

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-93256; File No. SR-NASDAQ-2021-007)

October 4, 2021

Self-Regulatory Organizations; The Nasdaq Stock Market LLC; Order Granting Approval of a 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

I. Introduction

On February 1, 2021, The Nasdaq Stock Market LLC (“Nasdaq” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² a proposed rule change to adopt additional initial listing criteria for companies primarily operating in jurisdictions that do not provide the Public Company Accounting Oversight Board (“PCAOB”) with the ability to inspect public accounting firms. The proposed rule change was published for comment in the Federal Register on February 16, 2021.³ On March 26, 2021, pursuant to Section 19(b)(2) of the Act,⁴ the Commission designated a longer period within which to approve the proposed rule change, disapprove the proposed rule change, or institute proceedings to determine whether to disapprove the proposed rule change.⁵ On May 17, 2021, the

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 91089 (February 9, 2021), 86 FR 9549 (“Notice”). Comments on the proposed rule change can be found at: <https://www.sec.gov/comments/sr-nasdaq-2021-007/srnasdaq2021007.htm>.

⁴ 15 U.S.C. 78s(b)(2).

⁵ See Securities Exchange Act Release No. 91413, 86 FR 17263 (April 1, 2021). The Commission designated May 17, 2021 as the date by which the Commission shall approve or disapprove, or institute proceedings to determine whether to approve or disapprove, the proposed rule change.

Commission instituted proceedings to determine whether to approve or disapprove the proposed rule change.⁶ This order approves the proposed rule change.

II. Description of the Proposed Rule Change

The Exchange states that the Exchange's rules, in addition to federal securities laws, require that a company's financial statements included in its initial registration statement or annual report be audited by an independent public accountant that is registered with the PCAOB.⁷ According to the Exchange, the Exchange 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, and on the PCAOB's critical role in overseeing the quality of the auditor's work.⁸ The Exchange states its belief that accurate financial statement disclosure is critical for investors to make informed investment decisions.⁹

The Exchange states that the former Chairman and former Chief Accountant of the Commission and the former 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 countries.¹⁰ The Exchange states that similar concerns have been

⁶ See Securities Exchange Act Release No. 91904, 86 FR 27659 (May 21, 2021).

⁷ See Notice, supra note 3, at 9549. See also Nasdaq Rules 5210(b) and 5250(c)(3) (requiring for initial and continued listing on Nasdaq that companies must be audited by an independent public accountant that is registered as a public accounting firm with the PCAOB); 15 U.S.C. 7212(a) (Registration with the PCAOB); 17 CFR 210.2-01 (Qualifications of Accountants).

⁸ See Notice, supra note 3, at 9550.

⁹ See id.

¹⁰ See id. (citing to various statements by former Commission Chairman Jay Clayton, former Commission Chief Accountant Wes Bricker, and former PCAOB Chairman William D. Duhnke III, available at <https://www.sec.gov/news/public->

expressed by members of Congress, the State Department, and the President’s Working Group on Financial Markets.¹¹ The Exchange states that it shares these concerns and 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 (“Restrictive Market”).¹²

The Exchange further states that such concerns can be compounded when a company from a Restrictive Market lists on the Exchange through an initial public offering (“IPO”) or a 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.¹³

statement/statement-vital-role-audit-quality-and-regulatory-access-audit-and-other;
<https://www.sec.gov/news/public-statement/emerging-market-investments-disclosure-reporting>; and <https://www.sec.gov/news/public-statement/clayton-emerging-markets-roundtable-2020-07-09>). See id. at 9550, n.8.

¹¹ See id. at 9550 (citing to “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>; Former Commission 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; Press Statement of Michael R. Pompeo, Former Secretary of State, New Nasdaq Restrictions Affecting Listing of Chinese Companies (June 4, 2020), available at <https://2017-2021-translations.state.gov/2020/06/04/new-nasdaq-restrictions-affecting-listing-of-chinese-companies/index.html>; 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>). See id. at 9550, nn.9-11.

