Securities Regulation Daily Wrap Up, INITIAL PUBLIC OFFERINGS—SEC approves final rules that expand SPAC IPO disclosure requirements, (Jan 24, 2024)

By Suzanne Cosgrove



The rules are designed to bring greater transparency to SPAC sponsor compensation, dilution, conflicts of interest and other relevant information for investors in SPAC IPOs and de-SPAC transactions.

The SEC has adopted final rules, by a 3-to-2 vote, that seek to strengthen investor protections in initial public offerings by special purpose acquisition companies, known as SPACs, and in subsequent business transactions between SPACs and target companies they seek to merge with, commonly called de-SPAC transactions (*Special Purpose Acquisition Companies, Shell Companies, and Projections*, Release No. 33-11265, January 24, 2024).

In addition, the new rules more closely align required disclosures and legal liabilities that can occur in de-SPAC transactions with those in traditional IPOs, and they address investor protection concerns with respect to shell companies and blank-check companies. For example, in some situations, the rules would require the target company to sign a registration statement filed by a SPAC or another shell company in connection with a de-SPAC transaction, which would make the target company a "co-registrant" responsible for disclosures in the registration statement, the SEC said in a release.

In addition, the rules make the Private Securities Litigation Reform Act of 1995 (PSLRA) safe harbor from liability for forward-looking statements unavailable to certain blank-check companies, including SPACs.

Treating like cases alike. Private companies can use SPAC IPOs and de-SPAC transactions to enter the public markets. However, "just because a company uses an alternative method to go public does not mean that its investors are any less deserving of time-tested investor protections," said SEC Chair Gary Gensler in a statement. "IPOs are IPOs, and as Aristotle once said, 'treat like cases alike.'"

SPACs' structural complexity, along with their sponsors' financial incentives, raised unique investor protection concerns, noted Commissioner Jaime Lizárraga. Unlike sponsors and private investment in public equity, or "PIPE," investors who commonly receive SPAC shares at a discount, retail investors are more adversely affected by the dilution effects of SPAC structures, he said. Retail investors have not been covered by the same legal protections in a de-SPAC transaction as in a traditional IPO.

The adoption of the final rules will help ensure that the guidelines for SPACs are substantially aligned with those of traditional IPOs, Gensler said, increasing investor protections in three areas: disclosure, use of projections, and issuer obligations. "Taken together, these steps will help protect investors by addressing information asymmetries, misleading information, and conflicts of interest in SPAC and de-SPAC transactions."

Gensler noted two stages are embedded in the SPAC process. "First is when a blank-check company raises money from the public through an IPO, what I call the SPAC blank-check IPO. Second involves the merger or de-SPAC, what I call the SPAC target IPO. Whatever you call it, this second step of the process functionally is used to fulfill a similar purpose to traditional IPOs," he said.

Timing questioned as SPACs turn tepid. The Commission initially proposed the amendments on March 30, 2022, closely following a spike in SPACs' popularity that has since dwindled. Hundreds of SPAC IPOs were offered in the

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period between 2020 and 2021, but just 31 SPAC blank-check IPOs were recorded in 2023, Gensler noted.

The slow road to finalizing the SPAC rules has been problematic, said Commissioner Hester Peirce, who cast her vote against the measures, along with Commissioner Mark Uyeda. “With the time and resources it saved by engaging in a narrower rulemaking, the Commission could have undertaken a more meaningful project to assess and address the causes of the troubling dearth of public companies and the specific challenges of small companies seeking capital in the public markets,” Peirce said.

“Nearly two years after the Commission proposed this rulemaking, the SPAC market is a shell of its former self,” said Uyeda in a statement. “Today’s recommendation shows that the Commission intends to never let them (SPACs) return.”

Shrinking the path to public markets. Peirce argued the rules “will exacerbate a problem -- the shrinking pool of public companies -- by closing down one road into the public markets.” She noted in 1996 there were more than 8,000 listed companies on U.S. stock exchanges, but in mid-2022, the last data available, that number was just over 4,200 -- even as real GDP increased by 80 percent during the same period. In addition, the 1990s saw an annual average of around 412 IPOs, while that average declined to just 248 IPOs over the last 10 years – dropping to 132 IPOs if SPACs are excluded.

“The popularity of SPACs with certain types of companies was an indicator that the traditional IPO process was not working for these kinds of companies," Peirce said.

“Today’s action will render SPACs a much less useful pathway for companies to enter the public markets,” Peirce said. Further, she said the rule and accompanying release include guidance regarding investment company status “that will increase costs and harm investor protection by potentially rushing the completion of de-SPAC transactions” and hike costs “without commensurate benefit” by requiring target companies to co-register on the SPAC’s registration statement.

Certain features of SPACs needed fixing, Peirce said, “but the market was fixing them before the Commission proposed this rule.”

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