

Required fields are shown with yellow backgrounds and asterisks.

Page 1 of * <input type="text" value="44"/>	SECURITIES AND EXCHANGE COMMISSION WASHINGTON, D.C. 20549 Form 19b-4	File No.* SR - <input type="text" value="2020"/> - * <input type="text" value="028"/>	Amendment No. (req. for Amendments *) <input type="text"/>
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Filing by The Nasdaq Stock Market LLC  
Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934

Initial * <input checked="" type="checkbox"/>	Amendment * <input type="checkbox"/>	Withdrawal <input type="checkbox"/>	Section 19(b)(2) * <input checked="" type="checkbox"/>	Section 19(b)(3)(A) * <input type="checkbox"/>	Section 19(b)(3)(B) * <input type="checkbox"/>
			Rule		
Pilot <input type="checkbox"/>	Extension of Time Period for Commission Action * <input type="checkbox"/>	Date Expires * <input type="text"/>	<input type="checkbox"/> 19b-4(f)(1)	<input type="checkbox"/> 19b-4(f)(4)	<input type="checkbox"/> 19b-4(f)(6)
			<input type="checkbox"/> 19b-4(f)(2)	<input type="checkbox"/> 19b-4(f)(5)	
			<input type="checkbox"/> 19b-4(f)(3)	<input type="checkbox"/> 19b-4(f)(6)	

Notice of proposed change pursuant to the Payment, Clearing, and Settlement Act of 2010	Security-Based Swap Submission pursuant to the Securities Exchange Act of 1934
Section 806(e)(1) * <input type="checkbox"/>	Section 806(e)(2) * <input type="checkbox"/>
Section 3C(b)(2) * <input type="checkbox"/>	

Exhibit 2 Sent As Paper Document <input type="checkbox"/>	Exhibit 3 Sent As Paper Document <input type="checkbox"/>
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**Description**

Provide a brief description of the action (limit 250 characters, required when Initial is checked \*).

Proposal to apply additional and more stringent criteria to an applicant or listed company based on the qualifications of the companys auditor

**Contact Information**

Provide the name, telephone number, and e-mail address of the person on the staff of the self-regulatory organization prepared to respond to questions and comments on the action.

First Name * <input type="text" value="Amma"/>	Last Name * <input type="text" value="Anaman"/>
Title * <input type="text" value="Assistant General Counsel"/>	
E-mail * <input type="text" value="amma.anaman@nasdaq.com"/>	
Telephone * <input type="text" value="(301) 978-8011"/>	Fax <input type="text"/>

**Signature**

Pursuant to the requirements of the Securities Exchange Act of 1934,

has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

(Title \*)

Date <input type="text" value="05/18/2020"/>	<input type="text" value="EVP and Chief Legal Officer"/>
By <input type="text" value="John Zecca"/>	<input type="text"/>
(Name *)	

NOTE: Clicking the button at right will digitally sign and lock this form. A digital signature is as legally binding as a physical signature, and once signed, this form cannot be changed.

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

For complete Form 19b-4 instructions please refer to the EFFS website.

**Form 19b-4 Information \***

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The self-regulatory organization must provide all required information, presented in a clear and comprehensible manner, to enable the public to provide meaningful comment on the proposal and for the Commission to determine whether the proposal is consistent with the Act and applicable rules and regulations under the Act.

**Exhibit 1 - Notice of Proposed Rule Change \***

Add Remove View

The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

**Exhibit 1A- Notice of Proposed Rule Change, Security-Based Swap Submission, or Advance Notice by Clearing Agencies \***

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The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change, security-based swap submission, or advance notice being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

**Exhibit 2 - Notices, Written Comments, Transcripts, Other Communications**

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Exhibit Sent As Paper Document

Copies of notices, written comments, transcripts, other communications. If such documents cannot be filed electronically in accordance with Instruction F, they shall be filed in accordance with Instruction G.

**Exhibit 3 - Form, Report, or Questionnaire**

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Exhibit Sent As Paper Document

Copies of any form, report, or questionnaire that the self-regulatory organization proposes to use to help implement or operate the proposed rule change, or that is referred to by the proposed rule change.

**Exhibit 4 - Marked Copies**

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The full text shall be marked, in any convenient manner, to indicate additions to and deletions from the immediately preceding filing. The purpose of Exhibit 4 is to permit the staff to identify immediately the changes made from the text of the rule with which it has been working.

**Exhibit 5 - Proposed Rule Text**

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The self-regulatory organization may choose to attach as Exhibit 5 proposed changes to rule text in place of providing it in Item I and which may otherwise be more easily readable if provided separately from Form 19b-4. Exhibit 5 shall be considered part of the proposed rule change.

**Partial Amendment**

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If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission's permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e. partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.

1. Text of the Proposed Rule Change

(a) The Nasdaq Stock Market LLC (“Nasdaq” or “Exchange”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> is filing with the Securities and Exchange Commission (“SEC” or “Commission”) a proposal to apply additional and more stringent criteria to an applicant or listed company based on the qualifications of the company’s auditor.

A notice of the proposed rule change for publication in the Federal Register is attached as Exhibit 1. The text of the proposed rule change is attached as Exhibit 5.

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

The proposed rule change was approved by the Board of Directors of the Exchange on May 18, 2020. No other action is necessary for the filing of the rule change.

Questions and comments on the proposed rule change may be directed to:

Amma Anaman  
Assistant General Counsel  
Nasdaq, Inc.  
(301) 978-8011

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

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

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

a. Purpose

Nasdaq's listing requirements include transparent criteria and corporate governance requirements. These requirements are designed to protect investors and the public interest; to ensure that a company seeking to list on Nasdaq is prepared for the rigors of operating as a public company; to provide transparent disclosure to investors in accordance with the SEC's and Nasdaq's reporting requirements; and to ensure sufficient investor interest to support liquid trading. Those criteria are set forth in the Nasdaq Rule 5000 Series.

In addition to the criteria set forth in the Rule 5000 Series, Rule 5101 describes Nasdaq's broad discretionary authority over the initial and continued listing of securities on 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.<sup>3</sup>

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<sup>3</sup> See Rule 5101.

Nasdaq rules<sup>4</sup> and federal securities laws<sup>5</sup> require a company's financial statements included in its initial registration statement or annual report to be audited by an independent public accountant that is registered with the Public Company Accounting Oversight Board ("PCAOB"). Company management is responsible for preparing the company's financial statements and for establishing and maintaining disclosure controls and procedures and internal control over financial reporting. The company's auditor, based on its independent audit of the evidence supporting the amounts and disclosures in the financial statements, expresses an opinion on whether the financial statements present fairly, in all material respects, the company's financial position, results of operations and cash flows. "To form an appropriate basis for expressing an opinion on the financial statements, the auditor must plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement due to error or fraud."<sup>6</sup>

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

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

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

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

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

Nasdaq and investors rely on the work of auditors to provide reasonable assurances that the financial statements provided by a company are free of material misstatements. Nasdaq and investors further rely on the PCAOB's critical role in overseeing the quality of the auditor's work. The Chairman and the Chief Accountant of the Commission, along with the Chairman of the PCAOB, have raised concerns that national barriers on access to information can impede effective regulatory oversight of U.S.-listed companies with operations in certain countries, including the PCAOB's inability to inspect the audit work and practices of auditors in those countries.<sup>8</sup> In

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<sup>7</sup> See Public Company Accounting Oversight Board, *Public Companies that are Audit Clients of PCAOB-Registered Firms from Non-U.S. Jurisdictions where the PCAOB is Denied Access to Conduct Inspections* (April 1, 2020), available at <https://pcaobus.org/International/Inspections/Pages/IssuerClientsWithoutAccess.aspx>.

