

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-98659; File No. SR-NASDAQ-2023-022)

September 29, 2023

Self-Regulatory Organizations; The Nasdaq Stock Market LLC; Order Instituting Proceedings to Determine Whether to Approve or Disapprove a Proposed Rule Change to Create a New, Non-Trading Limited Underwriter Membership Class and Impose Related Requirements for Principal Underwriting Activity

I. Introduction

On July 12, 2023, 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 create a new, non-trading limited underwriter membership class and impose related requirements for principal underwriting activity in connection with a company applying for initial listing on the exchange with a transaction involving an underwriter. The proposed rule change was published for comment in the Federal Register on July 31, 2023.³ On September 12, 2023, pursuant to Section 19(b)(2) of the Exchange 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 The Commission has received no comment letters on the proposed rule change. The Commission is

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 97985 (July 25, 2023), 88 FR 49508 (July 31, 2023) (“Notice”).

⁴ 15 U.S.C. 78s(b)(2).

⁵ See Securities Exchange Act Release No. 99366, 88 FR 63999 (September 18, 2023). The Commission designated October 29, 2023, 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.

instituting proceedings pursuant to Section 19(b)(2)(B) of the Act⁶ to determine whether to approve or disapprove the proposed rule change.

II. Description of the Proposed Rule Change

Nasdaq states in its proposal that it recently issued an Equity Regulatory Alert⁷ that highlighted the important role of underwriters as gatekeepers in the initial public offerings (“IPO”) process and the applicability of market rules and the federal securities laws.⁸ Nasdaq states that notwithstanding the important role of underwriters, the Exchange does not currently require underwriters of companies that are going public on the Exchange to be Exchange members.⁹

Nasdaq therefore is proposing to amend its rules to create a new, limited membership class for those underwriters seeking only to perform underwriting activity as the principal underwriter on the Exchange¹⁰ (and not seeking access to trade via the Nasdaq Market Center)

⁶ 15 U.S.C. 78s(b)(2)(B).

⁷ <https://www.nasdaqtrader.com/MicroNews.aspx?id=ERA2022-9>.

⁸ Nasdaq also described that it had observed instances in the Fall of 2022 of unusually high price spikes immediately following the pricing of certain IPOs on the Exchange, mostly with respect to small-cap companies whose offerings were less than \$25 million. The IPOs that were the subject of these extreme price spikes then experienced equally dramatic price declines to a level at or below the offering price. See Notice, supra note 3, 88 FR at 49509.

⁹ See Nasdaq General Rules, General 1, Section 1(b)(11) for the definition of “member” or “Nasdaq Member”.

¹⁰ Under the proposal “Principal underwriter” is defined as having the same definition used in Rule 405 promulgated under the Securities Act of 1933 (“Securities Act”). Rule 405 under the Securities Act states that the term principal underwriter means an underwriter in privity of contract with the issuer of the securities as to which he is underwriter. Such definition provides that the term “issuer” in the definition of “principal underwriter” has the meaning given in Sections 2(4) and 2(11) of the Securities Act. 17 CFR 230.405.

and to require a company applying for initial listing in connection with a transaction involving an underwriter to have a principal underwriter¹¹ that is a member or limited member of Nasdaq.¹²

The Exchange proposes to amend its General Rules to add a definition of “Limited Underwriting Member” to General 1, Section 1, add rules concerning a new, limited underwriting membership to General 3, Section 1031¹³; and provide an exemption from registration for certain investment banking representatives associated solely with Limited Underwriting Members in General 4, Section 1230.¹⁴ The Exchange is also proposing to amend Equity 7, Section 10 to exempt Limited Underwriting Members from being assessed a trading rights fee. In addition, the Exchange proposes to amend Rule 5210 of the Listing Rules to impose a requirement that each Company applying for initial listing in connection with a transaction involving an underwriter have a principal underwriter that is a Member or Limited Underwriting Member.¹⁵

¹¹ The Exchange proposes to apply the requirements herein to a principal underwriter (defined as an underwriter in privity of contract with the issuer of the securities as to which he is underwriter) because the definition of principal underwriter points to the lead underwriter, who is generally responsible for organizing the offering, including tasks such as determining allocation of shares and the offering price, in conjunction with the issuer. Although offerings may require more than one underwriter, or a group of underwriters known as an underwriting syndicate, the Exchange proposes to focus on the lead underwriters given the substantial role they typically play in the offering process.

¹² See Notice, supra note 3, 88 FR at 49508.

