SEC Finalizes New SPAC Regulations

On January 24, 2024, the SEC approved—in a three-to-two vote along party lines—a final rule increasing disclosures for special purpose acquisition companies (SPACs) for initial public offerings (IPOs) and business combinations with private operating companies (de-SPAC transactions). The rule would better align requirements for de-SPAC transactions and IPOs and enhances investor protections. The rule also covers shell companies and projections.

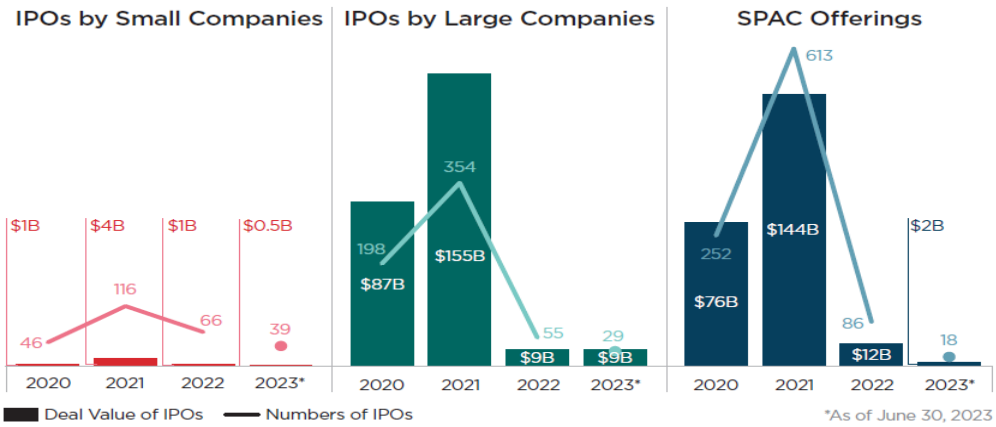
Effective Date	Compliance Date	Compliance Date XBRL
125 days after Federal Register publication	125 days after Federal Register publication	490 days after Federal Register publication

Background

A SPAC is a company with no commercial operations formed strictly to raise capital through an IPO to acquire an existing company. The IPO proceeds are escrowed for the future acquisition of one or more companies. A SPAC generally sets a two-year period to identify and complete a business transaction. If the SPAC fails to do so within the specified period, it must return the funds to its shareholders and then dissolve. This structure is similar to blank check companies, which were popular in the 1980s and became a source of securities fraud schemes. Blank check companies eventually fell out of favor with increased regulation by the SEC, most notably Rule 419, issued in 1992. Although SPACs are not subject to Rule 419 requirements, they are typically structured to operate under similar—though usually less stringent—conditions to attract investors and comply with exchange-listing requirements.

As highlighted in the chart below, SPAC activity surged in 2020 and 2021 but slowed dramatically in 2022 following the issuance of an SEC staff statement on April 12, 2021, which highlighted potential accounting implications related to warrants that are commonly included in SPAC transactions. Despite the recent decline, SPAC IPOs still constituted more than half of all U.S. IPOs respectively in 2020, 2021, and 2022 and constituted 43% of all U.S. IPOs in 2023.[1]

[1] SPAC Analytics, SPAC and US IPO Activity, spacanalytics.com.



Source: Office of the Advocate for Small Business Capital Formation, Annual Report Fiscal Year 2023

Enhanced Disclosures

New Subpart 1600 of Regulation S-K prescribes disclosures about the SPAC's sponsor, potential conflicts of interest, and dilution, as well as new disclosures for de-SPAC transactions. To the extent that the disclosure requirements in Subpart 1600 address the same subject matter as the existing form disclosure requirements, the requirements of Subpart 1600 are controlling. The rule defines a SPAC, a de-SPAC transaction, and a target company.

