MEMO# 34112

April 13, 2022

SEC Proposes Rules and Amendments Related to SPACs

[34112]

April 14, 2022

TO: Accounting/Treasurers Committee
SEC Rules Committee
Small Funds Committee RE: SEC Proposes Rules and Amendments Related to SPACs

On March 30, the SEC proposed a package of new rules and amendments related to special purpose acquisition companies (SPACs).[1] The proposal is intended to enhance investor protections in initial public offerings (IPOs) by SPACs and in subsequent business combination transactions between SPACs and private operating companies ("de-SPAC transactions").

This memorandum focuses on proposed Rule 3a-10 under the Investment Company Act, which would create a new safe harbor from the definition of "investment company" for SPACs that satisfy specified conditions (i.e., those SPACs would not be investment companies and would not be subject to regulation under the Act).

ICI currently does not intend comment on this proposal. However, if you have any feedback on it that you wish to share, please contact me directly (matt.thornton@ici.org or 202-371-5406). Comments are due to the SEC no sooner than May 31, 2022.

General Summary of the Proposal

The proposal begins by describing SPACs and de-SPAC transactions,[2] developments since the 1990s, and policy concerns that the SEC has heard.[3] The SEC believes that its proposed rules and amendments, if adopted, "could help the SPAC market function more efficiently by improving the relevance, completeness, clarity, and comparability of the disclosures provided by SPACs at the initial public offering and de-SPAC transaction stages, and by providing important investor protections to strengthen investor confidence in this market."[4]

At a high level, the proposal would:

- Add new Subpart 1600 of Regulation S-K that would impose specialized disclosure requirements in connection with SPAC IPOs and de-SPAC transactions;[5]
- Provide procedural protections and align the disclosures provided, as well as the legal

obligations of companies, in de-SPAC transactions more closely with those in traditional IPOs;[6]
- Add a new rule (Securities Act Rule 140a) that would deem anyone who has acted as an underwriter of the securities of a SPAC and takes steps to facilitate a de-SPAC transaction, or any related financing transaction or otherwise participates (directly or indirectly) in the de-SPAC transaction, to be engaged in a distribution and to be an underwriter in the de-SPAC transaction;[7]
- Add a new rule (Securities Act Rule 145a) that would deem any business combination of a reporting shell company, involving another entity that is not a shell company, to involve a sale of securities to the reporting shell company's shareholders;[8]
- Add new Article 15 of Regulation S-X, as well as related amendments, to more closely align the financial statement reporting requirements in business combinations involving a shell company and a private operating company with those in traditional IPOs; and
- Amend Regulation S-K to enhance the reliability of projections disclosure in SEC filings, including projections in connection with de-SPAC transactions.

Summary of the Proposed Investment Company Act Rule

The proposal also would add new Rule 3a-10 under the Investment Company Act, which would create a new safe harbor from the definition of "investment company" for SPACs that satisfy specified conditions. The SEC states that "some SPACs have sought to operate in novel ways that suggest that SPACs and their sponsors should increase their focus on evaluating when a SPAC could be an investment company."[9] The SEC recognizes that SPACs "are generally formed to identify, acquire and operate a target company through a business combination and not with a stated purpose of being an investment company," but also points out that "most SPACs ordinarily invest substantially all their assets in securities, often for a period of a year or more, … [and] whatever income a SPAC generates during this period is generally attributable to its securities holdings."[10]

More specifically, the proposed rule would create a non-exclusive safe harbor from the definition of "investment company" under Section 3(a)(1)(A),[11] provided that:

- The SPAC's assets consist solely of government securities, government money market funds, and cash items prior to completion of the de-SPAC transaction;
- Those assets may not at any time be acquired or disposed of for the primary purpose of recognizing gains or decreasing losses resulting from market value changes;
- The SPAC complies with certain restrictions on its activities, related in large part to its duration;[12]
- Any assets of the SPAC not used in connection with the de-SPAC transaction, or in the event that the SPAC fails to satisfy the aforementioned timing requirements for filing a Form 8-K or completing a de-SPAC transaction, will be distributed in cash to investors as soon as reasonably practicable thereafter;
- The SPAC is primarily engaged in the business of seeking to complete a single de-SPAC transaction;[13] and
- The SPAC does not hold itself out as being primarily engaged in the business of investing, reinvesting, or trading in securities.

The SEC explains that these conditions are meant to work together to reduce the likelihood that investors would view a SPAC as a fund-like investment.

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endnotes

[1] Special Purpose Acquisition Companies, Shell Companies, and Projections, SEC Release No. 33-11048 (Mar. 30, 2022) (the "proposal"), available at www.sec.gov/rules/proposed/2022/33-11048.pdf. The Commissioners voted 3-1 to issue the proposal, with Commissioner Peirce voting against it.