<sup>8</sup> See SEC Chairman Jay Clayton, SEC Chief Accountant Wes Bricker and PCAOB Chairman William D. Duhnke III, *Statement on the Vital Role of Audit Quality and Regulatory Access to Audit and Other Information Internationally—Discussion of Current Information Access Challenges with Respect to U.S.-listed Companies with Significant Operations in China* (December 7, 2018), available at <https://www.sec.gov/news/public-statement/statement-vital-role-audit-quality-and-regulatory-access-audit-and-other> ("Some of these laws, for example, act to prohibit foreign-domiciled registrants in certain jurisdictions from responding

particular, the PCAOB is currently prevented from inspecting the audit work and practices of PCAOB-registered auditors in Belgium, France, China and Hong Kong (to the extent their audit clients have operations in mainland China).<sup>9</sup>

Nasdaq shares these concerns and believes that accurate financial statement disclosure is critical for investors to make informed investment decisions. Nasdaq is concerned that constraints on the PCAOB's ability to inspect auditor work in countries with national barriers on access to information weaken assurances that the disclosures

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directly to SEC requests for information and documents or doing so, in whole or in part, only after protracted delays in obtaining authorization. Other laws can prevent the SEC from being able to conduct any type of examination, either onsite or by correspondence...Positions taken by some foreign authorities currently prevent or significantly impair the PCAOB's ability to inspect non-U.S. audit firms in certain countries, even though these firms are registered with the PCAOB.”). On April 21, 2020, these concerns were reiterated by the Chairman and the Chief Accountant of the Commission, along with the Chairman of the PCAOB and the Directors of the SEC Divisions of Corporation Finance and Investment Management. See SEC Chairman Jay Clayton, PCAOB Chairman William D. Duhnke III, SEC Chief Accountant Sagar Teotia, SEC Division of Corporation Finance Director William Hinman, SEC Division of Investment Management Director Dalia Blass, *Emerging Market Investments Entail Significant Disclosure, Financial Reporting and Other Risks; Remedies are Limited* (April 21, 2020), available at <https://www.sec.gov/news/public-statement/emerging-market-investments-disclosure-reporting>.

<sup>9</sup> See *supra* note 7. The PCAOB notes that “[t]he position taken by authorities in mainland China may in some circumstances cause a registered firm located in another jurisdiction to attempt to resist PCAOB inspection of public company audit work that the firm has performed relating to the company’s operations in mainland China. Only in mainland China and Hong Kong, however, is the position of the Chinese authorities effectively an obstacle to inspection of all, or nearly all, registered firms in the jurisdiction.” In addition, the PCAOB’s cooperative arrangement with the French audit authority expired in December 2019, preventing inspections of registered firms in France until a new arrangement is concluded. According to the PCAOB, it expects to enter into bilateral cooperative arrangements soon that will permit the PCAOB to commence inspections in Belgium and resume inspections in France.

and financial information of companies with operations in such countries are not misleading.

Currently, Nasdaq may rely upon its broad authority provided under Rule 5101 to deny initial or continued listing or to apply additional and more stringent criteria when the auditor of an applicant or a Nasdaq-listed company: (1) has not been subject to an inspection by the PCAOB (either historically or because it is newly formed and as therefore not yet undergone a PCAOB inspection), (2) is an auditor that the PCAOB cannot inspect, or (3) 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 auditors' conduct in other audits or in its system of quality controls.

Nasdaq believes that codifying the nature and scope of its existing discretion when assessing the qualifications of a company's auditor will increase transparency to investors, companies and market participants. Accordingly, in order to preserve and strengthen the quality of and public confidence in the Nasdaq market, and in order to enhance investor confidence, Nasdaq proposes to amend IM-5101-1 to add a new subparagraph (b) that sets forth factors Nasdaq may consider in applying additional and more stringent criteria to an applicant or listed company based on the qualifications of the company's auditor. Such factors include:

(1) whether the auditor has been subject to a PCAOB inspection, such as where the auditor is newly formed and has therefore not yet undergone a PCAOB inspection or where the auditor, or an accounting firm engaged to assist with the audit, is located in a jurisdiction that limits the PCAOB's ability to inspect the auditor;



(2) if the company's auditor has been inspected by the PCAOB, whether the results of that inspection indicate that the auditor has failed to respond to any requests by the PCAOB or that the inspection has uncovered significant deficiencies in the auditors' conduct in other audits or in its system of quality controls;

(3) whether the auditor can demonstrate that it has adequate personnel in the offices participating in the audit with expertise in applying U.S. GAAP, GAAS or IFRS, as applicable, in the company's industry;

(4) whether the auditor's training program for personnel participating in the company's audit is adequate;

(5) for non-U.S. auditors, whether the auditor is part of a global network or other affiliation of individual auditors where the auditors draw on globally common technologies, tools, methodologies, training and quality assurance monitoring; and

(6) whether the auditor can demonstrate to Nasdaq sufficient resources, geographic reach or experience as it relates to the company's audit.

Nasdaq will consider these factors holistically and may be satisfied with an auditor's qualifications notwithstanding the fact that the auditor raises concerns with respect to some of the factors set forth above. For example, Nasdaq may be satisfied that an auditor that is not subject to PCAOB inspection has mitigated the risk that it may have significant undetected deficiencies in its system of quality controls by being a part of a global network where the auditors draw on globally common technologies, tools, methodologies, training and quality assurance monitoring.

The proposed rule will include examples of additional and more stringent criteria that Nasdaq may apply to an applicant or a Nasdaq-listed company to obtain comfort that

the company satisfies the financial listing requirements and is suitable for listing. These could include, as explained in greater detail below, requiring: (i) higher equity, assets, earnings or liquidity measures than otherwise required under the Rule 5000 Series; (ii) that any offering be underwritten on a firm commitment basis, which typically involves more due diligence by the broker-dealer than would be done in connection with a best-efforts offering; or (iii) 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.

Nasdaq and investors rely on the company's auditors to provide reasonable assurances that the financial statements provided by a company are free of material misstatements and do not, for example, overstate the company's equity, assets or revenues. Where Nasdaq is concerned that the company's auditor does not satisfy the criteria proposed in IM-5101-1(b), Nasdaq may still obtain comfort that the company truly satisfies the financial listing criteria by imposing a higher standard. Nasdaq may also have concerns that a company listing on Nasdaq through an initial public offering, business combination, direct listing or issuing securities previously trading over the counter ("OTC") may not develop sufficient public float, investor base, and trading interest to provide the depth and liquidity necessary to promote fair and orderly trading, resulting in a security that is illiquid. In such cases, Nasdaq may impose additional liquidity measures on the company, such as requiring a higher public float percentage, market value of unrestricted publicly held shares or average OTC trading volume. Nasdaq may also obtain additional comfort regarding the quality of the company's financial statements by requiring the offering to be underwritten, which helps to ensure

that third parties other than the auditor are conducting significant due diligence on the company, its registration statement and its financial statements.