Sponsor Disclosure

The rule defines a SPAC sponsor as "any entity and/or person primarily responsible for organizing, directing, or managing the business and affairs of a special purpose acquisition company, excluding, if an entity is a SPAC sponsor, officers and directors of the special purpose acquisition company who are not affiliates of any such entity that is a SPAC sponsor." The following disclosures about the sponsor are required:

- The sponsor's controlling persons and any persons who have direct and indirect material interests in the sponsor
- The experience, material roles, and responsibilities of the sponsor, its officers, directors, or affiliates, as well as details on any agreement, arrangement, or understanding between these parties in determining whether to proceed with a de-SPAC transaction and the redemption of outstanding securities
- Tabular disclosure of the material terms of any lock-up agreements with the sponsor and its affiliates
- The nature and amounts of all compensation that has or will be awarded to, earned by, or paid to the sponsor, its affiliates, and any promoters for all services rendered in all capacities to the SPAC and its affiliates, and the nature and amounts of any reimbursements to be paid to the sponsor, its affiliates, and any promoters upon the completion of a de-SPAC transaction. This includes the amount of securities issued or to be issued by the SPAC to the SPAC sponsor, its affiliates, and promoters and the price paid or to be paid for such securities. Any mechanisms, such as an anti-dilution provision, to keep the SPAC sponsor ownership at a certain level (or similar mechanisms for affiliates or promoters) and any potential cancellation of shares issued or to be issued to the SPAC sponsor (or its affiliates or promoters) or increase in shares issued to the SPAC sponsor (or its affiliates or promoters) will be required to be disclosed since these features would affect shares issued or to be issued to those parties
- Any circumstances or arrangements under which the SPAC sponsor, its affiliates, and promoters, directly or indirectly, have transferred or could transfer ownership of securities of the SPAC, or that have resulted or could result in the surrender or cancellation of such securities

Conflicts of Interest

Disclosure is required of any actual or potential material conflict of interest between any SPAC sponsor or its affiliates or the SPAC's officers, directors, or promoters, and unaffiliated SPAC security holders. This includes any conflict of interest in determining whether to proceed with a de-SPAC transaction and any conflicts related to the SPAC's compensation to the sponsor, the SPAC's officers and directors, or how the sponsor compensates its own officers and directors.

Dilution

The final rule will enable investors in a SPAC IPO and subsequent purchasers of SPAC shares to better understand the potential impact upon them of the various dilutive events that may occur over the life span of the SPAC, including shareholder redemptions, SPAC sponsor compensation, underwriting fees, warrants, convertible securities, and private investment in public equity (PIPE) financings. New disclosures are required about the potential for dilution in registration statements filed by SPACs, both for the IPO and de-SPAC transactions. Those disclosures include:

- A description of material potential sources of future dilution following a SPAC's IPO, as well as tabular disclosure of the amount of potential future dilution from the public offering price that will be absorbed by non-redeeming SPAC shareholders, to the extent quantifiable
- Each material potential source of additional dilution that non-redeeming shareholders may experience at different phases of the SPAC life cycle by electing not to redeem their shares in the de-SPAC transaction
- A tabular sensitivity analysis that shows the amount of potential dilution under a range of reasonably likely redemption levels and quantifies the increasing impact of dilution on non-redeeming shareholders as redemptions increase

Remaining Pro Forma Net Tangible Book Value per Share				
Offering Price of _____	25% of Maximum Redemption	50% of Maximum Redemption	75% of Maximum Redemption	Maximum Redemption

- A description of the model, methods, assumptions, estimates, and parameters necessary to understand the sensitivity analysis

Board Opinion

The final rule scales back the proposal's required fairness statement. Instead, disclosure is required for board's evaluation of a de-SPAC transaction, including whether the body determines the combination to be advisable and in the best interest of the SPAC and its shareholders. The rule calls for disclosure related to a non-exhaustive list of factors considered in connection with the decision to pursue a de-SPAC transaction, including any third-party reports, opinions, or appraisals materially related to the transaction, the target company's valuation, projections, financing terms, and dilution.

Prospectus Cover & Summary

In addition to the current requirements in Item 501 of Regulation S-K, the final rule includes a new requirement for plain English disclosures for SPAC and de-SPAC transactions on the prospectus cover page. SPAC transaction required details include the time frame for the SPAC to consummate a de-SPAC transaction, redemptions, sponsor compensation, dilution (including simplified tabular disclosure), and conflicts of interest. For de-SPAC transactions, details should include the fairness of the de-SPAC transaction, material financing transactions, sponsor compensation and dilution, and conflicts of interest.

