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Tougher Listing Standards for Reverse Merger Companies

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Companies that elect to go public through a reverse merger with a public shell will now find it tougher to list their shares on the three major U.S. exchanges. On November 9, 2011, the Securities and Exchange Commission announced approval of new rules adopted by the New York Stock Exchange LLC, the NYSE Amex LLC, and The NASDAQ Stock Market LLC - three major U. S. securities listing markets, that will tighten the listing standards for such reverse merger public companies.

A private company generally has access only to private forms of equity, while a public company generally has greater access to U.S. capital markets and can provide its investors greater liquidity as a result of having its stock listed on an exchange. A reverse merger is often viewed as a cheaper and quicker method of going public than an initial public offering because the legal and accounting fees are generally less expensive.

Regulators and auditors, however, sometimes find it difficult to obtain reliable information about public reverse merger companies, particularly for foreign-based companies.[1] In recent months, the SEC and the U.S. exchanges have halted or suspended trading in more than 35 foreign-based companies due to the lack of current and accurate information about the finances and operations of these companies. The SEC also has recently revoked the registration of several reverse merger companies due to failure to file required periodic reports with the SEC.

Under the additional listing requirements, a reverse merger company now must complete a one-year “seasoning” period of trading in the U.S. over-the-counter market or another U.S. or foreign regulated exchange after the company has filed all required information about the reverse merger transaction with the SEC. Additionally, the company must have filed all of its required reports with the SEC, including at least one annual report containing audited financial statements for at least one full fiscal year commencing after the date all required information about the reverse merger has been filed with the SEC. Further, a reverse merger company must maintain a required minimum closing per share stock price that is applicable to its initial listing standard (the minimum varies by exchange) for a specified, sustained period, and for at least 30 of the 60 trading days immediately prior to filing its application for listing and the exchange’s decision to approve the listing.

A reverse merger company may be exempt from these tougher listing standards if it is listing in connection with a substantial firm commitment underwritten public offering (the amount varies, based on the exchange) or if the reverse merger occurred so long ago that the company has filed with the SEC at least four annual reports with audited financial statements.

While a reverse merger remains an option for a private company to become public, an issuer that is considering a reverse merger followed by listing on one of these three exchanges should now factor these new listing standards into its decision-making process.

[1] In 2010, the SEC undertook an initiative to investigate reverse merger companies and in June 2011, the SEC issued an investor bulletin warning the public about the risks of investing in companies that have gone public by engaging in reverse mergers. For example, some foreign companies that access U.S. markets through reverse mergers use small U.S. auditing firms, which may not have the resources to meet their auditing obligations when the company's operations are based in another country. Additionally, management of these reverse merger companies may not have sufficient experience or expertise to manage a public company that is subject to U.S. securities laws and public company accounting rules. The internal controls over financial accounting that public reverse merger companies are required to maintain also may not be effective. Nasdaq also had expressed concern about gifting of stock to artificially met Nasdaq's public holder listing requirement and concerns about the manipulating of price of reverse merger companies' stocks to meet initial listing requirements.

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