

Nasdaq Stock Market to Apply Additional Criteria for Initial and Continued Listing

Nasdaq Stock Market has recently released two new Frequently Asked Questions (FAQs 416 and 1696) in connection with the particular circumstances under which Nasdaq will apply additional and more stringent criteria as part of its review of initial and continued listings. This memorandum discusses the FAQs and relevant Nasdaq listing rules.

Additional and More Stringent Criteria (FAQ 416)

Pursuant to Nasdaq Rule 5101 (the “Rule”), 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 apply additional or more stringent criteria for the initial or continued listing of particular securities. Nasdaq, based on its review of the application, may even deny, 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.

The Rule further provides that Nasdaq may deny initial or continued listing to a company when

- an individual with a history of regulatory misconduct is associated

with the company. Such individuals are typically an officer, director, substantial security holder or consultant to the company;

- a company files for bankruptcy protection;
- a company's independent auditors issue a disclaimer opinion on the financial statements that are required to be audited or when financial statements do not contain a required certification;
- a company fails to submit requested information, or makes any communication to Nasdaq containing a material misrepresentation or omits material information necessary to make a communication to Nasdaq not misleading.

Nasdaq has indicated that it will use its discretion to apply additional and more stringent criteria resulting in the denial of initial or continued listing in the following instances:

- Where the company plans a public offering resulting in insiders holding a large portion of the company's listed securities, the offering size was insufficient to establish the company's initial valuation, and there would not be sufficient liquidity to support a public market. See “*Compliance with the Minimum Round Lot Shareholder Requirement for Initial Listing*” and “*Nasdaq's Proposed Changes to the Listing Rules*” below.
- Where the company did not demonstrate sufficient nexus to the

U.S. capital market, including having no U.S. shareholders, operations or members of the board of directors or management.

- Based on the embryonic nature of the company's business, where the company had not commenced operations and would turn over most proceeds from its IPO to third parties to advance the company's business plan.
- Where the company failed to make any meaningful progress on its business plan two years after listing and had not generated any revenue. Where the company's management did not appear to have adequate prior public company experience or an understanding of the requirements to be a public company listed on Nasdaq.
- Where the company engaged an auditor that has not been subject to an inspection by the Public Company Accounting Oversight Board (PCAOB), an auditor that PCAOB cannot inspect, or an auditor that has not demonstrated sufficient resources, geographic reach or experience to adequately perform the company's audit. See section "*Additional Criteria Based on a Company's Auditor*" below.

Additional Criteria Based on a Company's Auditor (FAQ 1696)

With respect to Nasdaq's review of the company's auditor, Nasdaq may require information relating to:

- 1) whether the company's audit firm has been inspected by the PCAOB, the

results of that inspection, and whether the auditor has failed to respond to any requests by the PCAOB;

- 2) whether the audit firm can demonstrate that it has adequate personnel in the offices participating in the audit with expertise in applying U.S. GAAP and GAAS in the company's industry;
- 3) the scope of the firm's training program for personnel participating in the company's audit; and
- 4) for non-U.S. firms, whether the firm is part of a global network or other affiliation of individual firms, where the firms draw on globally common technologies, tools, methodologies, training and quality assurance monitoring.

When the PCAOB cannot inspect a company's auditor, Nasdaq may use its discretionary authority to obtain comfort that the company satisfies the financial listing requirements and is suitable for listing (e.g. higher equity, assets, or earnings). Nasdaq could also require that any offering be underwritten on a firm commitment basis and companies to impose lock-up restrictions on officers and directors to allow market mechanisms to determine an appropriate price for the company before such insiders can sell shares.

In addition, Nasdaq would typically deny listing or delist a company if the company's auditor is newly formed and has therefore not yet undergone a PCAOB inspection cycle or if the company's auditor otherwise does not demonstrate sufficient resources, geographic reach or experience as it relates to the company's audit, including in circumstances

where a PCAOB inspection has uncovered significant deficiencies in the audit firms' conduct in other audits or in its system of quality controls.

