



## Nasdaq Proposes Fortifying Listing Rules, Potentially Curbing Listings of Chinese Companies

MAY 28, 2020

### ***Nasdaq Moves to Impose Stricter Requirements for Companies from “Restrictive Markets”***

In May 2020, Nasdaq filed three proposals with the Securities and Exchange Commission (SEC) intended to address concerns about companies that have their businesses principally administered in certain jurisdictions defined by Nasdaq as “Restrictive Markets” (including China) looking to go public or become listed on Nasdaq. The proposals relate to auditors, initial listing criteria for foreign companies, and management’s qualifications.

All three proposals apply to companies that have their businesses principally administered in Restrictive Markets, which are defined as jurisdictions that have:

- secrecy laws,
- blocking statutes,
- national security laws, or
- other laws and regulations restricting access to information by regulators of U.S.-listed companies in those jurisdictions.

To determine where a company is “principally administered” from, Nasdaq may consider the geographic location of:

- principal business segments,
- operations, or assets,
- board and shareholders’ meetings,
- headquarters or principal executive offices, senior management and employees, and
- books and records.

Below, we discuss each proposal and their potential effects on Nasdaq applicants and listed companies – including Chinese companies looking to access the U.S. capital markets through an initial public offering (IPO) or business combination listed on Nasdaq.

### ***Inspecting Audit Work and Practices in Certain Countries***

NASDAQ RULE

RULE CHANGE

NASDAQ RULE	RULE CHANGE
5101, 5005(a)(37), 5005(a)	<p><b>Audit Concerns</b></p> <p>Clarify that Nasdaq may use its existing discretionary authority under Rule 5101 to deny initial or continued listing or to apply stringent criteria to an applicant or listed company based on qualifications of the company's auditor by setting forth factors to consider, including:</p> <ol style="list-style-type: none"> <li>1. Whether the auditor has been subject to a Public Company Accounting Oversight Board ("PCAOB") inspection (such as formed and has not yet had a PCAOB inspection or where the auditor is located in a jurisdiction that limits the PCAOB's authority over the auditor);</li> <li>2. If the company's auditor has been inspected by the PCAOB, whether the results of that inspection indicate that the auditor is responsive to any requests by the PCAOB or that the inspection has uncovered significant deficiencies in the auditor's conduct in the system of quality controls;</li> <li>3. Whether the auditor can demonstrate that it has adequate personnel in the offices participating in the audit with expertise in GAAS, or IFRS in the company's industry;</li> <li>4. Whether the auditor's training program for personnel in the offices participating in the audit is adequate;</li> <li>5. For non-U.S. auditors, whether the auditor is part of a global network of auditors where the auditors draw on globally consistent methodologies, training, and quality assurance monitoring; and</li> <li>6. Whether the auditor can demonstrate to Nasdaq sufficient resources, geographic reach, or experience as it relates to the audit. Nasdaq will consider these factors holistically and may be satisfied with an auditor's qualifications notwithstanding the factors listed above.</li> </ol> <p>Examples of additional and more stringent criteria Nasdaq may apply to obtain comfort that a company satisfies the financial requirements for listing could include requiring:</p> <ul style="list-style-type: none"> <li>• higher equity, assets, earnings, or liquidity measures than otherwise required under the Rule 5000 Series;</li> <li>• that any offering be underwritten on a firm commitment basis (typically involving more due diligence by the broker-dealer than a best-efforts offering); or</li> <li>• companies to impose lock-up restrictions on officers and directors to allow market mechanisms to determine appropriate price before insiders can sell their shares.</li> </ul> <p><b>Other Use of Discretionary Authority</b></p> <p>Nasdaq noted that the risk to investors is greater when a company's business is principally administered in a Restrictive Market. Nasdaq is amending Rule 5101 to allow Nasdaq to use its discretionary authority to impose additional or more stringent criteria when a company has its business principally administered in a Restrictive Market (a "Restrictive Market Company").</p> <p>Nasdaq believes that the proposed rules recognize that one size does not fit all companies and provide Nasdaq with flexibility to apply the rules on a case-by-case basis, based on the listed company's specific circumstances with respect to its auditor's qualifications and the company principally administers its business. Under Nasdaq's existing rules, Nasdaq is willing to discuss with listed companies on a case-by-case basis, what remedial measures may be appropriate to address Nasdaq's public interest concerns, and for how long such measures would be required. In the event Nasdaq staff issues a delisting determination, the company may appeal the decision through the appeal process.</p>

