

Capital Markets Alert

November 2022

Nasdaq, NYSE and FINRA Issue Regulatory Guidance Following Micro-Cap IPO Trading Anomalies

As a result of unusual trading patterns in the wake of several recent initial public offerings (IPOs) by companies with small market capitalizations, the Nasdaq Stock Market LLC (Nasdaq), the New York Stock Exchange LLC (NYSE) and the Financial Industry Regulatory Authority (FINRA) each issued a regulatory alert on Nov. 17 to guide IPO reviews.

Nasdaq issued Equity Regulatory Alert No. 2022-9, NYSE issued Regulatory Memorandum NYSE RM-22-18 and FINRA issued Regulatory Notice 22-25, each of which notes the extreme volatility exhibited by these IPOs and identifies important considerations for underwriters conducting such offerings.

While none of the three alerts reference an effectiveness date, these policy enhancements were expected by market participants due to statements and supplemental information requests by exchange staff members engaged in the review and approval of micro-cap IPOs in September and October. Additionally, the financial press reported on the slowdown in Nasdaq approvals in several articles, particularly with respect to issuers with primary operations in China.

Nasdaq and NYSE Guidance

The Nasdaq and NYSE alerts list advises micro-cap underwriters to review several non-exhaustive areas and ask a range of questions when proceeding with an IPO. These include:

- **Syndicate composition.** Are shares allocated broadly, in a way that ensures liquidity is sufficient to encourage, rather than inhibit, price discovery? Are



shares allocated outside the United States immediately freely tradable? Is the underwriter fulfilling its obligation for price stabilization? Does the underwriter have sufficient experience successfully marketing an IPO of the proposed size and type in the United States?

- **Issuer profile.** Are the issuer and underwriter under common ownership or otherwise affiliated? Are there any relationships between the issuer and its affiliates and investors in the offering? Who are the selling shareholders, and what is their relationship with the issuer? Are the terms of the lockup reasonable? What additional diligence should be conducted to ensure those lockup agreements are not circumvented?

FINRA Guidance

In its alert, FINRA includes additional questions concerning potential abuse by foreign investors and notes the likelihood that social media scams may also play a role in trading manipulation. Questions in the following area include:

Investor profile. Are the IPO investors actually nominee accounts opened without the knowledge of the relevant individual? Do the investors' trading activities correspond

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to their ages, occupations, investment experience and sources of funding? Are such purchases being funded indirectly by the issuer or other third parties? Are omnibus accounts for foreign financial institutions being used and manipulated?

Market Participant and Underwriter Obligations

The stated goal of the enhanced reviews and investigations is to avoid the significant price spikes and collapses witnessed during summer 2022. Accordingly, the new review guidance will be supported by regulatory investigations into the conduct of market participants and micro-cap underwriters. Nasdaq Alert No. 2022-9 emphasizes these parties' "obligation to observe high standards of commercial honor and just and equitable principles of trade pursuant to Nasdaq Rule General 9, Section 1(a)," while NYSE Memorandum RM-22-18 underscores their "capacity as gatekeepers in the IPO process."

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