In certain instances, Nasdaq believes it may be appropriate to prevent the company's insiders from selling their shares if material misstatements are detected by the company's auditors and have not been disclosed to investors. Therefore, Nasdaq may also 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. Nasdaq may impose each of these requirements separately or in combination. In some cases, Nasdaq may determine that listing is not appropriate and deny initial or continued listing to a company.

The risks to U.S. investors are heightened when a company's business is principally administered in a jurisdiction that has secrecy laws, blocking statutes, national security laws or other laws or regulations restricting access to information by regulators of U.S.-listed companies in such jurisdiction, which raise concerns about the accuracy of disclosures, accountability, and access to information.<sup>10</sup> Nasdaq also proposes to amend IM-5101-1 to add a new subparagraph (c) to clarify that Nasdaq may also use its discretionary authority to impose additional or more stringent criteria, including the criteria set forth in IM-5101-1(b), in other circumstances, including when a company's business is principally administered in a jurisdiction that Nasdaq determines to have secrecy laws, blocking statutes, national security laws or other laws or regulations restricting access to information by regulators of U.S.-listed companies in such jurisdiction (a "Restrictive Market"). In determining whether a company's business is

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<sup>10</sup> See supra note 3.

principally administered in a Restrictive Market, Nasdaq may consider the geographic locations of the company's: (a) principal business segments, operations or assets; (b) board and shareholders' meetings; (c) headquarters or principal executive offices; (d) senior management and employees; and (e) books and records.<sup>11</sup> Nasdaq will consider these factors holistically, recognizing that a company's headquarters may not be the office from which it conducts its principal business activities. For example, a company's headquarters could be located in Country A, while the majority of its senior management, employees, assets, operations and books and records are located in Country B, which is a Restrictive Market. In this case, Nasdaq would consider the company's business to be principally administered in Country B, which is a Restrictive Market, and Nasdaq would use its discretionary authority to apply additional or more stringent criteria to the company.

Lastly, Nasdaq proposes to identify certain paragraphs within IM-5101-1 as subparagraphs (a), (d) and (e), add headings to the subparagraphs, and to relocate text describing Nasdaq's review process to paragraph (e), in order to enhance readability of

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<sup>11</sup> This threshold would capture both foreign private issuers based in Restrictive Markets and companies based in the U.S. or another jurisdiction that principally administer their businesses in Restrictive Markets. The factors that Nasdaq would consider when determining whether a business is principally administered in a Restrictive Market is supported by SEC guidance regarding foreign private issuer status, which suggests that a foreign company may consider certain factors including the locations of: the company's principal business segments or operations; its board and shareholders' meetings; its headquarters; and its most influential key executives (potentially a subset of all executives). See Division of Corporation Finance of the SEC, *Accessing the U.S. Capital Markets — A Brief Overview for Foreign Private Issuers* (February 13, 2013), available at <https://www.sec.gov/divisions/corpfin/internatl/foreign-private-issuers-overview.shtml#IIA2c>.

the rule. Nasdaq also proposes to revise “listing qualifications panel” to “Hearings Panel (as defined in Rule 5805(d))” for consistency within Nasdaq’s rulebook.

In the event that Nasdaq relies on such discretionary authority and determines to deny the initial or continued listing of a company, it would issue a denial or delisting letter to the company that will inform the company of the factual basis for the Nasdaq’s determination and its right for review of the decision pursuant to the Rule 5800 Series.<sup>12</sup>

The Exchange believes that the proposed rule change will enhance transparency regarding how Nasdaq may exercise its existing discretion when considering the qualifications of the company’s auditor and the jurisdiction where the company principally administers its business in determining whether to grant initial or continued listing of a company.

b. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act,<sup>13</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act,<sup>14</sup> in particular, in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general to protect investors and the public interest. Further, the Exchange believes that this

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<sup>12</sup> See Rule 5815, which sets forth the review of staff determinations by a Hearings Panel, including the procedures for requesting and preparing for a hearing and the scope of the Hearing Panel’s discretion.

<sup>13</sup> 15 U.S.C. 78f(b).

<sup>14</sup> 15 U.S.C. 78f(b)(5).

proposal is not designed to permit unfair discrimination between customers, issuers, brokers, or dealers.

Nasdaq and investors rely on the work of auditors to provide reasonable assurances that the financial statements provided by a company are free of material misstatements. The PCAOB states that “[r]easonable assurance is obtained by reducing audit risk to an appropriately low level through applying due professional care, including obtaining sufficient appropriate audit evidence.”<sup>15</sup> Nasdaq believes that the PCAOB’s inability to inspect the audit work and practices of auditors in certain countries weakens the assurance that the auditor obtained sufficient appropriate audit evidence to express its opinion on a company’s financial statements, and decreases confidence that the auditor complied with PCAOB and SEC rules and professional standards in connection with the auditor’s performance of audits. The proposed rule would provide transparency to cases where Nasdaq may impose additional and more stringent criteria on a company based on the qualifications of its auditor in order to help provide greater assurances that the company’s financial statements are free of material misstatements due to fraud or error, thereby preventing fraudulent and manipulative acts and protecting investors and the public interest.

The proposed rule change would also protect investors and the public interest by providing Nasdaq and investors with greater assurances that the company indeed satisfies Nasdaq’s financial listing requirements set forth in the Rule 5000 Series. Nasdaq believes that without reasonable assurances that a company’s financial statements and related disclosures are free from material misstatements, there is a risk that a company

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<sup>15</sup> See supra note 6.

that would otherwise not have qualified to list on Nasdaq may satisfy Nasdaq's listing standards by presenting financial statements that contain undetected material misstatements. In *In the Matter of the Tassaway, Inc.*, the Commission observed that

Though exclusion from the system may hurt existing investors, primary emphasis must be placed on the interests of prospective future investors. The latter group is entitled to assume that the securities in the system meet the system's standards. Hence the presence in NASDAQ of non-complying securities could have a serious deceptive effect.<sup>16</sup>

The proposed rule change would provide greater assurances to investors that a company truly meets Nasdaq's financial listing requirement by clarifying that Nasdaq may use its existing discretion to apply additional and more stringent criteria, such as requiring: (i) higher equity, assets, earnings or liquidity measures than otherwise required under the Rule 5000 Series; (ii) that any offering be underwritten on a firm commitment basis, which typically involves more due diligence by the broker-dealer than would be done in connection with a best-efforts offering; or (iii) 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 some cases, Nasdaq may determine that listing is not appropriate and deny initial or continued listing to a company. Nasdaq believes that providing specific examples of such additional and more stringent criteria will alert companies seeking to list on Nasdaq, as well as currently listed companies, that the company may be subject to additional criteria as a condition for initial and continued listing on Nasdaq and will provide transparency to investors, companies and market participants, thereby protecting investors and the public interest.