¹² See id. at 9550.

¹³ See id.

According to the Exchange, such 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.¹⁴ Furthermore, the Exchange states that less liquid securities may be more susceptible to price manipulation and that, in particular, the risk of price manipulation due to insider trading is more acute with respect to a company that principally administers its business in a Restrictive Market (“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 Commission rules and professional standards in connection with its performance of audits.¹⁵ The Exchange states that 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.¹⁶

Nasdaq states that it believes the U.S. capital markets can provide Restrictive Market Companies with access to additional capital to fund ground-breaking research and technological advancements and that such companies provide U.S. investors with opportunities to diversify their portfolio by providing exposure to Restrictive Markets.¹⁷ However, Nasdaq further states that it believes that Restrictive Market Companies present unique potential risks to U.S. investors

¹⁴ See id. The Exchange also states that 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. See id.

¹⁵ See id.

¹⁶ See id.

¹⁷ See id. at 9553-54. See also Letter from Jeffrey S. Davis, Senior Vice President, General Counsel, Nasdaq, Inc. (April 30, 2021) (“Nasdaq Response Letter”), at 2.

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.¹⁸ Nasdaq states that it believes its proposal will reduce trading volatility and price manipulation and help to ensure that Restrictive Market Companies have sufficient investor base and public float to support fair and orderly trading on the Exchange.¹⁹

Specifically, the Exchange proposes to adopt a definition of "Restrictive Market"²⁰ and to apply additional initial listing requirements to a Restrictive Market Company listing on the Exchange in connection with an IPO or a business combination.²¹ The Exchange also proposes to prohibit a Restrictive Market Company from listing on the Nasdaq Capital Market in connection with a Direct Listing,²² but to allow a Restrictive Market Company to list on the

¹⁸ See Notice, supra note 3, at 9554.

¹⁹ See id. See also Nasdaq Response Letter, supra note 17, at 3.

²⁰ See infra note 24 and accompanying text.

²¹ The Exchange states that, currently, it may rely upon its discretionary authority under Nasdaq Rule 5101 to deny initial listing or apply additional or more stringent criteria when it is concerned that a small offering size for an IPO may not reflect the company's initial valuation or may not ensure sufficient liquidity to support trading in the secondary market. Pursuant to Nasdaq Rule 5101, Nasdaq has 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. See Nasdaq Rule 5101.

²² Nasdaq defines "Direct Listing" as the listing of "companies that have sold common equity securities in private placements, which have not been listed on a national securities exchange or traded in the over-the-counter market pursuant to FINRA Form 211 immediately prior to the initial pricing." See Nasdaq Rule IM-5315-1.

Nasdaq Global Select Market or Nasdaq Global Market in connection with a Direct Listing, provided that such company meets all applicable initial listing requirements for such market.

A. Definition of Restrictive Market

The Exchange proposes to adopt a new definition of Restrictive Market in Nasdaq Rule 5005(a)(37).²³ As proposed, a Restrictive Market will be defined as a jurisdiction that does not provide the PCAOB with access to conduct inspections of public accounting firms that audit Nasdaq-listed companies.²⁴ Under the proposed rule, 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.²⁵

²³ The Exchange proposes to renumber current paragraphs (a)(37) through (a)(46) of Nasdaq Rule 5005 in connection with the addition of the definition of Restrictive Market. See Notice, supra note 3, at 9551.

²⁴ See proposed Nasdaq Rule 5005(a)(37). The Exchange states that the PCAOB maintains a map of where it can and cannot conduct oversight activities on its website and 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. See Notice, supra note 3, at 9551.