¹³ Proposed General 3, Section 1031, among other things, sets forth the only rules, with certain exceptions, that Limited Underwriting Members and their associated persons would be subject to under the Exchange’s rules. In addition, Proposed General 3, Section 1031(c), among other things, requires Limited Underwriting Members and their Associated Persons to be members of FINRA. See note 48, infra, and accompanying text.

¹⁴ See Notice, supra note 3, 88 FR at 49508-09.

¹⁵ Id. at 49509. The Exchange states that the proposed rule change primarily impacts membership rules and other non-listing rules, which would apply to the underwriters themselves. Id.

As part of the proposal, as stated above, Nasdaq would impose a new requirement in its Listing Rules at 5210(l), requiring each Company applying for initial listing in connection with a transaction involving an underwriter to have a principal underwriter that is a Member or Limited Underwriting Member of Nasdaq.¹⁶ In proposed Nasdaq Rule 5210(l), the Exchange would also specify that “principal underwriter” shall have the same definition used in Rule 405 promulgated under the Securities Act.¹⁷

Within its General Rules, as described in more detail below, the Exchange is proposing to amend General 1 (General Provisions), General 3 (Membership and Access), and General 4 (Registration Requirements).

The Exchange proposes to add the definition of Limited Underwriting Member to General 1, Section 1 (Definitions) and defines Limited Underwriting Member to mean a broker or dealer admitted to limited underwriting membership in Nasdaq.¹⁸

The Exchange proposes to add the new category of membership to General 3, Section 1031, within which the Exchange proposes to include information about persons eligible to become Limited Underwriting Members, Limited Underwriting Member access to the Exchange, and rules applicable to Limited Underwriting Members.¹⁹

The Exchange would specify in General 3, Section 1031(a), that (i) any registered broker or dealer shall be eligible for limited underwriting membership in the Exchange, except such registered brokers or dealers as are excluded under paragraph (b) of Rule 1002;²⁰ and (ii) any

¹⁶ Id.

¹⁷ Id. See also note 8, supra. Proposed Nasdaq Rule 5210(l) also cross references Proposed General 1, Section 1(b) that is described below.

¹⁸ Id. See also Proposed Nasdaq Rule General 1, Section 1(b).

¹⁹ Id. See also Proposed Nasdaq Rule General 3, Section 1031(a).

²⁰ Id. In relevant part, General 3, Section 1002(b) provides that, subject to certain

person shall be eligible to become an Associated Person of a Limited Underwriting Member, except such persons as are excluded under paragraph (b) of Rule 1002.²¹ The Exchange states in its proposal that Proposed Rule 1031(a) is consistent with the existing rules for persons eligible to become Members and Associated Persons in General 3, Rule 1002(a).²²

Further, proposed General 3, Section 1031(b) states that (i) a limited underwriting membership provides no rights to transact on the Exchange and (ii) a limited underwriting membership is solely to allow a firm that is not otherwise a Member to serve as a principal underwriter, pursuant to the requirement in Rule 5210(l), for a Company applying to list on the Exchange.²³

The Exchange states that it is proposing to apply a limited ruleset to its newly proposed limited membership class.²⁴ Specifically, in proposed Nasdaq Rule General 3, Section

exceptions, no registered broker or dealer shall be admitted to membership, and no Member shall be continued in membership, if such broker, dealer, or Member fails or ceases to satisfy the qualification requirements established by the Rules, or if such broker, dealer, or Member is or becomes subject to a statutory disqualification, or if such broker, dealer, or Member fails to file such forms as may be required in accordance with such process as the Exchange may prescribe. See also Proposed Nasdaq Rule General 3, Section 1031(a). Under Proposed General 3(c)(2) Limited Underwriter Members and their associated persons must also be a member of FINRA at all times.

²¹ Id. at 49510. The Exchange states in its proposal that in relevant part, General 3, Section 1002(b) provides that, subject to such exceptions as may be explicitly provided elsewhere in the Rules, no person shall become associated with a Member, continue to be associated with a Member, or transfer association to another Member, if such person fails or ceases to satisfy the qualification requirements established by the Rules, or if such person is or becomes subject to a statutory disqualification; and no broker or dealer shall be admitted to membership, and no Member shall be continued in membership, if any person associated with it is ineligible to be an Associated Person under this subsection. Id.

²² Id.

²³ Id.

²⁴ Id. Members of the Exchange, unlike Limited Underwriting Members, are subject to all of the Exchange's Rules (which includes the limited ruleset applicable to the newly proposed limited membership class). Id.