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<sup>16</sup> See *In the Matter of Tassaway, Inc.*, Securities Exchange Act Release No. 11291, 1975 WL 160383; 45 S.E.C. 706 (March 13, 1975).

Nasdaq believes that its proposal to add a new subparagraph (c) to clarify that Nasdaq may also use its discretionary authority to impose additional or more stringent criteria, including the criteria set forth in IM-5101-1(b), in other circumstances, including when a company's business is principally administered in a Restrictive Market, will help ensure that Nasdaq has access to the information needed to carry out its regulatory duties, thereby preventing fraudulent and manipulative acts and protecting investors and the public interest.

The Exchange believes that the proposed rules clarify Nasdaq's discretionary authority under Rule 5101 "to 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."<sup>17</sup> Nasdaq has maintained its broad discretionary authority for 26 years. On June 3, 1994, the Commission approved a proposal from National Association of Securities Dealers, Inc. ("NASD") to amend Schedule D to the NASD By-Laws to clarify the NASD's discretionary authority to exclude an issuer from Nasdaq or require additional or more stringent criteria for inclusion in Nasdaq for issuers that are managed, controlled or influenced by persons with a history of significant securities or commodities violations.<sup>18</sup> In approving the proposal, the Commission stated that "[a]lthough the

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<sup>17</sup> See supra note 3.

<sup>18</sup> Securities Exchange Act Release No. 34151 (June 3, 1994), 59 FR 29843 (June 9, 1994) (SR-NASD-94-19) (available at <https://www.govinfo.gov/content/pkg/FR-1994-06-09/html/94-14031.htm>). This was the predecessor to current Nasdaq Rule 5101.



Commission is of the view that the NASD's current rules authorize it to exclude an issuer, the proposal would clarify that authority. The Commission believes that this rule change provides greater protection to both existing and prospective investors. This rule change provides investors greater assurance that the risk associated with investing in Nasdaq is market risk rather than the risk that the promoter or other persons exercising substantial influence over the issuer is acting in an illegal manner.”<sup>19</sup> Similarly, the Exchange believes that the current proposal would clarify Nasdaq's existing authority and would help reduce the risk for existing and prospective investors that the financial statements of a Nasdaq-listed company may contain material misstatements that were not discovered due to a lack of robust oversight of the company's auditor.

The proposed rule changes would apply to all companies listed and seeking to list on Nasdaq. However, Nasdaq may only apply additional and more stringent criteria when an applicant or a Nasdaq-listed company is unable to demonstrate to Nasdaq, through the enumerated factors, that its auditor has sufficient PCAOB inspection history, quality controls, resources, geographic reach and experience to adequately perform the company's audit. Nasdaq may also only apply its discretionary authority when a company's business is principally administered in a Restrictive Market.

Notwithstanding the forgoing, the Exchange believes that the proposal does not unfairly discriminate among companies because Nasdaq and the SEC have identified additional concerns around companies with auditors that do not have sufficient PCAOB inspection history, quality controls, resources, geographic reach and experience to adequately perform the company's audit and companies whose business is principally

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<sup>19</sup> Id.

administered in a Restrictive Market. In light of these concerns, the proposed rule change will increase assurances that companies listed on Nasdaq satisfy Nasdaq's financial listing requirements and are suitable for listing on a U.S. securities exchange, and that Nasdaq has access to the information required to perform its regulatory duties, which will prevent fraudulent and manipulative acts and practices, promote just and equitable principles of trade and protect investors and the public interest.

Under the proposed changes, the Exchange will use its discretion in determining to apply additional and more stringent criteria. The Exchange believes that this is not unfair discrimination among companies because applying additional and more stringent criteria may not be appropriate in all circumstances, for example if the company's auditor is able to demonstrate that it has sufficient PCAOB inspection history, quality controls, resources, geographic reach and experience to adequately perform the company's audit. Similarly, it may not be appropriate for Nasdaq to apply its discretionary authority in all cases where a company's business is principally administered in a Restrictive Market. For example, a company may be headquartered in Country A, which is a Restrictive Market, but have the majority of its employees, operations, senior management, assets and books and records in Country B, which is not a Restrictive Market. In such cases, Nasdaq would consider the company's business to be principally administered in Country B and Nasdaq would not use its discretionary authority to apply additional or more stringent criteria.

Nasdaq believes that the proposed changes recognize that one size does not fit all companies and clarify the scope of the Exchange's existing discretion to apply additional and more stringent criteria, including potentially prohibiting a company's listing, based

on the qualifications of its auditor or the jurisdiction where the company principally administers its business, thereby protecting investors and the public interest.

Lastly, Nasdaq believes its proposal to identify certain paragraphs within IM-5101-1 as subparagraphs (a), (d) and (e), add headings to the subparagraphs, and to relocate text describing Nasdaq's review process to paragraph (e), will enhance readability of the rule. Similarly, Nasdaq believes its proposal to and revise "listing qualifications panel" to "Hearings Panel (as defined in Rule 5805(d))" will enhance consistency within Nasdaq's rulebook. Nasdaq believes both proposals will promote investor protection and the public interest.

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

The Exchange does not believe that the proposed rule change will impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act. Nasdaq is adopting this proposed rule change to enhance investor protection, which is a central purpose of the Act. Any impact on competition, either among listed companies or between exchanges, is incidental to that purpose.

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

No written comments were either solicited or received.

6. Extension of Time Period for Commission Action

The Exchange does not consent to an extension of the time period for Commission action.

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2)

Not applicable.

8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission

Not applicable.

9. Security-Based Swap Submissions Filed Pursuant to Section 3C of the Act

Not applicable.

10. Advance Notices Filed Pursuant to Section 806(e) of the Payment, Clearing and Settlement Supervision Act

Not applicable.

11. Exhibits

1. Notice of Proposed Rule Change for publication in the Federal Register.
5. Text of the proposed rule change.

**EXHIBIT 1**

## SECURITIES AND EXCHANGE COMMISSION

(Release No. \_\_\_\_\_ ; File No. SR-NASDAQ-2020-028)

May \_\_, 2020

Self-Regulatory Organizations; The Nasdaq Stock Market LLC; Notice of Filing of Proposed Rule Change to Adopt Requirements for the Nasdaq Capital and Global Markets applicable to Direct Listings

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup>, and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on May 19, 2020, The Nasdaq Stock Market LLC (“Nasdaq” or “Exchange”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I, II, and III, below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

The Exchange proposes to apply additional and more stringent criteria to an applicant or listed company based on the qualifications of the company’s auditor.

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

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

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

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

In its filing with the Commission, the Exchange included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The Exchange has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

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

1. Purpose

Nasdaq's listing requirements include transparent criteria and corporate governance requirements. These requirements are designed to protect investors and the public interest; to ensure that a company seeking to list on Nasdaq is prepared for the rigors of operating as a public company; to provide transparent disclosure to investors in accordance with the SEC's and Nasdaq's reporting requirements; and to ensure sufficient investor interest to support liquid trading. Those criteria are set forth in the Nasdaq Rule 5000 Series.

