statement and its financial statements. The Exchange believes that the proposal will help ensure that Restrictive Market Companies seeking to list on the Exchange have sufficient investor base and public float to support fair and orderly trading on the Exchange.

In developing the Proposal, Nasdaq analyzed the data behind its observations. An analysis of initial public offerings from January 1, 2015 to September 30, 2020, found that 113 Restrictive Market companies listed on Nasdaq through an IPO and 39 of such companies would not have qualified under proposed Rule 5210(k)(i) because they had offering amounts of \$25 million or less.<sup>26</sup> Of those, 20, or 51%, were cited for a compliance issue, a significantly higher rate than other Restrictive Market Companies (16%).

During the period from January 1, 2015 to September 30, 2020, 84 Restrictive Market Companies had a ratio of offering size to Market Value of Listed Securities of 25% or less. Of these, 25, or 30%, failed to comply with one or more listing standards after listing, which is a significantly higher non-compliance rate than other foreign companies (11%) and other Restrictive Market Companies (21%) that had such listings. In some cases, when the ratio of

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<sup>26</sup> Two of these companies were considered to be principally administered in a Restrictive Market because they had at least 50% of the company's assets located in a Restrictive Market and 37 met the definition because they had at least 50% of the company's revenues derived from a Restrictive Market.

offering size to Market Value of Listed Securities is low there may be concerns about whether there are sufficient freely tradable shares to meet investor demand.

Lastly, during the period from January 1, 2015 to September 30, 2020, 35 Restrictive Market Companies would not have qualified under either proposed Rule 5210(k)(i)(a) or (b). Of these companies, 18 were cited for a compliance concern.

### III. Minimum Market Value of Publicly Held Shares for a Business Combination

Nasdaq believes that a business combination, as described in Rule 5110(a) or IM-5101-2, involving a Restrictive Market Company presents similar risks to U.S. investors as IPOs of Restrictive Market Companies. However, such a business combination would typically not involve an offering. Therefore, Nasdaq proposes to adopt a new Rule 5210(k)(ii) that would impose a similar new requirement as applicable to IPOs, but would reflect that the listing would not typically be accompanied by an offering. Specifically, proposed Rule 5210(k)(ii) would require the listed company to have a minimum Market Value of Unrestricted Publicly Held Shares following the business combination equal to the lesser of: (a) \$25 million; or (b) 25% of the post-business combination entity's Market Value of Listed Securities.

For example, Company A is currently listed on the Nasdaq Capital Market and plans to acquire a company that principally administers its business in a Restrictive Market, in accordance with IM-5101-2. Following the business combination, Company A intends to transfer to the Nasdaq Global Select Market. Company A expects the post-business combination entity to have a Market Value of Listed Securities of \$250,000,000. Since 25% of \$250,000,000 is \$62,500,000, which is higher than \$25,000,000, to qualify for listing on the Nasdaq Global Select Market the post-business combination entity must have a minimum Market Value of Unrestricted Publicly Held Shares of at least \$25,000,000. However, Company A would also

need to comply with the other applicable listing requirements of the Nasdaq Global Select Market, including a Market Value of Unrestricted Publicly Held Shares of at least \$45,000,000.<sup>27</sup>

In contrast, Company B is currently listed on Nasdaq Capital Market and plans to combine with a non-Nasdaq entity that principally administers its business in a Restrictive Market, resulting in a change of control as defined in Rule 5110(a), whereby the non-Nasdaq entity will become the Nasdaq-listed company. Following the change of control, Company B expects the listed company to have a Market Value of Listed Securities of \$50,000,000. Since 25% of \$50,000,000 is \$12,500,000, which is lower than \$25,000,000, the listed company must have a minimum Market Value of Unrestricted Publicly Held Shares following the change of control of at least \$12,500,000. However, the company would also need to comply with the other applicable listing requirements of the Nasdaq Capital Market, including a Market Value of Unrestricted Publicly Held Shares of at least \$5 million.<sup>28</sup>

Market Value of Unrestricted Publicly Held Shares excludes securities subject to resale restrictions from the calculation of Publicly Held Shares because securities subject to resale restrictions are not freely transferrable or available for outside investors to purchase and therefore do not truly contribute to a security's liquidity upon listing. Nasdaq believes that requiring the post-business combination entity to have a minimum Market Value of Unrestricted Publicly Held Shares of at least \$25 million or 25% of its Market Value of Listed Securities, whichever is lower, would help to provide an additional assurance that there are sufficient freely tradable shares and investor interest to support fair and orderly trading on the Exchange when the target company principally administers its business in a Restrictive Market. Nasdaq believes that this will help mitigate the unique risks that Restrictive Market Companies present to U.S. investors due to restrictions on the PCAOB's ability to inspect the audit work and practices of

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<sup>27</sup> See Rule 5315(f)(2)(C).