[2] "A SPAC is typically a shell company that is organized for the purpose of merging with or acquiring one or more unidentified private operating companies (a 'de-SPAC transaction') within a certain time frame (often two years) and that conducts a firm commitment underwritten initial public offering of $5 million or more in units consisting of redeemable shares and warrants. A SPAC is organized and managed by its sponsor, which is usually compensated through an amount equal to a percentage (often 25 percent) of the SPAC's initial public offering proceeds (in the form of discounted shares and warrants) to be received upon the completion of a de-SPAC transaction." Proposal at 9.

[3] Proposal at 8-22. The SEC mentions the following concerns: the amount of sponsor compensation and other costs and their dilutive effects on a SPAC's shareholders; the nature of the sponsor compensation (i.e., its dependence on the completion of a de-SPAC transaction) as a potential conflict of interest that could lead sponsors to enter into de-SPAC transactions that are unfavorable to unaffiliated shareholders; the adequacy of the disclosures provided to investors in terms of explaining the potential benefits, risks, and effects for investors, as well as the potential benefits for the sponsor and other affiliates of the SPAC; the disclosure about the private operating company provided through the de-SPAC transaction process may be less complete and reliable than that provided by an issuer in a traditional IPO; the use of projections in de-SPAC transactions that have appeared to be unreasonable, unfounded or potentially misleading; and the lack of a named underwriter in these transactions that would typically perform traditional gatekeeping functions, such as due diligence, and would be subject to liability under Section 11 of the Securities Act for untrue statements of material facts or omissions of material facts.

[4] Proposal at 18.

[5] These would include: (i) additional disclosures about the sponsor of the SPAC, potential conflicts of interest, and dilution; (ii) additional disclosures on de-SPAC transactions, including a requirement that the SPAC state (A) whether it reasonably believes that the de-SPAC transaction and any related financing transaction are fair or unfair to investors, and (B) whether it has received any outside report, opinion, or appraisal relating to the fairness of the transaction; and (iii) certain disclosures on the prospectus cover page and in the prospectus summary of registration statements filed in connection with SPAC IPOs and de-SPAC transactions.

[6] More specifically, the SEC proposes to: (i) amend the registration statement forms and schedules filed in connection with de-SPAC transactions to require additional disclosures

about the private operating company; (ii) require that disclosure documents in de-SPAC transactions be disseminated to investors at least 20 calendar days in advance of a shareholder meeting or the earliest date of action by consent, or the maximum period for disseminating such disclosure documents permitted under the laws of the jurisdiction of incorporation or organization if such period is less than 20 calendar days; (iii) deem a private operating company in a de-SPAC transaction to be a co-registrant of a registration statement on Form S-4 or Form F-4 when a SPAC files such a registration statement for a de-SPAC transaction, such that the private operating company and its signing persons would be subject to liability under Section 11 of the Securities Act as signatories to the registration statement; (iv) amend the definition of smaller reporting company to require a re-determination of smaller reporting company status following the consummation of a de-SPAC transaction; and (v) re-define "blank check company" to encompass SPACs and certain other blank check companies for purposes of the Private Securities Litigation Reform Act of 1995 (PSLRA) such that the safe harbor for forward-looking statements under the PSLRA would not be available to SPACs, including with respect to projections of target companies seeking to access the public markets through a de-SPAC transaction.

[7] This is intended to "better motivate SPAC underwriters to exercise the care necessary to ensure the accuracy of the disclosure in these transactions by affirming that they are subject to Section 11 liability [under the Securities Act] for that information." Proposal at 20.

[8] The SEC's concern is that such shell company shareholders may not receive a Securities Act registration statement containing disclosures about the private company that is entering the public market for the first time.

[9] Proposal at 135.

[10] Proposal at 137.

[11] Section 3(a)(1)(A) defines an "investment company" as any issuer that is or holds itself out as being engaged primarily, or proposes to engage primarily, in the business of investing, reinvesting, or trading in securities. This is referred to as the "subjective test." The SEC states that depending on the facts and circumstances, SPACs could meet the definition of "investment company" in Section 3(a)(1)(A).

[12] Specifically, the SPAC would be required to: (i) seek to complete a single de-SPAC transaction as a result of which: (A) the surviving company will be primarily engaged in the business of the target company or companies, which business is not that of an investment company, and (B) the surviving company will have at least one class of securities listed for trading on a national securities exchange; (ii) file a Form 8-K, no later than 18 months after the effective date of its initial registration statement, disclosing an agreement to engage in the de-SPAC transaction with at least one target company; and (iii) complete the de-SPAC transaction no later than 24 months after the effective date of its initial registration statement.

[13] This would be evidenced by: the activities of the SPAC's officers, directors and employees; its public representations of policies; its historical development; and an appropriate resolution of its board of directors.