In addition to the criteria set forth in the Rule 5000 Series, Rule 5101 describes Nasdaq's broad discretionary authority over the initial and continued listing of securities on 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.<sup>3</sup>

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

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<sup>3</sup> See Rule 5101.

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

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

about whether the financial statements are free of material misstatement due to error or fraud.”<sup>6</sup>

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

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

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

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

<sup>7</sup> See Public Company Accounting Oversight Board, *Public Companies that are Audit Clients of PCAOB-Registered Firms from Non-U.S. Jurisdictions where the PCAOB is Denied Access to Conduct Inspections* (April 1, 2020), available at <https://pcaobus.org/International/Inspections/Pages/IssuerClientsWithoutAccess.aspx>.



inability to inspect the audit work and practices of auditors in those countries.<sup>8</sup> In particular, the PCAOB is currently prevented from inspecting the audit work and practices of PCAOB-registered auditors in Belgium, France, China and Hong Kong (to the extent their audit clients have operations in mainland China).<sup>9</sup>

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<sup>8</sup> See SEC Chairman Jay Clayton, SEC Chief Accountant Wes Bricker and PCAOB Chairman William D. Duhnke III, *Statement on the Vital Role of Audit Quality and Regulatory Access to Audit and Other Information Internationally—Discussion of Current Information Access Challenges with Respect to U.S.-listed Companies with Significant Operations in China* (December 7, 2018), available at <https://www.sec.gov/news/public-statement/statement-vital-role-audit-quality-and-regulatory-access-audit-and-other> (“Some of these laws, for example, act to prohibit foreign-domiciled registrants in certain jurisdictions from responding directly to SEC requests for information and documents or doing so, in whole or in part, only after protracted delays in obtaining authorization. Other laws can prevent the SEC from being able to conduct any type of examination, either onsite or by correspondence... Positions taken by some foreign authorities currently prevent or significantly impair the PCAOB’s ability to inspect non-U.S. audit firms in certain countries, even though these firms are registered with the PCAOB.”). On April 21, 2020, these concerns were reiterated by the Chairman and the Chief Accountant of the Commission, along with the Chairman of the PCAOB and the Directors of the SEC Divisions of Corporation Finance and Investment Management. See SEC Chairman Jay Clayton, PCAOB Chairman William D. Duhnke III, SEC Chief Accountant Sagar Teotia, SEC Division of Corporation Finance Director William Hinman, SEC Division of Investment Management Director Dalia Blass, *Emerging Market Investments Entail Significant Disclosure, Financial Reporting and Other Risks; Remedies are Limited* (April 21, 2020), available at <https://www.sec.gov/news/public-statement/emerging-market-investments-disclosure-reporting>.

<sup>9</sup> See *supra* note 7. The PCAOB notes that “[t]he position taken by authorities in mainland China may in some circumstances cause a registered firm located in another jurisdiction to attempt to resist PCAOB inspection of public company audit work that the firm has performed relating to the company’s operations in mainland China. Only in mainland China and Hong Kong, however, is the position of the Chinese authorities effectively an obstacle to inspection of all, or nearly all, registered firms in the jurisdiction.” In addition, the PCAOB’s cooperative arrangement with the French audit authority expired in December 2019, preventing inspections of registered firms in France until a new arrangement is concluded. According to the PCAOB, it expects to enter into bilateral cooperative arrangements soon that will permit the PCAOB to commence inspections in Belgium and resume inspections in France.

Nasdaq shares these concerns and believes that accurate financial statement disclosure is critical for investors to make informed investment decisions. Nasdaq is concerned that constraints on the PCAOB's ability to inspect auditor work in countries with national barriers on access to information weaken assurances that the disclosures and financial information of companies with operations in such countries are not misleading.

Currently, Nasdaq may rely upon its broad authority provided under Rule 5101 to deny initial or continued listing or to apply additional and more stringent criteria when the auditor of an applicant or a Nasdaq-listed company: (1) has not been subject to an inspection by the PCAOB (either historically or because it is newly formed and as therefore not yet undergone a PCAOB inspection), (2) is an auditor that the PCAOB cannot inspect, or (3) 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 auditors' conduct in other audits or in its system of quality controls.

Nasdaq believes that codifying the nature and scope of its existing discretion when assessing the qualifications of a company's auditor will increase transparency to investors, companies and market participants. Accordingly, in order to preserve and strengthen the quality of and public confidence in the Nasdaq market, and in order to enhance investor confidence, Nasdaq proposes to amend IM-5101-1 to add a new subparagraph (b) that sets forth factors Nasdaq may consider in applying additional and more stringent criteria to an applicant or listed company based on the qualifications of the company's auditor. Such factors include:

(1) whether the auditor has been subject to a PCAOB inspection, such as where the auditor is newly formed and has therefore not yet undergone a PCAOB inspection or where the auditor, or an accounting firm engaged to assist with the audit, is located in a jurisdiction that limits the PCAOB's ability to inspect the auditor;

(2) if the company's auditor has been inspected by the PCAOB, whether the results of that inspection indicate that the auditor has failed to respond to any requests by the PCAOB or that the inspection has uncovered significant deficiencies in the auditors' conduct in other audits or in its system of quality controls;

(3) whether the auditor can demonstrate that it has adequate personnel in the offices participating in the audit with expertise in applying U.S. GAAP, GAAS or IFRS, as applicable, in the company's industry;

(4) whether the auditor's training program for personnel participating in the company's audit is adequate;

(5) for non-U.S. auditors, whether the auditor is part of a global network or other affiliation of individual auditors where the auditors draw on globally common technologies, tools, methodologies, training and quality assurance monitoring; and

(6) whether the auditor can demonstrate to Nasdaq sufficient resources, geographic reach or experience as it relates to the company's audit.

Nasdaq will consider these factors holistically and may be satisfied with an auditor's qualifications notwithstanding the fact that the auditor raises concerns with respect to some of the factors set forth above. For example, Nasdaq may be satisfied that an auditor that is not subject to PCAOB inspection has mitigated the risk that it may have significant undetected deficiencies in its system of quality controls by being a part of a

global network where the auditors draw on globally common technologies, tools, methodologies, training and quality assurance monitoring.

The proposed rule will include examples of additional and more stringent criteria that Nasdaq may apply to an applicant or a Nasdaq-listed company to obtain comfort that the company satisfies the financial listing requirements and is suitable for listing. These could include, as explained in greater detail below, requiring: (i) higher equity, assets, earnings or liquidity measures than otherwise required under the Rule 5000 Series; (ii) that any offering be underwritten on a firm commitment basis, which typically involves more due diligence by the broker-dealer than would be done in connection with a best-efforts offering; or (iii) 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.

Nasdaq and investors rely on the company's auditors to provide reasonable assurances that the financial statements provided by a company are free of material misstatements and do not, for example, overstate the company's equity, assets or revenues. Where Nasdaq is concerned that the company's auditor does not satisfy the criteria proposed in IM-5101-1(b), Nasdaq may still obtain comfort that the company truly satisfies the financial listing criteria by imposing a higher standard. Nasdaq may also have concerns that a company listing on Nasdaq through an initial public offering, business combination, direct listing or issuing securities previously trading over the counter ("OTC") may not develop sufficient public float, investor base, and trading interest to provide the depth and liquidity necessary to promote fair and orderly trading, resulting in a security that is illiquid. In such cases, Nasdaq may impose additional

liquidity measures on the company, such as requiring a higher public float percentage, market value of unrestricted publicly held shares or average OTC trading volume.