1031(c)(1) the Exchange is proposing to apply only the following rules to Limited Underwriting Members with certain exceptions: General 1 (General Provisions); General 2 (Organization and Administration), with the exception of Sections 6(a) and 22; General 3 (Membership and Access); General 4 (Registration Requirements); General 5 (Discipline), with the exception of Rules 8211 and 9557; General 9 (Regulation), Sections 1 and 20; and Equity 7, Section 10 (Pricing Schedule, Membership Fees).²⁵ The Exchange would specify the aforementioned rules applicable to this new membership class in General 3, Section 1031(c)(1).²⁶ The Exchange states that with the proposal, it “aims to apply only those rules it deems appropriate to a firm serving as a principal underwriter, including those rules it deems critical to such firms.”²⁷

The Exchange states that it proposes to apply General 1 to Limited Underwriting Members because General 1 provides defined terms that would be applicable to Limited Underwriting Members and, as explained above, the proposed rule change would also add a definition (Limited Underwriting Member) to General 1.²⁸

The Exchange proposes to apply General 2 (with the exception of Sections 6(a) and 22) to Limited Underwriting Members because General 2 relates to organization and administration including requirements surrounding fees, limitations on affiliations, and a requirement for an

²⁵ Id.

²⁶ Id.

²⁷ Id.

²⁸ Id.

executive representative, among other obligations.²⁹ The Exchange proposes to specifically exclude General 2, Sections 6(a)³⁰ and Section 22.³¹

The Exchange also states that it is proposing to subject Limited Underwriting Members to General 3 because General 3 contains membership rules, including an obligation to follow specified procedures for applying to be a member, making changes to membership, or terminating membership.³² The proposed rule change would also add additional details regarding the limited underwriting membership to Proposed General 3, Rule 1031.³³

The Exchange proposes to apply General 4 to Limited Underwriting Members, which includes registration requirements that are applicable to Limited Underwriting Members.³⁴ However, the Exchange is also proposing, in proposed General 4, Section 1230(4), to exempt from the requirement to register, with the Exchange, those persons associated solely with a Limited Underwriting Member whose functions are related solely and exclusively to underwriting if such persons are registered with FINRA as an Investment Banking Representative³⁵.

²⁹ Id.

³⁰ General 2, Section 6(a) states that General Equity and Options Rules and Equity Rules shall apply to all Members and persons associated with a Member, which the Exchange states is not accurate in the case of Limited Underwriting Members. Id.

³¹ Id. General 2, Section 22 relates to Sponsored Participants and client access to the Nasdaq Market Center via a Member, which the Exchange states is not applicable to underwriting activity.

³² Id.

³³ Id.

³⁴ Id.

³⁵ Id. at 49511. In FINRA Rule 1220(b)(5), FINRA describes the requirement for representatives to register as an “Investment Banking Representative” if his or her activities in the investment banking or securities business of a member involve: (i) advising on or facilitating debt or equity securities offerings through a private placement or a public offering, including but not limited to origination, underwriting, marketing,

Under the proposal, the rules in General 5 will apply to Limited Underwriter Members with two exceptions. The Exchange stated its belief that it is critical to subject Limited Underwriting Members to General 5 (with the exception of Rules 8211 and 9557), which contains the Exchange’s disciplinary rules.³⁶ In particular, Nasdaq states that General 5, Rule 8210 provides the Exchange with authority to require information from Exchange Members.³⁷ The Exchange proposes to specifically exclude General 5, Rule 8211 and Rule 9557.³⁸ Rule 8211 relates to members submission of trade data and Rule 9557 relates to procedures for regulating activities under General 9, Sections 40 and 41, which incorporate FINRA Rules 4110 and 4120, which relate to FINRA carrying or clearing members.³⁹ The Exchange stated that it does not believe that Rule 8211 and Rule 9557 are relevant to underwriting activity.⁴⁰

The Exchange proposes to require Limited Underwriting Members to comply with only two sections of General 9: Sections 1 and 20. The Exchange stated that it believes it is important to subject Limited Underwriting Members to General 9, Section 1 which includes general

structuring, syndication, and pricing of such securities and managing the allocation and stabilization activities of such offerings, or (ii) advising on or facilitating mergers and acquisitions, tender offers, financial restructurings, asset sales, divestitures or other corporate reorganizations or business combination transactions, including but not limited to rendering a fairness, solvency or similar opinion. Id.

³⁶ Id. at 49510. General 5, Rule 8001 provides that the Exchange and FINRA are parties to the FINRA Regulatory Contract (often referred to as a Regulatory Services Agreement (“RSA”)) pursuant to which FINRA has agreed to perform certain functions described in the Exchange’s Rules on behalf of the Exchange. The Exchange states that it does not anticipate that the proposed rule change would have any material impact on the current RSA. Id.