²⁵ See proposed Nasdaq Rule 5005(a)(37). The term "Company" means the issuer of a security listed or applying to list on Nasdaq. See Nasdaq Rule 5005(a)(6). The Exchange provides the following examples. Company X's books and records are located in Country Y, which is not a Restrictive Market, while 90% of its revenues are driven from operations in Country Z, which is a Restrictive Market. Nasdaq would consider Company X's business to be principally administered in Country Z, so Company X would be considered a Restrictive Market Company. Alternatively, Company A's books and records are 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, so Company A would be considered a Restrictive Market Company. See Notice, supra note 3, at 9551.

B. Minimum Offering Size or Public Float Percentage Requirement for an IPO

The Exchange proposes to adopt new Nasdaq Rule 5210(k)(i) to require a Restrictive Market Company listing its Primary Equity Security²⁶ on Nasdaq in connection with its IPO to offer a minimum amount of securities in a Firm Commitment Offering²⁷ in the U.S. to Public Holders²⁸ that (i) will result in gross proceeds to the Company of at least \$25 million or (ii) will represent at least 25% of the Company's post-offering Market Value of Listed Securities,²⁹ whichever is lower. A Restrictive Market Company listing on the Exchange in connection with an IPO that is subject to the proposed rule would also need to comply with all other applicable listing requirements.³⁰ The Exchange states that it believes this proposed listing requirement for

²⁶ Nasdaq 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)."

²⁷ Nasdaq 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."

²⁸ Nasdaq 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."

²⁹ "Market Value" means the consolidated closing bid price multiplied by the measure to be valued. See Nasdaq Rule 5000(a)(23). "Listed Securities" means securities listed on Nasdaq or another national securities exchange. See Nasdaq Rule 5000(a)(22).

³⁰ The Exchange provides the following examples to illustrate the proposed rule. First, Company X, which principally administers its business in a Restrictive Market, is applying to list on Nasdaq Global Market and has an expected post-offering Market Value of Listed Securities of \$75,000,000. Since 25% of \$75,000,000 is \$18,750,000, which is lower than \$25,000,000, pursuant to the requirements of the proposed rule, Company X would be eligible to list based on a Firm Commitment Offering in the U.S. to Public Holders of at least \$18,750,000. 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 of at least \$8 million. See Notice, supra note 3, at 9551; Nasdaq Rule 5405(b)(1)(C). See also Nasdaq Rules 5005(a)(45) (definition of "Unrestricted Publicly Held Shares"), 5005(a)(46) (definition of "Unrestricted Securities"), and 5005(a)(37) (definition of "Restricted Securities"). As another example,

Restrictive Market Companies conducting an IPO will provide greater support for the company's price, as determined through the offering, and will help assure there will be sufficient liquidity, U.S. investor interest, and distribution to support price discovery once the security is listed.³¹ In addition, the Exchange states 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.³²

The Exchange further states that it 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.³³ The Exchange states that it

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, pursuant to the requirements of the proposed rule, Company Y would be eligible to list 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. 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. See Notice, supra note 3, at 9551-52; Nasdaq Rule 5315(f)(2)(C).

³¹ See Notice, supra note 3, at 9552.

³² See id.

³³ See id. Specifically, the Exchange states that 39 out of 113 Restrictive Market Companies that listed on Nasdaq through an IPO from January 1, 2015 to September 30, 2020 would not have qualified under the requirement in proposed Nasdaq Rule 5210(k)(i) because they had offering amounts of \$25 million or less. According to Nasdaq, two of these companies were considered to be Restrictive Market Companies 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. Of those companies that would not have qualified under the requirement in proposed Nasdaq Rule 5210(k)(i), twenty, or 51%, were cited for a compliance issue, which Nasdaq states is a significantly higher rate than other Restrictive Market Companies (16%). The Exchange also states that, during the same period, 25 out of 84 (or 30%) of Restrictive Market Companies that had a ratio of offering size to Market Value of Listed Securities of 25% or less failed to comply with one or more

believes the proposed listing requirement for Restrictive Market Companies conducting an IPO will mitigate such compliance concerns.³⁴