Nasdaq may also obtain additional comfort regarding the quality of the company's financial statements by requiring the offering to be underwritten, which helps to ensure that third parties other than the auditor are conducting significant due diligence on the company, its registration statement and its financial statements.

In certain instances, Nasdaq believes it may be appropriate to prevent the company's insiders from selling their shares if material misstatements are detected by the company's auditors and have not been disclosed to investors. Therefore, Nasdaq may also 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. Nasdaq may impose each of these requirements separately or in combination. In some cases, Nasdaq may determine that listing is not appropriate and deny initial or continued listing to a company.

The risks to U.S. investors are heightened when a company's business is principally administered in a jurisdiction that has secrecy laws, blocking statutes, national security laws or other laws or regulations restricting access to information by regulators of U.S.-listed companies in such jurisdiction, which raise concerns about the accuracy of disclosures, accountability, and access to information.<sup>10</sup> Nasdaq also proposes to amend IM-5101-1 to add a new subparagraph (c) to clarify that Nasdaq may also use its discretionary authority to impose additional or more stringent criteria, including the criteria set forth in IM-5101-1(b), in other circumstances, including when a company's

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<sup>10</sup> See supra note 3.

business is principally administered in a jurisdiction that Nasdaq determines to have secrecy laws, blocking statutes, national security laws or other laws or regulations restricting access to information by regulators of U.S.-listed companies in such jurisdiction (a “Restrictive Market”). In determining whether a company’s business is principally administered in a Restrictive Market, Nasdaq may consider the geographic locations of the company’s: (a) principal business segments, operations or assets; (b) board and shareholders’ meetings; (c) headquarters or principal executive offices; (d) senior management and employees; and (e) books and records.<sup>11</sup> Nasdaq will consider these factors holistically, recognizing that a company’s headquarters may not be the office from which it conducts its principal business activities. For example, a company’s headquarters could be located in Country A, while the majority of its senior management, employees, assets, operations and books and records are located in Country B, which is a Restrictive Market. In this case, Nasdaq would consider the company’s business to be principally administered in Country B, which is a Restrictive Market, and Nasdaq would use its discretionary authority to apply additional or more stringent criteria to the company.

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<sup>11</sup> This threshold would capture both foreign private issuers based in Restrictive Markets and companies based in the U.S. or another jurisdiction that principally administer their businesses in Restrictive Markets. The factors that Nasdaq would consider when determining whether a business is principally administered in a Restrictive Market is supported by SEC guidance regarding foreign private issuer status, which suggests that a foreign company may consider certain factors including the locations of: the company’s principal business segments or operations; its board and shareholders’ meetings; its headquarters; and its most influential key executives (potentially a subset of all executives). See Division of Corporation Finance of the SEC, *Accessing the U.S. Capital Markets — A Brief Overview for Foreign Private Issuers* (February 13, 2013), available at <https://www.sec.gov/divisions/corpfm/internatl/foreign-private-issuers-overview.shtml#IIA2c>.

Lastly, Nasdaq proposes to identify certain paragraphs within IM-5101-1 as subparagraphs (a), (d) and (e), add headings to the subparagraphs, and to relocate text describing Nasdaq's review process to paragraph (e), in order to enhance readability of the rule. Nasdaq also proposes to revise "listing qualifications panel" to "Hearings Panel (as defined in Rule 5805(d))" for consistency within Nasdaq's rulebook.

In the event that Nasdaq relies on such discretionary authority and determines to deny the initial or continued listing of a company, it would issue a denial or delisting letter to the company that will inform the company of the factual basis for the Nasdaq's determination and its right for review of the decision pursuant to the Rule 5800 Series.<sup>12</sup>

The Exchange believes that the proposed rule change will enhance transparency regarding how Nasdaq may exercise its existing discretion when considering the qualifications of the company's auditor and the jurisdiction where the company principally administers its business in determining whether to grant initial or continued listing of a company.

## 2. Statutory Basis

The Exchange believes that its proposal is consistent with Section 6(b) of the Act,<sup>13</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act,<sup>14</sup> in particular, in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to and perfect the

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<sup>12</sup> See Rule 5815, which sets forth the review of staff determinations by a Hearings Panel, including the procedures for requesting and preparing for a hearing and the scope of the Hearing Panel's discretion.

<sup>13</sup> 15 U.S.C. 78f(b).

<sup>14</sup> 15 U.S.C. 78f(b)(5).

mechanism of a free and open market and a national market system, and, in general to protect investors and the public interest. Further, the Exchange believes that this proposal is not designed to permit unfair discrimination between customers, issuers, brokers, or dealers.

Nasdaq and investors rely on the work of auditors to provide reasonable assurances that the financial statements provided by a company are free of material misstatements. The PCAOB states that “[r]easonable assurance is obtained by reducing audit risk to an appropriately low level through applying due professional care, including obtaining sufficient appropriate audit evidence.”<sup>15</sup> Nasdaq believes that the PCAOB’s inability to inspect the audit work and practices of auditors in certain countries weakens the assurance that the auditor obtained sufficient appropriate audit evidence to express its opinion on a company’s financial statements, and decreases confidence that the auditor complied with PCAOB and SEC rules and professional standards in connection with the auditor’s performance of audits. The proposed rule would provide transparency to cases where Nasdaq may impose additional and more stringent criteria on a company based on the qualifications of its auditor in order to help provide greater assurances that the company’s financial statements are free of material misstatements due to fraud or error, thereby preventing fraudulent and manipulative acts and protecting investors and the public interest.

The proposed rule change would also protect investors and the public interest by providing Nasdaq and investors with greater assurances that the company indeed satisfies Nasdaq’s financial listing requirements set forth in the Rule 5000 Series. Nasdaq

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<sup>15</sup> See supra note 6.



believes that without reasonable assurances that a company's financial statements and related disclosures are free from material misstatements, there is a risk that a company that would otherwise not have qualified to list on Nasdaq may satisfy Nasdaq's listing standards by presenting financial statements that contain undetected material misstatements. In *In the Matter of the Tassaway, Inc.*, the Commission observed that

Though exclusion from the system may hurt existing investors, primary emphasis must be placed on the interests of prospective future investors. The latter group is entitled to assume that the securities in the system meet the system's standards. Hence the presence in NASDAQ of non-complying securities could have a serious deceptive effect.<sup>16</sup>

The proposed rule change would provide greater assurances to investors that a company truly meets Nasdaq's financial listing requirement by clarifying that Nasdaq may use its existing discretion to apply additional and more stringent criteria, such as requiring: (i) higher equity, assets, earnings or liquidity measures than otherwise required under the Rule 5000 Series; (ii) that any offering be underwritten on a firm commitment basis, which typically involves more due diligence by the broker-dealer than would be done in connection with a best-efforts offering; or (iii) 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 some cases, Nasdaq may determine that listing is not appropriate and deny initial or continued listing to a company. Nasdaq believes that providing specific examples of such additional and more stringent criteria will alert companies seeking to list on Nasdaq, as well as currently listed companies, that the company may be subject to additional criteria as a condition for

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<sup>16</sup> See *In the Matter of Tassaway, Inc.*, Securities Exchange Act Release No. 11291, 1975 WL 160383; 45 S.E.C. 706 (March 13, 1975).

initial and continued listing on Nasdaq and will provide transparency to investors, companies and market participants, thereby protecting investors and the public interest.