<sup>28</sup> See Rule 5505(b)(3)(C).

auditors in those countries, which create concerns about the accuracy of disclosures, accountability and access to information.

Nasdaq found that out of seven business combinations involving Restrictive Market Companies from 2015 through September 30, 2020, five would not have qualified under proposed Rule 5210(k)(ii). All five of these companies have been cited for a deficiency after the completion of their business combination. Of the two business combinations involving Restrictive Market Companies that would have qualified under proposed Rule 5210(k)(ii), one was cited for a compliance concern. As such, Nasdaq believes that a business combination, as described in Nasdaq Rule 5110(a) or IM-5101-2, involving a Restrictive Market Company presents similar risks to U.S. investors as an IPO of a Restrictive Market Company and, therefore, believes it is appropriate to apply similar thresholds to post-business combination entities to ensure that a company listing through a business combination would have satisfied equivalent standards that apply to an IPO.

#### IV. Direct Listings of Restrictive Market Companies

Nasdaq proposes to adopt Rule 5210(k)(iii) to provide that a Restrictive Market Company would be permitted to list on the Nasdaq Global Select Market or Nasdaq Global Market in connection with a Direct Listing (as defined in IM-5315-1), provided that the company meets all applicable listing requirements for the Nasdaq Global Select Market and the additional requirements of IM-5315-1, or the applicable listing requirements for the Nasdaq Global Market and the additional requirements of IM-5405-1. However, such companies would be not be permitted to list on the Nasdaq Capital Market in connection with a Direct Listing notwithstanding the fact that such companies may meet the applicable initial listing requirements for the Nasdaq Capital Market and the additional requirements of IM-5505-1.

Direct Listings are currently required to comply with enhanced listing standards pursuant to IM-5315-1 (Nasdaq Global Select Market) and IM-5405-1 (Nasdaq Global Market). If a

company's security has had sustained recent trading in a Private Placement Market,<sup>29</sup> Nasdaq may attribute a Market Value of Unrestricted Publicly Held Shares equal to the lesser of (i) the value calculable based on a Valuation<sup>30</sup> and (ii) the value calculable based on the most recent trading price in the Private Placement Market.<sup>31</sup> Nasdaq believes that the price from such sustained trading in the Private Placement Market for the company's securities is predictive of the price in the market for the common stock that will develop upon listing of the securities on Nasdaq and that qualifying a company based on the lower of such trading price or the Valuation helps assure that the company satisfies Nasdaq's requirements.

Nasdaq may require a company listing on the Nasdaq Global Select Market that has not had sustained recent trading in a Private Placement Market to satisfy the applicable Market Value of Unrestricted Publicly Held Shares requirement and provide a Valuation evidencing a Market Value of Publicly Held Shares of at least \$250,000,000.<sup>32</sup> For a company that has not had sustained recent trading in a Private Placement Market and that is applying to list on the Nasdaq Global Market, Nasdaq will generally require the company to provide a Valuation that demonstrates a Market Value of Listed Securities and Market Value of Unrestricted Publicly Held Shares that exceeds 200% of the otherwise applicable requirement.<sup>33</sup> Nasdaq believes that in the absence of recent sustained trading in the Private Placement Market, the requirement to demonstrate a Market Value of Publicly Held Shares of at least \$250 million for a company seeking to list on Nasdaq Global Select Market, or that the company exceeds 200% of the otherwise applicable price-based requirement for a company seeking to list on Nasdaq Global

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<sup>29</sup> See Rule 5005(a)(34).

<sup>30</sup> See IM-5315-1(a)(1).

<sup>31</sup> See IM-5315-1(a)(1) (Nasdaq Global Select Market) and IM-5405-1(a)(1) (Nasdaq Global Market).

<sup>32</sup> See IM-5315-1(b).

<sup>33</sup> See IM-5405-1(a)(2) (Nasdaq Global Market).

Market, helps assure that the company satisfies Nasdaq's requirement by imposing a standard that is more than double the otherwise applicable standard.