C. Minimum Market Value of Unrestricted Publicly Held Shares Requirement for a Business Combination

The Exchange proposes to adopt new Nasdaq Rule 5210(k)(ii) to require a Company that is conducting a business combination, as described in Nasdaq Rule 5110(a)³⁵ or IM-5101-2,³⁶ with a Restrictive Market Company to have a minimum Market Value of Unrestricted Publicly Held Shares³⁷ following the business combination equal to the lesser of (i) \$25 million or (ii)

listing standards after listing, which, according to the Exchange, is a significantly higher non-compliance rate than for other foreign companies (11%) and other Restrictive Market Companies (21%) that had such listings. The Exchange also found that, during the same period, 35 Restrictive Market Companies would not have met either the \$25 million offering size requirement or the 25% of the company's post-offering Market Value of Listed Securities requirement, and 18 of those companies were cited for a compliance concern. See id.

³⁴ See id.

³⁵ Nasdaq Rule 5110(a) (Business Combinations with non-Nasdaq Entities Resulting in a Change of Control) sets forth requirements applicable to a Company that engages in a business combination with a non-Nasdaq entity, resulting in a change of control of the Company and potentially allowing the non-Nasdaq entity to obtain a Nasdaq Listing.

³⁶ Nasdaq Rule IM-5101-2 (Listing of Companies Whose Business Plan is to Complete One or More Acquisitions) sets forth requirements applicable to a Company whose business plan is to complete an IPO and engage in a merger or acquisition with one or more unidentified companies within a specific period of time.

³⁷ Nasdaq Rule 5005(a)(45) defines "Unrestricted Publicly Held Shares" as Publicly Held Shares that are Unrestricted Securities. "Publicly Held Shares" means shares not held directly or indirectly by an officer, director or any person who is the beneficial owner of more than 10 percent of the total shares outstanding. See Nasdaq Rule 5005(a)(35). "Unrestricted Securities" means securities that are not subject to resale restrictions for any reason, including, but not limited to, securities: (i) acquired directly or indirectly from the issuer or an affiliate of the issuer in unregistered offerings such as private placements or Regulation D offerings; (ii) acquired through an employee stock benefit plan or as compensation for professional services; (iii) acquired in reliance on Regulation S, which cannot be resold within the United States; (iv) subject to a lockup agreement or

25% of post-business combination entity's Market Value of Listed Securities. A Restrictive Market Company subject to the proposed rule would also need to comply with all other applicable listing requirements.³⁸

The Exchange states that it 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, Nasdaq 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

a similar contractual restriction; or (v) considered "restricted securities" under Rule 144. See Nasdaq Rules 5005(a)(46) and (37).

³⁸ The Exchange provides the following examples to illustrate the proposed rule. First, 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, pursuant to the requirements of the proposed rule, to qualify for listing the post-business combination entity must have a minimum Market Value of Unrestricted Publicly Held Shares of at least \$25,000,000. The company 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. See Notice, supra note 3, at 9552; Nasdaq Rule 5315(f)(2)(C). As another example, 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 Nasdaq 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, pursuant to the requirements of the proposed rule, 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. The post-business combination company would also need to comply with all other applicable listing requirements of the Nasdaq Capital Market, including a Market Value of Unrestricted Publicly Held Shares of at least \$5 million. See Notice, supra note 3, at 9552; Nasdaq Rule 5505(b)(3)(C).

apply to an IPO.³⁹ The Exchange further states that it believes that the proposed listing requirement for post-business combination entities 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.⁴⁰

D. Direct Listings of Restrictive Market Companies

The Exchange proposes to adopt new Nasdaq Rule 5210(k)(iii) to provide that a Restrictive Market Company that is listing its Primary Equity Security on Nasdaq in connection with a Direct Listing, as defined in Nasdaq Rule IM-5315-1,⁴¹ would be permitted to list on: (i) the Nasdaq Global Select Market, provided that the Company meets all applicable listing requirements for the Nasdaq Global Select Market and the additional requirements of Nasdaq Rule IM-5315-1, or (ii) the Nasdaq Global Market, provided that the Company meets all applicable listing requirements for the Nasdaq Global Market and the additional requirements of Nasdaq Rule IM-5405-1.⁴² On the other hand, proposed Nasdaq Rule 5210(k)(iii) would provide