³⁷ Id. at 49511.

³⁸ Id.

³⁹ Id.

⁴⁰ Id.

standards by which Members must abide.⁴¹ In particular, General 9, Section 1(a) requires Members to observe just and equitable principles of trade.⁴² Additionally, the proposal would require Limited Underwriting Members to comply with General 9, Section 20 which requires Members to establish and maintain a system to supervise the activities of each registered representative and associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations and with applicable Nasdaq rules.⁴³

The Exchange also proposes to include Equity 7, Section 10 to Limited Underwriting Members because this section includes the membership and application fees applicable to Limited Underwriting Members.⁴⁴ However, because Limited Underwriting Members would not be able to trade on the Exchange, the Exchange is proposing to add language to Equity 7, Section 10(a) to specify that Limited Underwriting Members would not be charged the monthly trading rights fee.⁴⁵ Limited Underwriting Members would be subject to a \$2,000 application fee under Equity 7, Section 10(b) and a \$3,000 yearly membership fee under Equity 7, Section 10(a).⁴⁶

The Exchange states that it proposes to avoid applying all those Exchange rules not specified in proposed General 3, Section 1031(c)(1) to Limited Underwriting Members in an

⁴¹ Id.

⁴² Id.

⁴³ Id. The Exchange stated that it believes it is important to apply General 9, Section 20 because it would provide the Exchange with authority to assess whether a Limited Underwriting Member has an adequate supervisory system and written supervisory procedures in place. Id.

⁴⁴ Id.

⁴⁵ Id.

⁴⁶ Id.

effort to impose minimal burden on Limited Underwriting Members, while still allowing the Exchange to have regulatory authority over such members.⁴⁷

The Exchange also proposes to include a requirement, in General 3, Section 1031(c)(2), that Limited Underwriting Members and their Associated Persons shall at all times be members of FINRA.⁴⁸ The Exchange also has proposed to add to General 3, Section 1031(c)(1) language stating that for purposes of interpreting and applying the rules set forth in the proposal and described above that apply to Limited Underwriting Members references to “Member,” “Members,” or “membership” shall be functionally equivalent to “Limited Underwriting Member,” “Limited Underwriting Members,” or “limited underwriting membership” respectively.⁴⁹

Lastly, the Exchange would designate the proposed changes to be operative 60 days after publication of the Commission’s approval order of SR-NASDAQ-2023-022 in the Federal Register.⁵⁰ The Exchange stated that it believes this delay will allow time for firms involved with upcoming IPOs to become Limited Underwriting Members, if they choose, and for

⁴⁷ Id. The Exchange also states generally that it believes the rules that Limited Underwriting Members would not be subject to under its proposal primarily relate to trading activity so therefore in its view are not relevant.

⁴⁸ Id. at 49510-11. Limited Underwriting Members would, therefore, be eligible to waive-in to Exchange membership, as provided for in General 3, Section 1013(b). Prospective Limited Underwriting Members would need to submit a membership application (see supra note 9) in which they would select “Waive-In Membership” for the application type and “Limited Underwriting Member of NQX” for the nature of intended activity. For “waive-in” applicants, the Exchange relies substantially upon FINRA’s determination to approve the applicant for FINRA membership when the Exchange evaluates the applicant for Exchange membership. Id.

⁴⁹ Id. at 49510.

⁵⁰ Id. at 49511.

companies planning IPOs to select alternative underwriters if their current firm is not, and does not intend to become, a Member or Limited Underwriting Member.⁵¹

III. Proceedings to Determine Whether to Approve or Disapprove SR-NASDAQ-2023-022 and Grounds for Disapproval Under Consideration

The Commission is instituting proceedings pursuant to Section 19(b)(2)(B) of the Act⁵² to determine whether the proposed rule change should be approved or disapproved. Institution of such proceedings is appropriate at this time in view of the legal and policy issues raised by the proposed rule change. Institution of proceedings does not indicate that the Commission has reached any conclusions with respect to any of the issues involved. Rather, as described below, the Commission seeks and encourages interested persons to provide additional comment on the proposed rule change to inform the Commission's analysis of whether to approve or disapprove the proposed rule change.

