Katten

Corporate & Financial Weekly Digest

April 9, 2021 | Volume XVI, Issue 14

SEC/CORPORATE

SEC Corp Fin Staff Issues Statement on SPAC Transactions

On March 31, the staff of the Division of Corporation Finance (the Staff) of the Securities and Exchange Commission issued a staff statement (the Staff Statement) relating to accounting, financial reporting and governance issues for private companies to consider before engaging in a business combination with a special purpose acquisition company (SPAC).

Shell Company Restrictions

The Staff Statement serves as a reminder of important limitations under the federal securities laws that apply to SPACs, given their status as shell companies under the federal securities laws, and that should be considered in the context of a business combination. These shell company limitations include:

- A requirement to file with the SEC financial statements for the target business in a SPAC business combination within four business days of completion of the business combination. The 71-day extension period applicable to acquisitions of target businesses by operating companies does not apply in the context of a SPAC transaction.
- The combined company following a SPAC business combination is not eligible to incorporate by reference into Registration Statements on Form S-1 its reports filed pursuant to the Securities Exchange Act of 1934 (Exchange Act), proxy statements or information statements until three years after completion of the business combination.
- The combined company following a SPAC business combination is not eligible to use Form S-8 for the registration of compensatory securities until 60 calendar days after the combined company files its “Form 10 information” upon completion of the business combination.
- The combined company will remain an “ineligible issuer” as defined under the Securities Act of 1933 (the Securities Act) for three years following completion of the business combination, meaning that, during that period, the combined company (1) cannot qualify as a “well-known seasoned issuer,” (2) may not use free writing prospectuses in the context of registered securities offerings, (3) may not conduct a roadshow in the context of a registered securities offering that constitutes a free writing prospectus, including an electronic roadshow, and (4) may not rely on the safe harbor of Rule 163A of the Securities Act, for statements made in advance of filing a registration statement for a securities offering.

Additionally, although not specifically mentioned in the Staff Statement, under existing SEC rules and guidance, the combined company following a business combination will not be eligible to use Form S-3 for short-form registrations until one year following the business combination. In addition, as a former shell company, the combined company will not be eligible to use Rule 144 until one year after the Form 10 information becomes available upon completion of the business combination.

Books and Records and Internal Control Requirements

The Staff highlights in the Staff Statement that public companies with Exchange Act reporting obligations are subject to (1) the “books and records” provisions of the federal securities laws, which require public companies to maintain books, records and accounts in reasonable detail that accurately and fairly reflect the company’s transaction and disposition of assets, and (2) the “internal controls” provisions, which require companies to devise and maintain a system of internal accounting controls "sufficient to provide reasonable assurances about management's control, authority, and responsibility over the issuer's assets." These obligations, the Staff states, are among the most important for effective and reliable financial information for investors and markets. These requirements generally apply to a SPAC before it consummates a business combination and to the combined company following completion of the business combination. The Staff states that it is important for the SPAC and target business in a business combination to consider these requirements, given that the private target company may not have experience with annual or interim reporting, application of SEC rules and disclosure obligations and the adoption of new accounting standards in the financial statements that may be required in connection with the business combination.

Importantly, unlike a traditional IPO process that can often take many months to complete and provide a greater period of time for private companies to prepare for becoming public, SPAC business combinations are often completed in a relatively quick time frame. In light of the Staff Statement, the additional resources that may be required in connection with transitioning to a public company via a SPAC transaction and the relatively quick timetable upon which SPAC transactions have been completed, private companies considering entering into a business combination with a SPAC should consider enhancing their accounting and financial reporting capabilities in the lead-up to preparing for a SPAC business combination.

Stock Exchange Listing Standards

Following completion of a SPAC business combination, the combined company will be subject to the quantitative and qualitative listing standards of the national securities exchange on which it is listed, typically either the New York Stock Exchange or NASDAQ stock market. The Staff states that a private company entering into a business combination with a SPAC should consider how it will maintain a listing throughout and after the merger. Applicable quantitative listing standards that a listed company must satisfy include requirements as to the number of round lot holders, number of publicly held shares, market value of publicly held shares and share price. Qualitative standards that a listed company must satisfy include corporate governance standards, including the requirements to have a board of directors comprised of a majority of independent directors, an independent audit committee and a code of conduct applicable to directors, officers and employees.

As set forth in the Staff Statement, advance planning may be necessary "to identify, elect, and on-board a newly-constituted independent board and audit committee." Given the relatively quick timetable upon which SPAC transactions have been completed and competition for talented and experienced director candidates, private companies planning a SPAC transaction should consider potential desirable director candidates early in the process.