³⁹ See Notice, supra note 3, at 9553. The Exchange states that it found that out of seven business combinations involving Restrictive Market Companies from 2015 through September 30, 2020, five would not have qualified under proposed Nasdaq Rule 5210(k)(ii) to have a minimum Market Value of Unrestricted Publicly Held Shares following the business combination of \$25 million or 25% of the post-business combination entity's Market Value of Listed Securities, whichever is lower. The Exchange states that all five of these companies have been cited for a deficiency after the completion of their business combination. On the other hand, Nasdaq states that only one out of the two business combinations involving Restrictive Market Companies that would have qualified under proposed Nasdaq Rule 5210(k)(ii) during such period was cited for a compliance concern. See id.

⁴⁰ See id.

⁴¹ See supra note 22.

⁴² See Notice, supra note 3, at 9553.

that a Restrictive Market Company would not be permitted to list on the Nasdaq Capital Market in connection with a Direct Listing, notwithstanding the fact that the Company may meet the applicable initial listing requirements for the Nasdaq Capital Market and the additional requirements in Nasdaq Rule IM-5505-1.⁴³

The Exchange's rules currently set forth initial listing requirements for companies listing on the Nasdaq Global Select Market, Nasdaq Global Market, and Nasdaq Capital Market,⁴⁴ and additional listing requirements for Companies conducting a Direct Listing on such markets.⁴⁵ The Exchange states that it 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 because such companies would be subject to the additional listing requirements set forth in Nasdaq Rule IM-5315-1 or IM-5405-1, respectively.⁴⁶ On the other hand, the Exchange states that it does not believe that the additional requirements for Direct Listing on the Nasdaq Capital Market, set forth in Nasdaq Rule IM-5501-1, 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.⁴⁷

⁴³ See id.

⁴⁴ See Nasdaq Rules 5315, 5405, and 5505.

⁴⁵ See Nasdaq Rules IM-5315-1, IM-5405-1, and IM-5505-1.

⁴⁶ See Notice, supra note 3, at 9553.

⁴⁷ See id. As an example, the Exchange states that 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. See Nasdaq Rules 5315(e)(2), 5315(f)(2)(C), 5405(a)(2), and 5405(b)(1)(C). In contrast, the Nasdaq Capital Market only 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

III. Discussion and Commission Findings

The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.⁴⁸ In particular, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,⁴⁹ which requires, among other things, that the rules of a national securities exchange be 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, and are not designed to permit unfair discrimination between customers, issuers, brokers, or dealers.

The Exchange has proposed to adopt enhanced initial listing standards for Restrictive Market Companies conducting an IPO or engaged in a business combination in order to help assure the existence of adequate investor base and public float to support fair and orderly trading for securities issued by Restrictive Market Companies that are listing on the Exchange for the first time.⁵⁰ In addition, the Exchange has proposed to prohibit Direct Listings on Nasdaq Capital Market of securities issued by Restrictive Market Companies due to concerns regarding liquidity and fair and orderly trading.⁵¹ As stated by the Exchange, listed companies that are

million. See Nasdaq Rules 5505(a)(2) and 5505(b)(3)(C); Notice, supra note 3, at 9553, n.34.

⁴⁸ 15 U.S.C. 78f(b). In approving this proposed rule change, the Commission has considered the proposed rule change's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

⁴⁹ 15 U.S.C. 78f(b)(5).

⁵⁰ See supra notes 32 and 40 and accompanying text.