Pursuant to Section 19(b)(2)(B) of the Act,⁵³ the Commission is providing notice of the grounds for disapproval under consideration. As described above, the Exchange has proposed to create a new, non-trading, limited underwriter membership class and impose related requirements for principal underwriting activity in connection with a company applying for initial listing on the Exchange with a transaction involving an underwriter. The Commission is instituting proceedings to allow for additional analysis of, and input from commenters with respect to, the proposed rule change's consistency with the Act, and in particular, Section 6(b)(5) of the Act, 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

⁵¹ Id.

⁵² 15 U.S.C. 78s(b)(2)(B).

⁵³ Id.

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.⁵⁴

Specifically, the Commission believes there are questions as to whether there is sufficient information and justification in the proposal as to those rules that are being excluded from applying to Limited Underwriter Members as well as those rules that the Exchange proposes to make applicable to Limited Underwriter Members. The Commission therefore believes that there are questions as to whether the Exchange has provided sufficient information to demonstrate that the proposal is consistent with Section 6(b)(5) of the Act.⁵⁵

Under the Commission's Rules of Practice, the "burden to demonstrate that a proposed rule change is consistent with the Exchange Act and the rules and regulations issued thereunder ... is on the self-regulatory organization ['SRO'] that proposed the rule change."⁵⁶ The description of a proposed rule change, its purpose and operation, its effect, and a legal analysis of its consistency with applicable requirements must all be sufficiently detailed and specific to support an affirmative Commission finding,⁵⁷ and any failure of an SRO to provide this information may result in the Commission not having a sufficient basis to make an affirmative finding that a proposed rule change is consistent with the Exchange Act and the applicable rules and regulations.⁵⁸

⁵⁴ 15 U.S.C. 78f(b)(5).

⁵⁵ Id.

⁵⁶ Rule 700(b)(3), Commission Rules of Practice, 17 CFR 201.700(b)(3).

⁵⁷ Id.

⁵⁸ Id.

For these reasons, the Commission believes it is appropriate to institute proceedings pursuant to Section 19(b)(2)(B) of the Exchange Act⁵⁹ to determine whether the proposal should be approved or disapproved.

IV. Procedure: Request for Written Comments

The Commission requests that interested persons provide written submissions of their data, views, and arguments with respect to the issues identified above, as well as any other concerns they may have with the proposal. In particular, the Commission invites the written views of interested persons concerning whether the proposed rule change is consistent with Sections 6(b)(5) or any other provision of the Act, or the rules and regulations thereunder. Although there do not appear to be any issues relevant to approval or disapproval that would be facilitated by an oral presentation of data, views, and arguments, the Commission will consider, pursuant to Rule 19b-4 under the Act,⁶⁰ any request for an opportunity to make an oral presentation.⁶¹

Interested persons are invited to submit written data, views, and arguments regarding whether the proposed rule change should be approved or disapproved by [INSERT DATE 21 DAYS AFTER DATE OF PUBLICATION IN THE *FEDERAL REGISTER*]. Any person who wishes to file a rebuttal to any other person's submission must file that rebuttal by [INSERT DATE 35 DAYS AFTER DATE OF PUBLICATION IN THE *FEDERAL REGISTER*]. The

⁵⁹ 15 U.S.C. 78s(b)(2)(B).

⁶⁰ 17 CFR 240.19b-4.

⁶¹ Section 19(b)(2) of the Act, as amended by the Securities Acts Amendments of 1975, Public Law 94-29 (Jun. 4, 1975), grants to the Commission flexibility to determine what type of proceeding—either oral or notice and opportunity for written comments—is appropriate for consideration of a particular proposal by a self-regulatory organization. See Securities Acts Amendments of 1975, Senate Comm. on Banking, Housing & Urban Affairs, S. Rep. No. 75, 94th Cong., 1st Sess. 30 (1975).

Commission asks that commenters address the sufficiency of the Exchange's statements in support of the proposal, in addition to any other comments they may wish to submit about the proposed rule change.

Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (<https://www.sec.gov/rules/sro.shtml>); or
- Send an email to rule-comments@sec.gov. Please include File Number SR-NASDAQ-2023-022 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-2023-022. 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 (<https://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 a.m. and 3 p.m. Copies of the filing also will be available for inspection and copying at the principal office of the Exchange. Do not include personal identifiable information in submissions; you should

submit only information that you wish to make available publicly. We may redact in part or withhold entirely from publication submitted material that is obscene or subject to copyright protection. All submissions should refer to file number to File Number SR-NASDAQ-2023-022 and should be submitted by [INSERT DATE 21 DAYS AFTER DATE OF PUBLICATION IN THE *FEDERAL REGISTER*].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.⁶²

Sherry R. Haywood,

Assistant Secretary.

⁶² 17 CFR 200.30-3(a)(57).