Conclusion

The Staff Statement serves as a timely reminder that there are many important considerations related to being a public company that private companies should consider when preparing for a business combination with a SPAC. As discussed in detail above, this includes understanding special limitations and restrictions on SPACs that are not generally applicable to public operating companies, ensuring that the combined company has the capabilities and resources to comply with its ongoing financial and other reporting obligations under the Exchange Act and being mindful of, and planning for, the applicable listing requirements of the New York Stock Exchange and NASDAQ stock market, including requirements as to independent directors.

The SEC's Staff Statement.

BROKER-DEALER

SEC Issues Notice of Substituted Compliance Application and Proposed Substituted Compliance Order for United Kingdom and Reopens Comment Period for Notice and Proposed Substituted Compliance Order for France

On April 5, the Securities and Exchange Commission voted to take two actions in the implementation of security-based swap regulation under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act).

Substituted compliance is a mechanism that allows the SEC to determine that certain participants in US security-based swap markets may satisfy certain requirements under the Securities Exchange Act of 1934 (Exchange Act) by complying with comparable non-US requirements. Under the SEC's substituted compliance regime, the SEC may determine that registered non-US security-based swap dealers and registered non-US major security-based swap participants may satisfy certain requirements under Exchange Act section 15F and the rules and regulations thereunder by complying with comparable non-US requirements.

The SEC published a notice of application and proposed substituted compliance order in response to an application from the K Financial Conduct Authority (FCA). The FCA application seeks substituted compliance for UK-regulated firms based on compliance with UK requirements. The proposed substituted compliance order for the United Kingdom provides that certain UK-regulated firms that are also registered with the SEC as security-based swap dealers and major security-based swap participants conditionally may satisfy certain requirements under the exchange by complying with comparable UK requirements.

In addition, the SEC re-opened the comment period on the notice of application and proposed substituted compliance order in relation to the application by France's Autorité des Marchés Financiers (AMF) and Autorité de Contrôle Prudentiel et de Résolution (ACPR).

The public comment period is open for 25 days following publication in the Federal Register.

The SEC's original notice and proposed order for the United Kingdom.

The SEC's original notice and proposed order for France.

Compliance Issues Related to Suspicious Activity Monitoring and Reporting at Broker-Dealers

On March 29, the Securities and Exchange Commission Division of Examinations (EXAMS) issued a risk alert to remind broker-dealers of their obligations related to anti-money laundering (AML) rules and regulations, as well as to provide the staff's observations of compliance items related to those obligations. The risk alert is designed to assist broker-dealers with reviewing and enhancing their AML programs.

SEC examination staff observed deficiencies in firms' establishment of procedures and internal controls for identifying and reporting suspicious activity, including:

1. Not including any red flags in their policies and procedures to assist with identifying activity for further due diligence, or failing to include red flags associated with securities transactions;
2. Not establishing and implementing automated systems to monitor and report suspicious activity associated with trading in large volumes;
3. Failing to include securities priced between $1 and $5 per share (by setting price to $1) in automated monitoring of "penny stocks";
4. Setting Suspicious Activity Report (SAR) reporting thresholds at amounts significantly higher than the $5,000 threshold specified in the SAR Rule and thus failing to identify and report potentially suspicious transactions involving amounts between $5,000 and the firms' elevated thresholds; and
5. Deferring inappropriately to clearing firms to identify and report suspicious transactions in customer accounts and failing to adopt their own procedures that take into account the high-risk nature of their customers' activity.

In addition, EXAMS noted that some firms failed to implement appropriate procedures:

1. To sufficiently explain why they were not filing a SAR on activity that appeared identical to activity for which they otherwise filed SARs;
2. To review red flags identified by their own procedures, such as deposits and immediate liquidations of large quantities of low-priced securities, or allowing trading in penny stocks when their policies and procedures prohibited this activity; and
3. To accurately complete SARs, specifically noting that firms who each filed hundreds of SARs or more often contained the same generic boilerplate language, which failed to make clear the true nature of the suspicious activity and the securities involved, rendering the SAR less valuable to law enforcement and regulators trying to understand the activity and its criminal or regulatory implications.

The full text of the EXAMS risk alert.

FINRA Modifications to TRACE Dissemination Protocols for Specified Pool Transactions (MBS)

On April 6, the Financial Industry Regulatory Authority (FINRA) announced further updates to its Trade Reporting and Compliance Engine (TRACE) dissemination protocols for specified pool transactions, as described in Regulatory Notice 21-02 published on February 2.