⁵¹ See supra note 47 and accompanying text.

based in jurisdictions that do not provide the PCAOB with access to conduct inspections of public accounting firms that audit Nasdaq-listed companies raise concerns regarding the accuracy of disclosures, accountability, and access to information with respect to such companies and 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.⁵² The Exchange also states that less liquid securities may be more susceptible to price manipulation and that, in particular, the risk of price manipulation due to insider trading is more acute with respect to Restrictive Market Companies, 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 Commission rules and professional standards in connection with its performance of audits.⁵³

Further, the Exchange states that 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.⁵⁴ The Exchange states 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 Commission rules and professional standards in connection with the auditor's performance of audits.⁵⁵ Absent reasonable assurances from an auditor that a company's financial statements and related

⁵² See supra notes 10-12 and accompanying text.

⁵³ See supra note 15 and accompanying text.

⁵⁴ See supra note 8 and accompanying text.

⁵⁵ See Notice, supra note 3, at 9554.

disclosures are free from material misstatements, the Exchange states that 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.⁵⁶ The Exchange therefore believes that 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 Restrictive Market Company, thereby preventing fraudulent and manipulative acts, protecting investors, and promoting the public interest.⁵⁷

The Commission has consistently recognized that the development and enforcement of meaningful listing standards for an exchange is of critical importance to financial markets and the investing public.⁵⁸ Among other things, the Commission has stated that 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 that have or will have sufficient public float, investor base, and trading interest likely to generate depth and liquidity sufficient to promote fair and orderly markets.⁵⁹ Meaningful listing standards are also important given

⁵⁶ See id.

⁵⁷ See id. See also Nasdaq Response Letter, supra note 17, at 3.

⁵⁸ See infra notes 59-60.

⁵⁹ See, e.g., Securities Exchange Act Release Nos. 81856 (October 11, 2017), 82 FR 48296, 48298 (October 17, 2017) (SR-NYSE-2017-31); 81079 (July 5, 2017), 82 FR 32022, 32023 (July 11, 2017) (SR-NYSE-2017-11); 65708 (November 8, 2011), 76 FR 70799, 70802 (November 15, 2011) ("SR-NASDAQ-2011-073 Approval Order"); 63607 (December 23, 2010), 75 FR 82420, 82422 (December 30, 2010) ("SR-NASDAQ-2010-137 Approval Order"); and 57785 (May 6, 2008), 73 FR 27597, 27599 (May 13, 2008) ("SR-NYSE-2008-17 Approval Order"). The Commission has stated that adequate listing standards, by promoting fair and orderly markets, are consistent with Section 6(b)(5) of the Act, in that they are, among other things, designed to prevent fraudulent and manipulative acts and practices, promote just and equitable principles of trade, and protect investors and the public interest. See, e.g., Securities Exchange Act Release Nos. 82627 (February 2, 2018), 83 FR 5650, 5653, n.53 (February 8, 2018) (SR-NYSE-2017-

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.⁶⁰

The Commission has also previously stated that when the PCAOB is unable to inspect auditors there is a lack of transparency with respect to the audit quality provided by such firms and that the inability of the PCAOB to inspect auditors of certain registrants could generate uncertainty regarding their financial reporting quality.⁶¹ The Commission has stated that, as a result, there is uncertainty regarding the reliability of the financial information of issuers audited by firms that are not inspected by the PCAOB, which can potentially lead to suboptimal investment decisions by investors.⁶² Given these heightened risks identified by the Commission with respect to issuers audited by firms that the PCAOB is unable to inspect, the Commission concludes that the Exchange's proposal to impose heightened listing requirements on companies that principally administer their business in a jurisdiction that does not provide the PCAOB with access to conduct inspections of public accounting firms that audit Nasdaq-listed companies (*i.e.*, Restrictive Market Companies) is consistent with the Act and not designed to permit unfair discrimination. Furthermore, the Commission believes that the objective criteria proposed by the Exchange for determining whether a company's business is principally administered in a

30); 87648 (December 3, 2019), 84 FR 67308, 67314, n.42 (December 9, 2019) (SR-NASDAQ-2019-059); and 88716 (April 21, 2020), 85 FR 23393, 23395, n.22 (April 27, 2020) (SR-NASDAQ-2020-001).

