SEC ADOPTS FINAL

SPAC AND DE-SPAC RULES

Impacts from SEC's SPAC-Related Final Rules

Almost two years after its initial proposal and over two years after the 2020-21 SPAC boom, the SEC has adopted final rules (Rules) codifying enhanced disclosure requirements and imposing additional responsibilities for Special Purpose Acquisition Companies (SPACs), target companies of de-SPAC transactions and all directors and officers.[1]

National law firm Skadden, Arps, Slate, Meagher & Flom LLP authored a thorough summary of the Rules from a legal perspective.[2] The Rules largely track the SEC's proposal released in March 2022; however, the SEC did not adopt the hardline rule creating back-end liability on SPAC IPO underwriters participating in the de-SPAC transaction.

D&O Insurance Implications

1. IMPACT ON D&O INSURANCE UNDERWRITING

Certainly, the Rules codify significant obligations and increase legal liability for entities and individuals involved in SPAC IPO and de-SPAC transactions. However, the reality is that once the Rules come into effect, which is estimated June 2024, the impact on how D&O insurance underwriters assess and classify the D&O claims risk is not likely to materially change.

The number of SPAC formations has significantly decreased, aligning more closely with historical trends. In 2023, only 32 SPAC IPOs were priced, averaging $125 million each, marking a 21% year-over-year deceleration.[3] This shift has enabled D&O underwriters to keep up with the pace of insurance submissions for the resulting business combinations or liquidations more effectively. Consequently, they can now more carefully underwrite smaller transactions with reduced severity potential.

The overall quality of transactions, which has already shown improvement compared to the 2020-21 SPAC Boom, is not anticipated to undergo significant changes post-Rule adoption.

De-SPAC transactions that followed the SEC's proposed rules released in March 2022 have predominately adhered to the transparency and disclosure-based requirements outlined therein, which remain consistent in the final rules. What does this mean? The overall quality of transactions, which has already shown improvement compared to the 2020-21 SPAC Boom, is not anticipated to undergo significant changes post-Rule adoption.

D&O underwriters active in the SPAC and de-SPAC space throughout the past year have gained confidence in the quality of the filings, evidenced by a notable increase in available capital and accompanying reductions in costs and retentions. However, it's important to note that this doesn't imply a complete absence of elevated D&O litigation risk in SPAC and de-SPAC transactions since mid-2022. The stock price performance of de-SPAC companies has declined approximately 61.3% from March 2022 to January 2024, a sharper decline compared to VC-backed IPO companies at -31.6% and PE-backed IPO companies at -16.9%.[4] While the risk isn't as pronounced as during the 2020-21 SPAC Boom, it's also unlikely that the SEC Rules will significantly elevate claims probability risk beyond current levels.

2. D&O INSURANCE PROGRAM CONSIDERATIONS

The SEC Rules underscore the intricate interplay of risks and responsibilities, particularly evident in the co-registrant status of the target company in a de-SPAC transaction alongside the SPAC. While our stance is that adopting the SEC Rules won't substantially heighten liability beyond current levels, the D&O claims risk stemming from SPAC and de-SPAC transactions will persist at an elevated level. SPAC-related litigation and investigations are incredibly complex and costly to defend, carrying the potential for substantial liability for SPACs, target companies, directors and officers alike.

Businesses and their representatives must strategically design D&O programs to mitigate the risks associated with SPAC and de-SPAC transactions effectively. While SPACs and target companies may anticipate their D&O programs will adequately cover all D&O and securities-related exposures, this has yet to be the case.

The conventional method of structuring D&O coverage for SPACs and target companies has demonstrated its inadequacy, often leaving significant gaps or even complete absence of coverage for many claims-related exposures.

Key areas of focus in refining D&O programs include:

+ Assessing the adequacy of the SPAC's D&O program and determining the strategic or economic viability of converting the program to runoff at the time of a de-SPAC transaction.
+ Negotiating the removal of exclusions on target company D&O programs following a de-SPAC aimed at sidestepping coverage for the SPAC and severely limiting coverage for the target company.
+ Addressing potential misalignments between D&O programs for the SPAC and target company.
+ Creating solutions for costly SEC and DOJ investigations and proceedings targeting the companies and their directors and officers.

The absence of coverage can have a profound impact on a newly public company and its directors and officers. In this nuanced space, marketplace solutions are not standardized. The scope of coverage and the selection of insurers are crucial and should be negotiated with as much care as price and retentions. There is no need to choose between lower premium spend and broad coverage; both can be achieved through thoughtful negotiation and selection processes.

If you want to understand how to successfuly implement strategic cost-saving measures while optimizing protection from the D&O claims risks inherent in SPAC and de-SPAC transactions, talk to an IMA Executive Risk Solutions representative.

FOR ANY QUESTIONS, PLEASE REACH OUT TO:

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