FINRA disseminates a Reference Data Identifier (RDID) for specified pool transactions. The RDID represents approximated values for underlying data elements, such as the Loan-to-Value (LTV) ratio, original maturity and coupon, widely used to project cash flows and prepayment rates.

As part of the February 2 release, FINRA noted that it is modifying the convention for rounding the original LTV of transactions in agency pass-through mortgage-backed securities and Small Business Administration (SBA)-backed asset-backed securities traded in specified pool transactions. LTV ratios will be segmented into eight categories between zero and 121+, and FINRA will show the LTV as the upper limit of the applicable category.

The change will become effective on May 17. On that day, the TRACE RDID Master File will be updated with the changes. Because the volume of RDID reassignments that will occur on May 17 may impact system processing, FINRA is posting a sample test MBS Master File on FINRA.org from April 19 to May 14. This file will allow users to test the volume of changes that will occur.

FINRA Regulatory Notice 21-02.

Further discussion of Regulatory Notice 21-02.

FINRA Proposes Extension of Temporary COVID-19 Related Amendments

On March 31 and April 1, the Financial Industry Regulatory Authority (FINRA) proposed rule changes that would extend the expiration date for temporary amendments that (1) provide relief to individuals functioning as a principal or operations professional, (2) provide relief to FINRA staff from certain enforcement and procedural requirements, and (3) allow virtual hearings.

Specifically, the proposal would extend:

- SR-FINRA-2020-026, which would extend the 120-day period that certain individuals can function as a principal or operations professional without having successfully passed an appropriate qualification examination. The expiration date is extended from April 30 to June 30. SR-FINRA-2020-026.
- SR-FINRA-2020-015, which provides temporary relief for FINRA staff from "timing, method of service and other procedural requirements." The expiration date would be extended from April 30 to August 30. SR-FINRA-2020-015.
- SR-FINRA-2020-027, which allows the Office of Hearing Officers and National Adjudicatory Council to conduct virtual hearings for (1) appeals of Membership Application Program decisions, (2) disciplinary decisions, (3) eligibility proceedings and (4) cease and desist orders. The expiration date is extended from April 30 to August 30. SR-FINRA-2020-027.

FINRA Updated and New Supervision FAQ for Rule 3120 and Rule 3120 Reports

On April 7, the Financial Industry Regulatory Authority (FINRA) issued updated Supervision Frequently Asked Questions to clarify differences between the Rule 3120 Report and the Rule 3130 Report. FINRA also drafted a new Frequently Asked Question to address how member firms can change the date on which their Rule 3130 annual certification is due.

FINRA provided additional information on the following questions:

1. What is the difference between the FINRA Rule 3120 report and the FINRA Rule 3130 report?

   FINRA provides additional clarification that the Rule 3130 report identifies the processes a firm has in place, at the time of the CEO's certification, to establish, maintain, review, test and modify its written compliance policies and written supervisory procedures. Whereas, the Rule 3120 report requires member firms to conduct a look back of their system of supervisory controls and testing and to provide to their senior management (no less than annually) a report that: (1) details the manner, method and review for testing and verifying that a firm's system of supervisory policies and procedures are reasonably designed to achieve compliance with applicable rules and laws; (2) provides a summary of the test results and significant gaps found; and (3) identifies the changes a firm made or will need to make to its supervisory procedures in order to address deficiencies found through its testing.

2. What are the timetables for the FINRA Rules 3120 and 3130 reports and the Rule 3130 certification?

   FINRA provides an updated table, including frequency, time period covered by a report and party to submit a report to, for Rules 3120 and 3130.

3. How can member firms change the date on which their Rule 3130 annual certification is due?

   FINRA issued a new FAQ on changing the recertification date for Rule 3130. FINRA notes that the date may be changed by a firm certifying any time before the one-year anniversary of its most recent certification. This will require the firm to certify more than once within the one-year period. However, the following year, the annual certification would be due on or before the new date.

FINRA's full FAQ for Supervision.

CFTC

CFTC Issues Customer Advisory on Trading Based on Information Communicated Online

On April 6, the Commodity Futures Trading Commission's (CFTC) Office of Customer Education and Outreach (OCEO) issued a Customer Advisory, reminding investors to understand fully how commodity futures markets, physical markets and securities markets differ before engaging in trading activity based on tips or other information communicated through social media. The CFTC noted that posts on online message boards and social media platforms have contributed to increasing volatility in the market. Recently, large numbers of investors have engaged in speculative short-term trading in commodity-backed exchange traded products (ETP), physical commodities, commodity futures and options. Many of these investors held on to their positions too long or did not understand the product or market in which they were trading.