SPACs should include the following information in the prospectus summary in plain English:

- The process by which a potential business combination candidate will be identified and evaluated and if shareholder approval is required for the de-SPAC transaction
- The material terms of the trust or escrow account, including the amount of gross offering proceeds to be placed in the trust
- The material terms of the offered securities, including redemption rights and if the securities are the same class as those held by the sponsor and its affiliates
- The time period during which the SPAC intends to consummate a de-SPAC transaction, and its plans if it does not do so, including whether and how the time period may be extended, the consequences to the sponsor of not completing an extension of this time period, and whether shareholders will have voting or redemption rights with respect to an extension of time to consummate a de-SPAC transaction
- Any plans to seek additional financing and how such additional financing might impact shareholders
- Tabular disclosure of sponsor compensation and the extent to which material dilution may result from such compensation
- Material conflicts of interest

Details for de-SPAC transactions in the prospectus summary include:

- The background and material terms of the de-SPAC transaction, including—but not limited to—a description of any contacts, negotiations, or transactions that have occurred concerning the de-SPAC transaction
- Financing transactions in connection with de-SPAC transactions, including any payments from the SPAC sponsor to investors in connection with the financing transaction. In most—if not all—cases, this will require the registrant to disclose the price paid by PIPE investors and other benefits such as derivative securities acquired by PIPE purchasers (in addition to SPAC shares)
- The fairness of the de-SPAC transaction
- Material conflicts of interest
- Tabular disclosure on sponsor compensation and dilution
- Redemption rights. A statement on whether security holders are entitled to any redemption or appraisal rights, a summary of such redemption or appraisal rights, and—if there are no redemption or appraisal rights available for security holders who object to the de-SPAC transaction—a brief outline of any other rights that may be available to security holders

Investor Protections

The new rule better aligns the disclosures and liability protections for private operating companies entering the public markets through de-SPAC transactions to IPOs.

- **Target as Co-Registrant to Form S-4 and Form F-4**. Currently, only the SPAC and its principal executive officer, principal financial officer, controller, and at least a majority of its board of directors must sign the de-SPAC registration statement. The private operating company and its officers and directors are not required to sign the registration statement and may avoid liability for false or misleading statements. The final rule requires a private operating company to be treated as a co-registrant when a SPAC files a registration statement. This would make both the SPAC and the target company, and both sets of principal executive officers, principal financial officers, controllers, and boards of directors, liable for any material misstatements or omissions in the registration statement.

- **PSLRA Safe Harbor**. The final rule amends the definition of blank check company so that the Private Securities Litigation Reform Act (PSLRA) safe harbor for forward-looking statements, such as projections, covers filings by SPACs and certain other blank check companies.
- **Minimum Dissemination Period**. Disclosure documents in de-SPAC transactions are required to be disseminated to investors at least 20 calendar days before 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 fewer than 20 calendar days.
- **SRC Re-Determination**. Smaller reporting companies (SRCs) are a category of registrants that are eligible for scaled disclosure requirements. Currently, most SPACs qualify as SRCs and a post-business combination company after a de-SPAC transaction is permitted to retain this status until the next annual determination date when a SPAC is the legal acquirer of the private operating company in a de-SPAC transaction. The final rule requires a re-determination of a post-business combination company's SRC status before its first SEC filing after the filing of its Super Form 8-K, with its public float measured within four business days after the de-SPAC transaction and annual revenues measured using the annual revenues of the target company as of the most recently completed fiscal year reported in such Form 8-K. In a change from the proposal, the final rules provide that a registrant does not need to reflect non-SRC status in any filing that is due in the 45-day period following the consummation of the de-SPAC transaction; the registrant would begin to reflect non-SRC status in filings made no later than after the end of this 45-day period.

Shell Companies

Currently, business combinations between shell companies and non-shell companies may result in investors in the reporting shell company not always receiving the disclosures and other protections under securities regulations if the transaction is deemed an exchange and not a sale. The final rule covers all business combinations involving shell companies, including SPACs, and would:

- Rule that a business combination involving a reporting shell company and a non-shell company constitutes a sale of securities to the reporting shell company's shareholders under the Securities Act. This means the disclosure requirements and liability provisions of the Securities Act would apply. This change applies regardless of transaction structure or the form of business combination, *e.g.*, statutory merger, share exchange, stock purchase, asset purchase, etc.
- Better align the required financial statements of private operating companies in transactions involving shell companies with those required in IPO registration statements. The requirements include the disclosure of three years of statements of comprehensive income, changes in stockholders' equity, and cash flows. A shell company registrant can include two years of statements of comprehensive income, changes in stockholders' equity, and cash flows for the private operating company for all transactions involving an emerging growth company (EGC) shell company and a private operating company that would qualify as an EGC. Consistent with existing staff guidance, an entity that is or will be a predecessor, whether it is part of a shell company transaction or an issuer that is part of a shell company transaction, must have its financial statements audited by an independent accountant in accordance with the PCAOB standards. All issuers in a de-SPAC transaction would still need a PCAOB-registered audit firm to perform the audit.