Thus, companies listing in connection with a Direct Listing on the Nasdaq Global or Global Select Market tiers are already subject to enhanced listing requirements and Nasdaq believes it is appropriate to permit Restrictive Market Companies to list through a Direct Listing on the Nasdaq Global Select Market or Nasdaq Global Market. On the other hand, while companies listing in connection with a Direct Listing on the Capital Market are also subject to enhanced listing requirements, Nasdaq does not believe that these enhanced requirements are sufficient to overcome concerns regarding sufficient liquidity and investor interest to support fair and orderly trading on the Exchange with respect to Restrictive Market Companies.<sup>34</sup> Nasdaq believes that Restrictive Market Companies present unique risks to U.S. investors due to restrictions on the PCAOB's ability to inspect the audit work and practices of auditors in those countries, which create concerns about the accuracy of disclosures, accountability and access to information. Therefore, Nasdaq believes that precluding a Restrictive Market Company from listing through a Direct Listing on the Capital Market will help to ensure that the company has sufficient public float, investor base, and trading interest likely to generate depth and liquidity necessary to promote fair and orderly trading on the secondary market.

## V. Conclusion

Nasdaq believes that the U.S. capital markets can provide Restrictive Market Companies with access to additional capital to fund ground-breaking research and technological advancements. Further, such companies provide U.S. investors with opportunities to diversify their portfolio by providing exposure to Restrictive Markets. However, as discussed above,

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<sup>34</sup> For example, the Nasdaq Global Select Market and Nasdaq Global Market require a company to have at least 1,250,000 and 1.1 million Unrestricted Publicly Held Shares, respectively, and a Market Value of Unrestricted Publicly Held Shares of at least \$45 million and \$8 million, respectively. In contrast, the Nasdaq Capital Market requires a company to have at least 1 million Unrestricted Publicly Held Shares and a Market Value of Unrestricted Publicly Held Shares of at least \$5 million.

Nasdaq believes that Restrictive Market Companies present unique potential risks to U.S. investors due to restrictions on the PCAOB's ability to inspect the audit work and practices of auditors in those countries, which create concerns about the accuracy of disclosures, accountability and access to information.<sup>35</sup> Nasdaq believes that the proposed rule changes will help to ensure that Restrictive Market Companies have sufficient investor base and public float to support fair and orderly trading on the Exchange.

## 2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act,<sup>36</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act,<sup>37</sup> in particular, in that it is 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. Further, the Exchange believes that this proposal is not designed to permit unfair discrimination between customers, issuers, brokers, or dealers.

The Commission has previously opined on the importance of meaningful listing standards for the protection of investors and the public interest.<sup>38</sup> In particular, the Commission stated:

Among other things, listing standards provide the means for an exchange to screen issuers that seek to become listed, and to provide listed status only to those that are bona fide companies with sufficient public float, investor base, and trading interest likely to generate depth and liquidity sufficient to promote fair and orderly markets. Meaningful

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<sup>35</sup> See supra note 8.

<sup>36</sup> 15 U.S.C. 78f(b).

<sup>37</sup> 15 U.S.C. 78f(b)(5).

<sup>38</sup> Securities Exchange Act Release No. 65708 (November 8, 2011), 76 FR 70799 (November 15, 2011) (approving SR-Nasdaq-2011-073 adopting additional listing requirements for companies applying to list after consummation of a "reverse merger" with a shell company).

listing standards also are important given investor expectations regarding the nature of securities that have achieved an exchange listing, and the role of an exchange in overseeing its market and assuring compliance with its listing standards.<sup>39</sup>

Nasdaq believes that requiring a minimum offering size or public float percentage for Restrictive Market Companies seeking to list on Nasdaq through an IPO or business combination will ensure that a security to be listed on Nasdaq has adequate liquidity, distribution and U.S. investor interest to support fair and orderly trading in the secondary market, which will reduce trading volatility and price manipulation, thereby protecting investors and the public interest.

Similarly, Nasdaq believes that permitting Restrictive Market Companies to list on Nasdaq Global Select Market or Nasdaq Global Market, rather than the Nasdaq Capital Market, in connection with a Direct Listing will ensure that such companies satisfy more rigorous listing requirements, including the minimum amount of Publicly Held Shares and Market Value of Publicly Held Shares, which will help to ensure that the security has sufficient public float, investor base, and trading interest likely to generate depth and liquidity sufficient to promote fair and orderly trading, thereby protecting investors and the public interest.