Nasdaq believes that its proposal to add a new subparagraph (c) to clarify that Nasdaq may also use its discretionary authority to impose additional or more stringent criteria, including the criteria set forth in IM-5101-1(b), in other circumstances, including when a company's business is principally administered in a Restrictive Market, will help ensure that Nasdaq has access to the information needed to carry out its regulatory duties, thereby preventing fraudulent and manipulative acts and protecting investors and the public interest.

The Exchange believes that the proposed rules clarify Nasdaq's discretionary authority under Rule 5101 "to 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."<sup>17</sup> Nasdaq has maintained its broad discretionary authority for 26 years. On June 3, 1994, the Commission approved a proposal from National Association of Securities Dealers, Inc. ("NASD") to amend Schedule D to the NASD By-Laws to clarify the NASD's discretionary authority to exclude an issuer from Nasdaq or require additional or more stringent criteria for inclusion in Nasdaq for issuers that are managed, controlled or influenced by persons with a history of significant securities or commodities

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<sup>17</sup> See supra note 3.

violations.<sup>18</sup> In approving the proposal, the Commission stated that “[a]lthough the Commission is of the view that the NASD’s current rules authorize it to exclude an issuer, the proposal would clarify that authority. The Commission believes that this rule change provides greater protection to both existing and prospective investors. This rule change provides investors greater assurance that the risk associated with investing in Nasdaq is market risk rather than the risk that the promoter or other persons exercising substantial influence over the issuer is acting in an illegal manner.”<sup>19</sup> Similarly, the Exchange believes that the current proposal would clarify Nasdaq’s existing authority and would help reduce the risk for existing and prospective investors that the financial statements of a Nasdaq-listed company may contain material misstatements that were not discovered due to a lack of robust oversight of the company’s auditor.

The proposed rule changes would apply to all companies listed and seeking to list on Nasdaq. However, Nasdaq may only apply additional and more stringent criteria when an applicant or a Nasdaq-listed company is unable to demonstrate to Nasdaq, through the enumerated factors, that its auditor has sufficient PCAOB inspection history, quality controls, resources, geographic reach and experience to adequately perform the company’s audit. Nasdaq may also only apply its discretionary authority when a company’s business is principally administered in a Restrictive Market.

Notwithstanding the forgoing, the Exchange believes that the proposal does not unfairly discriminate among companies because Nasdaq and the SEC have identified

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<sup>18</sup> Securities Exchange Act Release No. 34151 (June 3, 1994), 59 FR 29843 (June 9, 1994) (SR-NASD-94-19) (available at <https://www.govinfo.gov/content/pkg/FR-1994-06-09/html/94-14031.htm>). This was the predecessor to current Nasdaq Rule 5101.

<sup>19</sup> Id.

additional concerns around companies with auditors that do not have sufficient PCAOB inspection history, quality controls, resources, geographic reach and experience to adequately perform the company's audit and companies whose business is principally administered in a Restrictive Market. In light of these concerns, the proposed rule change will increase assurances that companies listed on Nasdaq satisfy Nasdaq's financial listing requirements and are suitable for listing on a U.S. securities exchange, and that Nasdaq has access to the information required to perform its regulatory duties, which will prevent fraudulent and manipulative acts and practices, promote just and equitable principles of trade and protect investors and the public interest.

Under the proposed changes, the Exchange will use its discretion in determining to apply additional and more stringent criteria. The Exchange believes that this is not unfair discrimination among companies because applying additional and more stringent criteria may not be appropriate in all circumstances, for example if the company's auditor is able to demonstrate that it has sufficient PCAOB inspection history, quality controls, resources, geographic reach and experience to adequately perform the company's audit. Similarly, it may not be appropriate for Nasdaq to apply its discretionary authority in all cases where a company's business is principally administered in a Restrictive Market. For example, a company may be headquartered in Country A, which is a Restrictive Market, but have the majority of its employees, operations, senior management, assets and books and records in Country B, which is not a Restrictive Market. In such cases, Nasdaq would consider the company's business to be principally administered in Country B and Nasdaq would not use its discretionary authority to apply additional or more stringent criteria.

Nasdaq believes that the proposed changes recognize that one size does not fit all companies and clarify the scope of the Exchange's existing discretion to apply additional and more stringent criteria, including potentially prohibiting a company's listing, based on the qualifications of its auditor or the jurisdiction where the company principally administers its business, thereby protecting investors and the public interest.

Lastly, Nasdaq believes its proposal to identify certain paragraphs within IM-5101-1 as subparagraphs (a), (d) and (e), add headings to the subparagraphs, and to relocate text describing Nasdaq's review process to paragraph (e), will enhance readability of the rule. Similarly, Nasdaq believes its proposal to and revise "listing qualifications panel" to "Hearings Panel (as defined in Rule 5805(d))" will enhance consistency within Nasdaq's rulebook. Nasdaq believes both proposals will promote investor protection and the public interest.

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

The Exchange does not believe that the proposed rule change will impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act. Nasdaq is adopting this proposed rule change to enhance investor protection, which is a central purpose of the Act. Any impact on competition, either among listed companies or between exchanges, is incidental to that purpose.

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

No written comments were either solicited or received.

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

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date

if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the Exchange consents, the Commission shall: (a) by order approve or disapprove such proposed rule change, or (b) institute proceedings to determine whether the proposed rule change should be disapproved.

#### IV. Solicitation of Comments

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

##### Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-NASDAQ-2020-028 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-2020-028. 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 Web site (<http://www.sec.gov/rules/sro.shtml>).

Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any

person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

All submissions should refer to File Number SR-NASDAQ-2020-028 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>20</sup>

J. Matthew DeLesDernier  
Assistant Secretary

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<sup>20</sup> 17 CFR 200.30-3(a)(12).

**EXHIBIT 5**

Deleted text is [bracketed]. New text is underlined.

**The Nasdaq Stock Market LLC Rules**

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**5100. Nasdaq's Regulatory Authority****5101. Preamble to the Rule 5100 Series**

Nasdaq is entrusted with the authority to preserve and strengthen the quality of and public confidence in its market. Nasdaq stands for integrity and ethical business practices in order to enhance investor confidence, thereby contributing to the financial health of the economy and supporting the capital formation process. Nasdaq Companies, from new public Companies to Companies of international stature, are publicly recognized as sharing these important objectives.

Nasdaq, therefore, in addition to applying the enumerated criteria set forth in the Rule 5000 Series, 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. In all circumstances where the Listing Qualifications Department (as defined in Rule 5805) exercises its authority under Rule 5101, the Listing Qualifications Department shall issue a Staff Delisting Determination under Rule 5810(c)(1), and in all circumstances where an Adjudicatory Body (as defined in Rule 5805) exercises such authority, the use of the authority shall be described in the written decision of the Adjudicatory Body.

