

SEC Toughens Listing Requirements for Reverse Merger Companies

January 6, 2012 by Amin Amirkia

On November 9, 2011 the U.S. Securities and Exchange Commission ("SEC") approved additional listing requirements proposed by the New York Stock Exchange ("NYSE"), NYSE Amex ("Amex") and the NASDAQ Stock Market ("NASDAQ") for companies going public through reverse mergers. The additional requirements are a response to the highly publicized cases of reverse merger abuses in recent months, in many cases involving the alleged accounting fraud of U.S.-listed Chinese companies.

Under the new requirements, a company will not be eligible for listing until it:

- completes a one-year "seasoning period" by trading in the U.S. over-the-counter market or on another regulated U.S. or foreign exchange;
- timely files all periodic reports required to be filed with the SEC, including at least one annual report containing audited financial statements for one full fiscal year; and
- maintains a minimum closing stock price for a sustained period, and for at least 30 of the most recent 60 trading days, prior to the filing of its listing application and the exchange's decision to list.

Furthermore, the NYSE and Amex rules reserve the discretion to impose more stringent listing requirements in the case of particular reverse merger companies based on factors including:

- an inactive trading market in the company's securities;
- the existence of a low number of publicly held shares that are not subject to transfer restrictions;

- if the company has not had a Securities Act registration statement subject to the SEC's comprehensive review; and
- if the company has disclosed that it has material weaknesses in its internal controls and has not yet implemented an appropriate corrective action plan.

There are two exceptions under which a reverse merger company will not be subject to the additional listing requirements. First, where the company is applying to list its securities with a firm commitment underwritten public offering where the proceeds to the company will be at least US\$40 million and the offering occurs subsequent to or concurrently with the reverse merger. Second, if the company satisfies the one-year "seasoning period" and has filed at least four annual reports containing audited financial statements, then it may apply for listing under the respective exchanges' other initial listing standards.

Reverse mergers allow private companies, including those located overseas, to access U.S. investors and markets by merging with an existing public shell company. In some cases, regulators and auditors have greater difficulty obtaining reliable information from reverse merger companies, particularly in cases where the reverse merger company is based overseas. Recently, the SEC launched an initiative to determine whether certain companies with foreign operations were accurately reporting their financial results, suspended or halted the trading of more than 35 companies based overseas, and issued an investor bulletin warning investors about reverse merger companies. As a response to these concerns, NYSE and NASDAQ each proposed additional and more stringent listing requirements for reverse merger companies seeking to list on their exchanges.

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