While the proposal applies only to Restrictive Market Companies, the Exchange believes that the proposal is not designed to permit unfair discrimination among companies because Nasdaq believes that Restrictive Market Companies present unique potential risks to U.S. investors due to restrictions on the PCAOB's ability to inspect the audit work and practices of auditors in those countries, which create concerns about the accuracy of disclosures, accountability and access to information.

Nasdaq and investors rely on the work of auditors to provide reasonable assurances that the financial statements provided by a company are free of material misstatements. The PCAOB states that "[r]easonable assurance is obtained by reducing audit risk to an appropriately low

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<sup>39</sup> Id at 70802.

level through applying due professional care, including obtaining sufficient appropriate audit evidence.”<sup>40</sup> Nasdaq believes that the PCAOB’s inability to inspect the audit work and practices of auditors in certain countries weakens the assurance that the auditor obtained sufficient appropriate audit evidence to express its opinion on a company’s financial statements, and decreases confidence that the auditor complied with PCAOB and SEC rules and professional standards in connection with the auditor’s performance of audits. Nasdaq believes that without reasonable assurances from an auditor that a company’s financial statements and related disclosures are free from material misstatements, there is a risk that a company that would otherwise not have qualified to list on Nasdaq may satisfy Nasdaq’s listing standards by presenting financial statements that contain undetected material misstatements. In In the Matter of the Tassaway, Inc., the Commission observed that

Though exclusion from the system may hurt existing investors, primary emphasis must be placed on the interests of prospective future investors. The latter group is entitled to assume that the securities in the system meet the system’s standards. Hence the presence in NASDAQ of non-complying securities could have a serious deceptive effect.<sup>41</sup>

The proposed rule change would provide greater assurances to investors that a company truly meets Nasdaq’s financial listing requirements by imposing heightened listing criteria on a company that principally administers its business in a Restrictive Market, thereby preventing fraudulent and manipulative acts, protecting investors and promoting the public interest.

In addition, securities of Restrictive Market Companies may not develop sufficient public float, investor base, and trading interest to provide the depth and liquidity necessary to promote fair and orderly trading, resulting in a security that is illiquid. Nasdaq is concerned because

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<sup>40</sup> See supra note 6.

<sup>41</sup> See In the Matter of Tassaway, Inc., Securities Exchange Act Release No. 11291, 1975 WL 160383; 45 S.E.C. 706 (March 13, 1975).

illiquid securities may trade infrequently, in a more volatile manner and with a wider bid-ask spread, all of which may result in trading at a price that may not reflect their true market value.

Less liquid securities also may be more susceptible to price manipulation, as a relatively small amount of trading activity can have an inordinate effect on market prices. Price manipulation is a particular concern when insiders retain a significant ownership portion of the company. The risk of price manipulation due to insider trading is more acute when a company principally administers its business in a Restrictive Market and management lacks familiarity or experience with U.S. securities laws. Therefore, Nasdaq believes that it is not unfairly discriminatory to treat Restrictive Market Companies differently under this proposal because it will help ensure that securities of a Restrictive Market Company listed on Nasdaq have sufficient public float, investor base, and trading interest to provide the depth and liquidity necessary to promote fair and orderly markets, thereby promoting investor protection and the public interest.

B. Self-Regulatory Organization's Statement on Burden on Competition

The Exchange does not believe that the proposed rule changes will impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act. While the proposed rule changes will apply only to companies primarily operating in Restrictive Markets, Nasdaq and the SEC have identified specific concerns with such companies that make the imposition of additional initial listing criteria on such companies appropriate to enhance investor protection, which is a central purpose of the Act. Any impact on competition, either among listed companies or between exchanges, is incidental to that purpose.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

No written comments were either solicited or received.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period up to 90 days (i) as the Commission may designate if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the Exchange

consents, the Commission shall: (a) by order approve or disapprove such proposed rule change, or (b) institute proceedings to determine whether the proposed rule change should be disapproved.

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

##### Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-NASDAQ-2021-007 on the subject line.

##### Paper comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-NASDAQ-2021-007. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change.

Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-NASDAQ-2021-007 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>42</sup>

J. Matthew DeLesDernier,  
Assistant Secretary.

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<sup>42</sup> 17 CFR 200.30-3(a)(12).