⁶⁰ See, e.g., SR-NASDAQ-2011-073 Approval Order, supra note 59, 76 FR at 70802; SR-NASDAQ-2010-137 Approval Order, supra note 59, 75 FR at 82422; and SR-NYSE-2008-17 Approval Order, supra note 59, 73 FR at 27599.

⁶¹ See Holding Foreign Companies Accountable Act Disclosure, Securities Exchange Act Release No. 91364 (March 18, 2021), 86 FR 17528 (April 5, 2021), at 17534, 17537.

⁶² See id. at 17534-35.

Restrictive Market⁶³ should help to ensure that the Exchange applies the heightened listing standards to companies in a manner that is not designed to permit unfair discrimination consistent with Section 6(b)(5) of the Act.

With respect to the proposed heightened initial listing standards, the Commission believes that the proposed requirements should allow the Exchange to more accurately determine whether a Restrictive Market Company conducting an IPO or a post-business combination entity involving a Restrictive Market Company does not have adequate distribution and liquidity and is thus not suitable for listing and trading on the Exchange. The Exchange has provided data showing that it has observed that Restrictive Market Companies listing on Nasdaq in connection with an IPO and post-business combination entities involving Restrictive Market Companies that did not meet the proposed listing requirements have more non-compliance issues than similar companies that would have met the proposed listing requirements.⁶⁴ The Commission has previously stated that a Firm Commitment Offering is designed to promote appropriate price discovery and assists in creating a liquid market.⁶⁵ In addition, the Commission believes that having a minimum Market Value of Unrestricted Publicly Held Shares requirement should allow an exchange to more accurately determine whether a security does not have adequate distribution and liquidity, and should therefore help to ensure that an exchange does not list securities that do not have a sufficient market, with adequate depth and liquidity, and without sufficient investor interest to support an exchange listing.⁶⁶ Thus, the Commission concludes that the proposals to

⁶³ See supra note 25 and accompanying text.

⁶⁴ See supra notes 33 and 39 and accompanying text.

⁶⁵ See also Securities Exchange Act Release No. 86314 (July 5, 2019), 84 FR 33102 (July 11 2019) (SR-NASDAQ-2019-009) (Order Approving Revisions to Nasdaq's Initial Listing Standards Related to Liquidity), at 33112.

⁶⁶ See id. at 33111.

require (i) 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 and (ii) a company conducting a business combination, as described in Nasdaq Rule 5110(a) or IM-5101-2, with a Restrictive Market Company, to have a minimum Market Value of Unrestricted Publicly Held Shares following the business combination, and the proposed thresholds for such requirements, are consistent with the requirements of Section 6(b)(5) of the Act that the rules of the exchange be designed to prevent fraudulent and manipulative acts and practices, promote just and equitable principles of trade, and protect investors and the public interest, and not be designed to permit unfair discrimination.

One commenter states that the proposal is insufficient to address the risk that a company may satisfy Nasdaq's listing standards by presenting financial statements that contain undetected material misstatements and that the proposed rules should include provisions that would prohibit Restrictive Market Companies, including companies listed prior to the effectiveness of the proposal, from engaging an auditor or an accounting firm that is located in a jurisdiction that limits the PCAOB's ability to inspect the auditor to assist with the company audit.⁶⁷ In addition, this commenter expresses concerns raised by academics regarding the vulnerability of U.S. investors to "low-ball 'take private' transactions" in Restricted Market Companies, where "[t]he goal is to delist U.S. shares at a depressed buyout price and then relist in [a Restricted Market] at a much loftier valuation."⁶⁸ This commenter states that Nasdaq should promptly limit the U.S.