**IM-5101-1. Use of Discretionary Authority**

To further Companies' understanding of Rule 5101, Nasdaq has adopted this Interpretive Material as a non-exclusive description of the circumstances in which the Rule is generally invoked.

**(a) History of Regulatory Misconduct**

Nasdaq may use its authority under Rule 5101 to 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 Shareholder



(as defined in Rule 5635(e)(3)), or consultant to the Company. In making this determination, Nasdaq will consider a variety of factors, including:

- the nature and severity of the conduct, taken in conjunction with the length of time since the conduct occurred;
- whether the conduct involved fraud or dishonesty;
- whether the conduct was securities-related;
- whether the investing public was involved;
- how the individual has been employed since the violative conduct;
- whether there are continuing sanctions (either criminal or civil) against the individual;
- whether the individual made restitution;
- whether the Company has taken effective remedial action; and
- the totality of the individual's relationship to the Company, giving consideration to:
  - the individual's current or proposed position;
  - the individual's current or proposed scope of authority;
  - the extent to which the individual has responsibility for financial accounting or reporting; and
  - the individual's equity interest.

Based on this review, Nasdaq may determine that the regulatory history rises to the level of a public interest concern, but may also consider whether remedial measures proposed by the Company, if taken, would allay that concern. Examples of such remedial measures could include any or all of the following, as appropriate:

- the individual's resignation from officer and director positions, and/or other employment with the Company;
- divestiture of stock holdings;
- terminations of contractual arrangements between the Company and the individual; or

- the establishment of a voting trust surrounding the individual's shares.

[Nasdaq staff is willing to discuss with Companies, on a case-by-case basis, what remedial measures may be appropriate to address public interest concerns, and for how long such remedial measures would be required. Alternatively, Nasdaq may conclude that a public interest concern is so serious that no remedial measure would be sufficient to alleviate it. In the event that Nasdaq staff denies initial or continued listing based on such public interest considerations, the Company may seek review of that determination through the procedures set forth in the Rule 5800 Series. On consideration of such appeal, a listing qualifications panel comprised of persons independent of Nasdaq may accept, reject or modify the staff's recommendations by imposing conditions.]

#### (b) Audit Concerns

Accurate financial statement disclosure is critical for investors to make informed investment decisions. Nasdaq and investors rely on the work of auditors to provide reasonable assurance that the financial statements provided by the Company are free of material misstatements. Accordingly, in order to preserve and strengthen the quality of and public confidence in the Nasdaq market, and in order to enhance investor confidence, Nasdaq may rely upon Listing Rule 5101 to deny initial or continued listing or to apply additional and more stringent criteria to an applicant or a Nasdaq-listed Company based on the following considerations related to the Company's auditor:

(1) whether the auditor has been subject to a PCAOB inspection, such as where the auditor is newly formed and has therefore not yet undergone a PCAOB inspection or where the auditor, or an accounting firm engaged to assist with the audit, is located in a jurisdiction that limits the PCAOB's ability to inspect the auditor;

(2) if the Company's auditor has been inspected by the PCAOB, whether the results of that inspection indicate that the auditor has failed to respond to any requests by the PCAOB or that the inspection has uncovered significant deficiencies in the auditors' conduct in other audits or in its system of quality controls;

(3) whether the auditor can demonstrate that it has adequate personnel in the offices participating in the audit with expertise in applying U.S. GAAP, GAAS or IFRS, as applicable, in the Company's industry;

(4) whether the auditor's training program for personnel participating in the Company's audit is adequate;

(5) for non-U.S. auditors, whether the auditor is part of a global network or other affiliation of individual auditors where the auditors draw on globally common technologies, tools, methodologies, training and quality assurance monitoring; and

(6) whether the auditor can demonstrate to Nasdaq sufficient resources, geographic reach or experience as it relates to the company's audit.

Examples of additional and more stringent criteria that Nasdaq may apply to an applicant or a Nasdaq-listed Company to obtain comfort that the Company satisfies the financial listing requirements and is suitable for listing could include requiring: (i) higher equity, assets, earnings, or liquidity measures than otherwise required under the Rule 5000 Series; (ii) that any offering be underwritten on a firm commitment basis, which typically involves more due diligence by the broker-dealer than would be done in connection with a best-efforts offering; or (iii) 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 some cases, Nasdaq may determine that listing is not appropriate and deny initial or continued listing to a Company.

(c) Other Examples of the Use of Discretionary Authority

Nasdaq may also use its discretionary authority[, for example,] to impose additional or more stringent criteria, including the criteria set forth in IM-5101-1(b), in other circumstances. Examples of such use could include:

(1) when a Company files for protection under any provision of the federal bankruptcy laws or comparable foreign laws[.];

(2) when a Company's independent accountants issue a disclaimer opinion on financial statements required to be audited[, or];

(3) when financial statements do not contain a required certification[.]; or

(4) when a Company's business is principally administered in a jurisdiction that Nasdaq determines to have secrecy laws, blocking statutes, national security laws or other laws or regulations restricting access to information by regulators of U.S.-listed companies in such jurisdiction (a "Restrictive Market"). In determining whether a Company's business is principally administered in a Restrictive Market, Nasdaq may consider the geographic locations of the Company's: (a) principal business segments, operations or assets; (b) board and shareholders' meetings; (c) headquarters or principal executive offices; (d) senior management and employees; and (e) books and records.

In addition, pursuant to its discretionary authority, Nasdaq will review the Company's past corporate governance activities. This review may include activities taking place while the Company is listed on Nasdaq or an exchange that imposes corporate governance requirements, as well as activities taking place after a formerly listed company is no longer listed on Nasdaq or such an exchange. Based on such review, and in accordance with the Rule 5800 Series, Nasdaq may take any appropriate action, including placing restrictions on or additional requirements for listing, or denying listing of a security, if Nasdaq determines that there have been violations or evasions of such corporate governance standards. Such determinations will be made on a case-by-case basis as necessary to protect investors and the public interest.

(d) No Authority to Grant Exemptions or Exceptions

Although Nasdaq has broad discretion under Rule 5101 to impose additional or more stringent criteria, the Rule does not provide a basis for Nasdaq to grant exemptions or exceptions from the enumerated criteria for initial or continued listing, which may be granted solely pursuant to rules explicitly providing such authority.

(e) Remedial Measures

Nasdaq staff is willing to discuss with Companies, on a case-by-case basis, what remedial measures may be appropriate to address public interest concerns, and for how long such remedial measures would be required. Alternatively, Nasdaq may conclude that a public interest concern is so serious that no remedial measure would be sufficient to alleviate it. In the event that Nasdaq staff denies initial or continued listing based on such public interest considerations, the Company may seek review of that determination through the procedures set forth in the Rule 5800 Series. On consideration of such appeal, a Hearings Panel (as defined in Rule 5805(d)) comprised of persons independent of Nasdaq may accept, reject or modify the staff's recommendations by imposing conditions.

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