*Initial Listing Criteria for Foreign Companies*

NASDAQ RULE	RULE CHANGE
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5101, 5210(k)(i), 5210(k)(ii), 5210(k)(iii)	<p><b>Minimum Offering Size/Public Float - IPOs</b> Amended Rule 5210(k)(i) would require a Restrictive Market Company listing its securities on Nasdaq in connection with its IPO to offer a minimum amount of securities in a firm commitment underwritten offering in the U.S. to public holders that will result in the lower of either:</p> <ul style="list-style-type: none"> <li>• Gross proceeds of at least \$25 million; or</li> <li>• At least 25% of the company's post-offering market value of listed securities being sold in the offering.</li> </ul> <p><b>Minimum Market Value – Business Combinations</b> New Rule 5210(k)(ii) would impose similar minimum requirements applicable to IPOs by Restrictive Market Companies to business combinations involving a Restrictive Market Company, but would reflect that the listing for a business combination would usually not be accompanied by an offering. The new rule would require that the listed company have a minimum market value of unrestricted publicly held shares following the business combination equal to the lesser of:</p> <ul style="list-style-type: none"> <li>• \$25 million; or</li> <li>• 25% of the post-business combination entity's market value of listed securities.</li> </ul> <p>The market value of unrestricted publicly held shares excludes securities subject to resale restrictions, because these securities are not freely transferable or available for outside investors to purchase and do not contribute to the security's liquidity.</p> <p><b>Direct Listings</b> Although all companies listing in connection with a direct listing are already subject to additional and more stringent listing standards, new Rule 5210(k)(iii) would permit Restrictive Market Companies listing in connection with a direct listing to list on the Nasdaq Global Select or Nasdaq Global Markets but would prohibit listing on the Nasdaq Capital Market in connection with a direct listing.</p>

#### *Management's Qualifications*

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5210(c), 5250(g), 5810	<p><b>New Listing Standards</b> New Rule 5210(c) would require that applicants from Restrictive Markets:</p> <ul style="list-style-type: none"> <li>• have a member of senior management or a director with relevant past employment experience at a U.S.-listed public company or other experience, training, or background which results in the individual's general familiarity with the regulatory and reporting requirements for U.S.-listed public companies under Nasdaq rules and federal securities laws; or</li> <li>• retain an advisor, or advisors, acceptable to Nasdaq that will provide such guidance to the company.</li> </ul> <p>Once they meet the requirements of Rule 5210(f) and are listed, these Restricted Market Companies would be subject to new Rule 5250(g), which codifies the ongoing obligation for Restrictive Market Companies to continue to meet the same management qualification requirements as described above for Rule 5210(c).</p> <p>Restrictive Market Companies listed prior to the effectiveness of new Rules 5210(c) and 5250(g) would not be subject to the new management qualification requirements.</p> <p><b>Compliance Plans</b> Amended Rule 5810 would allow Restrictive Market Companies that are subject to, but do not maintain compliance with, these management qualification requirements to provide Nasdaq staff with a plan to regain compliance.</p> <p>Nasdaq staff would generally be able to allow, based on its review of the company's plan, a company up to 180 days to regain compliance, but the company would be required to disclose that it does not meet this requirement to alert investors to the heightened risk.</p>

#### *Effect of the Proposals*

While the proposed Nasdaq rules do not on their face specifically target China and Chinese companies, media reports note that Chinese companies will be among the greatest affected as Chinese companies have increasingly accessed the U.S. capital markets through the Nasdaq stock exchange in recent years. The proposed Nasdaq rules were issued amidst an environment of increased focus by the SEC and Congress on the lack of transparency on the

financial statements of Chinese companies – in particular, following the disclosure of accounting fraud by Luckin Coffee, a Chinese company previously listed on Nasdaq.

### **Congressional Action**

Congress is taking legislative action aimed at increasing the transparency of the accounting of foreign listed companies. The Senate passed a [bill](#) on May 20, 2020, to require the delisting of companies that have not had a PCAOB inspection of their auditors for three consecutive years and to require disclosure regarding foreign government ownership in the listed company, as well as the membership of any official of the Chinese Communist Party on its Board of Directors. The House of Representatives is expected to take up the issue in the near future. We are monitoring the legislative developments and will continue to provide updates on [Winston's Capital Markets & Securities Law Watch](#).

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