⁶⁷ See Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors (February 18, 2021) ("CII Letter I"), at 4-5; Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors (May 27, 2021) ("CII Letter II"), at 1-4.

⁶⁸ See CII Letter II, *supra* note 67, at 3 (citing Jesse Fried & Matthew J. Schoenfeld, Delisting Chinese Firms: A Cure Likely Worse than the Disease, Harv. L. Sch. F. On

investor exposure to potentially unfair take-private transactions by adopting provisions to prevent the initial listing of Restrictive Market Companies.⁶⁹ In response, the Exchange states that, while the commenter may prefer a different proposal, the commenter's suggested proposal is not the Exchange's proposal that is currently before the Commission.⁷⁰ The Exchange states that, instead, to address the concerns Nasdaq has observed arising from the 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 Restrictive Markets, Nasdaq has proposed heightened liquidity requirements designed to ensure that Restrictive Market Companies have sufficient investor base and public float to support fair and orderly trading on the Exchange, which Nasdaq believes, as structured, are consistent with Section 6(b)(5) of the Act.⁷¹

The proposed provisions suggested by the commenter are not part of Nasdaq's proposal, and the Commission must approve the proposal if it finds that the proposal is consistent with the Act and rules thereunder. The Commission believes the Exchange's proposal is reasonably designed to help address compliance concerns regarding securities of Restrictive Market Companies and to help ensure fair and orderly trading when such companies list on Nasdaq.

The Commission concludes that it is consistent with the Act to prohibit Restrictive Market Companies from listing on the Nasdaq Capital Market in connection with a Direct Listing. In support of its proposal, the Exchange states that it does not believe the listing requirements for Direct Listings on the Nasdaq Capital Market set forth in Nasdaq's rules are

Corp. Governance (June 9, 2020), <https://corpgov.law.harvard.edu/2020/06/09/de-listing-chinese-firms-a-cure-like-ly-worse-than-the-disease/>).

⁶⁹ See *id.* at 3-4.

⁷⁰ See Nasdaq Response Letter, *supra* note 17, at 3.

⁷¹ See *id.*

sufficient to overcome the risks that Restrictive Market Companies present with respect to liquidity.⁷² Given the heightened concerns enumerated by the Commission regarding companies that cannot be inspected by the PCAOB,⁷³ the Commission believes that the proposal to prohibit Restrictive Market Companies from listing on the Nasdaq Capital Market in connection with a Direct Listing is consistent with the requirements of Section 6(b)(5) of the Act that the rules of the exchange be designed to prevent fraudulent and manipulative acts and practices, promote just and equitable principles of trade, and protect investors and the public interest, and not be designed to permit unfair discrimination.

In sum, the Commission concludes that the proposed new initial listing requirements for Restrictive Market Companies, including the prohibition on Direct Listings on Nasdaq Capital Market, will help maintain fair and orderly markets and are designed to protect investors and the public interest, and are not designed to permit unfair discrimination given the risks that Restricted Market Companies present, and should help the Exchange in determining whether a Restricted Market Company will not have a sufficient market, with adequate depth and liquidity, and sufficient investor interest to support listing on the Exchange. A Restrictive Market Company subject to the proposed initial listing requirements for an IPO or business combination would also need to comply with all other applicable listing requirements for the market tier on which it is listing.⁷⁴

Based on the foregoing, the Commission finds that the proposed rule change is consistent with the Act.

⁷² See supra note 47 and accompanying text. See also Nasdaq Rules 5505 and IM-5505-1.

⁷³ See supra notes 61-62 and accompanying text.

⁷⁴ See Nasdaq Rule 5000 Series.

VII. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,⁷⁵ that the proposed rule change (SR-NASDAQ-2021-007) be, and hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.⁷⁶

J. Matthew DeLesDernier
Assistant Secretary

⁷⁵ 15 U.S.C. 78s(b)(2).

⁷⁶ 17 CFR 200.30-3(a)(12).