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Regulatory Recap

January 31, 2024

Notable Developments:

SEC tightens SPAC regulation

SEC fined JPMorgan \$18 million for violating the whistleblower protection rule

SEC announced charges against the founder and promoter of \$1.7 million crypto HyperFund

SEC announced settled charges against AON Investments and former partner for misleading a public pension fund investor

SEC denied the petition by the New Civil Liberties Alliance to amend the agency's Gag Rule

SEC Chairman Gensler delivered speech on shortening settlement cycle

FINRA published update on November 2022 targeted exam (sweep) regarding crypto asset communications

FINRA issued Regulatory Notice 24-02 announcing effective dates of new rules regarding residential supervisory location (effective June 1, 2024) and remote inspections pilot program (effective July 1, 2024)

SEC Tightens SPAC Regulation

On January 24, 2024, the SEC commissioners voted 3-to-2 to adopt final rules to tighten regulations of special purpose acquisition company (SPAC) transactions. SPAC transactions have recently been used by private companies as an exit venue for IPOs. These transactions consist of two phases: (1) an initial public offering by a SPAC, which is a shell company formed with the purpose of using the IPO proceeds to acquire a private operating business (target) to be identified after the IPO; and (2) a de-SPAC transaction, i.e., a merger or business combination of the SPAC with the target with the SPAC's shareholder approval. Once the requisite shareholder approval is obtained and the merger closes, the target company will become a public company via the merger.

SPAC gained popularity [during 2020-2021 but slowed in 2022-2023](#). Since Chairman Gary Gensler assumed his current role, he has been vocal about adequate protection for investors in SPAC deals and the need to treat (de-)SPAC transactions like IPOs. In a [speech](#) he gave in December 2021, Chairman Gensler provided his thoughts on tightening the SPAC regulations by requiring full and fair disclosures, providing standards around marketing practices and gatekeeper responsibilities and liabilities. These thoughts foretold not only tougher enforcement actions against fraud and misleading disclosures in SPAC IPO and de-SPAC merger transactions (including the [latest charges against Northern Star SPAC](#) for misrepresentations in its IPO disclosures regarding the initiation of substantive discussions with potential target companies) but also new rulemakings. In March 2022, the SEC [proposed](#) new SPAC [rules](#), that would require (i) enhanced IPO disclosures regarding SPAC sponsors, conflicts of interest and dilution and enhanced de-SPAC

disclosures, including with respect to the fairness of the business combination (i.e., the de-SPAC transaction) to the SPAC IPO investors; (ii) target companies to be a co-registrants when the SPAC files a registration statement for a de-SPAC transaction (making any target company responsible for the accuracy and completeness of the disclosures in the registration statement); (iii) the liability safe harbor for forward-looking statements in filings by SPACs to be unavailable in investors' private litigations against SPACs; and (iv) the underwriters in a SPAC IPO to also be the underwriters in the subsequent de-SPAC transaction if certain conditions are met, which would result in the investment banks acting in a SPAC IPO to be held responsible for the subsequent de-SPAC transaction.

The majority part of the proposed rules are preserved in the [final rules](#) adopted by the SEC, including:

Requiring enhanced disclosures regarding SPAC sponsor compensation, conflicts of interest, dilution, the target company, and other information important to investors in SPAC IPOs and de-SPAC transactions;

Requiring in certain situations (but not in all situations) the target company in a de-SPAC transaction to be a co-registrant with the SPAC in the de-SPAC filings and therefore, the target company would assume the responsibility for the disclosures in the registration statement filed by the SPAC in connection with the de-SPAC transaction;

Deeming any business combination transaction (including a de-SPAC transaction) that involves a reporting shell company (including a SPAC) to be a sale of securities to the reporting shell company's shareholders, and imposing financial statement requirements on de-SPAC transactions that will be better aligned with those financial statement requirements in traditional IPOs;

Making safe harbor for forward-looking statements in de-SPAC transactions unavailable in investor private litigation lawsuits against SPACs and targets, thereby aligning the treatment of forward-looking statements with that in traditional IPOs. The final rules also include disclosure requirements regarding forward-looking statements, including disclosure of all material bases of projections and material assumptions underlying the projections.

Two dissenting commissioners, Hester Pierce and Mark Uyeda, each issued a statement. Commissioner Uyeda argues in his [dissenting statement](#) that the final rules have gone far beyond balancing the application of a regulatory framework to both the IPO and M&A elements in SPAC transaction to become a form of "merit regulation in disguise". In his opinion, what the SEC tries to do is to impose stringent requirements to discourage people from engaging in SPAC IPO and de-SPAC merger in order to discourage SPAC transactions, as a result of the majority's distaste for them. Both Mark Uyeda and [Hester Pierce](#) ask whether this set of final rules would be a success if there are no SPAC IPOs or de-SPAC transactions after this rulemaking.

The final rules will become effective 125 days after publication of the final rules in the Federal Register. Compliance with respect to the structured data requirements (which require tagging of the information disclosed pursuant to subpart 1600 of Regulation S-K in Inline XBRL) will be required 490 days after publication of the final rules in the Federal Register.

Enforcement Actions:

SEC [fined](#) JPMorgan \$18 million on January 16, 2024 for violating the whistleblower protection rule. The SEC concluded that JPMorgan's confidential release agreements containing provisions that required retail clients to keep confidential the settlement, all underlying facts relating to the settlement and all information relating to the client accounts at issue, impeded its clients from voluntarily reporting to the SEC potential securities law violations by JPMorgan. This is one of the series of enforcement actions in recent months by the SEC against financial institutions for imposing confidentiality provisions in various agreements that have the effect of prohibiting employees and customers from voluntarily reporting violations of law. For example, SEC took enforcement actions against [DE Shaw](#) and [CBRE](#) in September 2023 and [Activision Blizzard](#) in February 2023.

SEC [announced](#) charges against the founder and promoter of \$1.7 billion crypto HyperFund on January 29, 2024.

SEC [announced](#) settled charges on January 25, 2024, against AON Investments, a registered investment adviser, and its former partner for failure to provide honest reasons for the discrepancy in its calculations of investment return rates for a public pension fund client and making misrepresentations to mislead the public pension fund client.

In Case You Missed It...

On January 30, 2024, SEC denied the petition by the New Civil Liberties Alliance ("NCLA") to amend the agency's Gag Rule, which prohibits a defendant or respondent from denying the SEC's allegations in a complaint or an administrative order in settling the SEC's charges in an enforcement case. The policy behind the Gag Rule is to avoid creating an impression that the conduct being sanctioned did not, in fact, occur. NCLA stated in its petition that the Gag Rule is unconstitutional and in practice, the SEC goes beyond the Gag Rule to require defendants or respondents who enter into settlement to agree to never to take action or make any public statement denying any allegation made by the SEC or create an impression that the SEC's complaint is without factual basis. If the defendant or respondent breaches the settlement agreement, the SEC may re-open the prosecution and charges.

SEC Chairman Gensler delivered a [speech](#) on January 25, 2024 before the European Commission regarding shortening settlement cycle to T+1 on May 28, 2024 and the IPO trade settlement will also be shortened from T+4 to T+2 on May 28.

FINRA published an [update](#) on a [targeted exam](#) (sweep) it conducted in November 2022 to review broker-dealer firms' communications with retail customers regarding crypto assets and crypto-related services and their compliance with FINRA Rule 2210.

FINRA issued Regulatory Notice [24-02](#) to announce new Rule 3110.19 regarding residential supervisory location effective on June 1, 2024 and Rule 3110.18 regarding remote inspections pilot program effective on July 1, 2024.