Compliance with the Minimum Round Lot Shareholder Requirement for Initial Listing (FAQ 1415)

Nasdaq requires at least 300 round lot holders for listing on the Nasdaq Capital Market. Nasdaq will aggregate information on shareholders lists for accounts held by the same person to eliminate duplicates from the count, including individual and retirement accounts for the same person. Nasdaq may also aggregate accounts that appear to represent a single investment decision, such as separate accounts for an individual and his or her minor children. In general, Nasdaq will seek to insure that each account represents a separate investment decision by a bona fide holder and, for this reason, would also exclude accounts that only hold shares that were given as gifts or for minimal consideration to the holder, especially if such gifts were made to allow the company to satisfy Nasdaq's listing requirements.

Nasdaq's Proposed Changes to the Listing Rules

On April 3, 2019, Nasdaq proposes to the Securities and Exchange Commission (the "SEC") to revise its initial listing standards to increase Nasdaq's requirement for initial listing and help assure adequate liquidity for listed securities (Release No. 34-85503; File No. SR-NASDAQ-2019-009). The proposed rule changes have been published to solicit comments. They have not been adopted as of the date of this memorandum.

I. *Nasdaq proposes to exclude restricted securities from the Exchange's calculations of a company's publicly held shares, market value of publicly held shares and round lot holders ("Initial Liquidity Calculations"). To do so, Nasdaq proposes to amend or add new definitions.*

Currently, securities subject to resale restrictions are included in the Exchange's Initial Liquidity Calculations, however, such securities are not freely transferrable or available for outside investors to purchase and therefore do not truly contribute to a security's liquidity upon listing.

To address this concern, Nasdaq proposes to adopt three new definition:

- 1) "restricted securities" shall mean any securities subject to resale restrictions for any reason, including restricted securities (1) acquired directly or indirectly from the issuer or an affiliate of the issuer in unregistered offerings such as private placements or Regulation D offerings; (2) acquired through an employee stock benefit plan or as compensation for professional services; (3) acquired in reliance on Regulation S, which cannot be resold within the United States; (4) subject to a lockup agreement or a similar contractual restriction; or (5) considered "restricted securities" under Rule 144.
- 2) "unrestricted shares" to mean securities of a company that are not restricted securities.

- 3) “round lot holder” to mean a holder of a normal unit of trading of unrestricted securities. As a result of these changes, a holder of only restricted securities would not be considered in the round lot holder count.

As a result of the new proposed definitions, only securities that are freely transferrable will be included in the calculation of publicly held shares and market value of publicly held shares to determine whether a company satisfies the Exchange’s initial listing criteria. Nasdaq believes that excluding restricted securities will better reflect the liquidity of, and investor interest in, a security and therefore will better protect investors.

- II.** *Nasdaq proposes to impose a new requirement that at least 50% of a company’s round lot holders must each hold shares with a market value of at least \$2,500.*

Nasdaq proposes to impose a new requirement of the minimum investment amount held by shareholders. For initial listing, at least 50% of a company’s required round lot holders must each hold shares with a market value of at least \$2,500. Nasdaq does not propose to impose this requirement on initial listings of warrants.

- III.** *Nasdaq proposes to require a minimum average daily trading volume for securities trading over-the-counter (“OTC”) at the time of their listing.*

For a company uplisting from the OTC, Nasdaq seeks to require such company’s securities to have a minimum average daily trading volume over the 30 trading days prior to listing of at least 2,000 shares a day, with trading occurring on more than half of those 30 days (i.e., at least 16 days).

Nasdaq proposes to adopt an exemption from the proposed average daily trading volume requirement for securities (including ADRs) listed in connection with a firm commitment underwritten public offering of at least \$4 million.

AUTHOR’S FINAL THOUGHT

For public interest reasons, Nasdaq Stock Market exercises its broad discretion on listing, suspending and delisting companies. Through its latest FAQs, Nasdaq attempts to explain its plans to increase its review process specifically with respect to small-cap and/or non-U.S. issuers. The additional criteria may be applied on a case-by-case basis. Any potential issuer should consider these factors even when it meets all enumerated criteria for initial or continued listing on Nasdaq. While the above rule changes submitted to the SEC are in the proposal stage, the author advises that any issuer considering a Nasdaq listing should apply such rules as if they were in effect.

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