Based on this recent trading activity, the OCEO reminded investors that there are risks associated with futures trading and buying physical commodities. In addition, the OCEO advised that investors should consider the following before engaging in trades that involve commodity futures or physical commodities: (1) only trade with "risk capital;" (2) experience in one market may not transfer to success in other markets; (3) know exactly what is in a commodity ETP and how its trading strategy can be affected by market forces; (4) better to develop your own trading plan than to follow others; (5) consider the source of your information; (6) investing in physical precious metals is not risk-free; and (7) beware of fraudsters using get-rich-quick promises.

The OCEO's Customer Advisory.

UK DEVELOPMENTS

FCA Update on Reporting LEIs of Non-EEA Third Country Issuers Under UK SFTR

On April 6, the UK Financial Conduct Authority (FCA) announced that legal entity identifiers (LEIs) of non-EEA third country issuers will not need to be reported under the UK version of the European Union's Regulation on reporting and transparency of securities financing transactions (UK SFTR), until at least April 13, 2022.

Under Article 4 of the UK SFTR, reporting counterparties must use LEIs to identify entities when submitting transaction reports under the UK SFTR.

In January 2020, ESMA granted 12 months of forbearance from the entry into force of EU SFTR reporting requirements for the reporting of LEIs of non-EEA third country issuers under the reporting technical standard.

Although the industry has made progress to encourage more extensive LEI coverage among non-EEA third country issuers, the FCA acknowledges that there continues to be many non-EEA third country issuers without an LEI.

The FCA stated that the extension of the period during which reports under the UK SFTR without the LEI of a non-EEA third country issuer will be accepted should help to reduce market disruption. The FCA expects reporting counterparties to continue engaging with non-EEA third country issuers to obtain an LEI. It also expects reporting counterparties to report an LEI for non-EEA third country issuers where available.

The FCA webpage.

For additional coverage on financial and regulatory news, visit *Bridging the Week*, authored by Katten's Gary DeWaal.

For more information, contact:

SEC/CORPORATE		
James J. Calder	+1.212.940.6460	james.calder@katten.com
Bonnie Lynn Chmil	+1.212.940.6415	bonnie.chmil@katten.com
Brian J. Hecht	+1.212.940.8516	brian.hecht@katten.com
David S. Kravitz	+1.212.940.6354	david.kravitz@katten.com
Laura Keidan Martin	+1.312.902.5487	laura.martin@katten.com
Mark J. Reyes	+1.312.902.5612	mark.reyes@katten.com
Jonathan D. Weiner	+1.212.940.6349	jonathan.weiner@katten.com
Mark D. Wood	+1.312.902.5493	mark.wood@katten.com
FINANCIAL MARKETS AND FUNDS		
Henry Bregstein	+1.212.940.6615	henry.bregstein@katten.com
Wendy E. Cohen	+1.212.940.3846	wendy.cohen@katten.com
Daniel J. Davis	+1.202.625.3644	daniel.davis@katten.com
Gary DeWaal	+1.212.940.6558	gary.dewaal@katten.com
Kevin M. Foley	+1.312.902.5372	kevin.foley@katten.com
Mark D. Goldstein	+1.212.940.8507	mark.goldstein@katten.com
Jack P. Governale	+1.212.940.8525	jack.governale@katten.com
Christian B. Hennion	+1.312.902.5521	christian.hennion@katten.com
Carolyn H. Jackson	+44.20.7776.7625	carolyn.jackson@katten.co.uk
Susan Light	+1.212.940.8599	susan.light@katten.com
Richard D. Marshall	+1.212.940.8765	richard.marshall@katten.com
Paul McCurdy	+1.212.940.6676	paul.mccurdy@katten.com
Fred M. Santo	+1.212.940.8720	fred.santo@katten.com
Christopher T. Shannon	+1.312.902.5322	chris.shannon@katten.com
Robert Weiss	+1.212.940.8584	robert.weiss@katten.com
Allison C. Yacker	+1.212.940.6328	allison.yacker@katten.com
Lance A. Zinman	+1.312.902.5212	lance.zinman@katten.com
Krassimira Zourkova	+1.312.902.5334	krassimira.zourkova@katten.com
UK DEVELOPMENTS		
Carolyn H. Jackson	+44.20.7776.7625	carolyn.jackson@katten.co.uk
Nathaniel Lalone	+44.20.7776.7629	nathaniel.lalone@katten.co.uk
Neil Robson	+44.20.7776.7666	neil.robson@katten.co.uk

* Click here to access the *Corporate & Financial Weekly Digest* archive.