Projections

Existing guidance in Item 10(b) of Regulation S-K lists factors to be considered in formulating and disclosing projections in SEC filings. A registrant has the option to present its good faith assessment of future performance but must have a **reasonable basis** for that assessment. A registrant should disclose the assumptions underlying the projections, the limitations of such projections, and the format of the projections.

New Item 1609 – De-SPAC Transactions Only

The final rule adds new Item 1609, which would only apply to de-SPAC transactions and includes the following additional disclosures relating to financial projections:

- For any projections disclosed in a filing, the purpose for which the projections were prepared and the party that prepared the projections
- All material bases of the disclosed projections, all material assumptions underlying the projections, and any factors that may impact such assumptions (including a discussion of any material growth or reduction rates or discount rates used in preparing the projections, and the reasons for selecting the rates)
- Whether the disclosed projections reflect the view of the board or management of the SPAC or target company, as applicable, as of the most recent practicable date prior to the date of the disclosure document required to be disseminated to security holders; if not, then a statement regarding the purpose of disclosing the projections and the reasons for any continued reliance by management or the board on the projections

Item 10(b) Updates – All Issuers

The SEC is concerned when companies present projections more prominently than actual historical results or use non-GAAP financial measures in projections without a clear explanation or definition. The amendments to Item 10(b) would generally apply to all issuers and will clarify:

- Any projected measures that are not based on either historical financial results or operational history should be clearly distinguished from projected measures that are based on historical financial results or operational history.
- It generally would be misleading to present projections that are based on historical financial results or operational history without presenting such historical measure or operational history with equal or greater prominence.
- The presentation of projections that include a non-GAAP financial measure should include a clear definition or explanation of the measure, a description of the GAAP financial measure to which it is most directly comparable, and why the non-GAAP measure was used instead of a GAAP measure.
- The guidance also applies to any projections of future economic performance of persons other than the registrant, such as the target company in a business combination, included in the registrant's SEC filings.

SPACs & the Investment Company Act (ICA)

The amendments address the registration status of SPACs under the ICA. An investment company is currently defined in Section 3(a)(1)(A) 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. Depending on the facts and circumstances, a SPAC could meet this definition. The proposal had a list of requirements to meet for a non-exclusive safe harbor under the ICA's

subjective test. In a change, the final rule only has a list of considerations to evaluate in determining if a SPAC meets the investment company definition. The below items should be considered at inception and throughout a SPAC's existence:

- **Nature of SPAC assets and income**. A SPAC that owns or proposes to acquire 40% or more of its total assets in investment securities would likely need to register under the ICA unless an exclusion applies.
- **Management activities**. The SEC would be concerned if a SPAC held its investors' money in securities, but the SPAC's officers, directors, and employees did not actively seek a de-SPAC transaction or spent a considerable amount of their time actively managing the SPAC's portfolio for the primary purpose of achieving investment returns.
- **Duration**. A SPAC's activities may become more difficult to distinguish from those of an investment company the longer the SPAC takes to achieve its stated business purpose.
- **Holding out**. The SPAC does not hold itself out as being primarily engaged in the business of investing, reinvesting, or trading in securities.
- **Merging with an investment company**. If a SPAC were to engage or propose to engage in a de-SPAC transaction with a target company that meets the definition of an investment company, such as a closed-end fund or a business development company, the SPAC is likely to be an investment company.

Effective Date

The rule has an extended effective date to provide sufficient time for an IPO filing to completed under existing rules for any pending or planned transactions. Any filings made on or after the effective date must comply with the final rules. The effective date will be 125 days after **Federal Register** publication.

Conclusion

The assurance team at **FORVIS** delivers extensive experience and skilled professionals to assist with your objectives. Our proactive approach includes candid and open communication to help address your financial reporting needs. At the end of the day, we know how important it is for you to be able to trust the numbers; our commitment to independence and objectivity helps provide the security and confidence you desire. FORVIS works with hundreds of publicly traded companies in the delivery of assurance, tax, or advisory services, within the U.S. and globally. For more information, visit forvis.com.

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