05-05-2021 (update 20-05-2021)

Public consultation by the FSMA about a proposal for minimum standards for the structuring, information disclosure and trading in SPACs on Euronext Brussels

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A SPAC, or Special Purpose Acquisition Company, is a new company established for the specific purpose of raising capital, applying for a stock exchange listing (IPO) and then, within a brief period - usually a maximum of 24 months - financing a merger with or acquisition of a private company, the target, and incorporating that target into the SPAC to form a business combination which thereby becomes a public company.

The company places the net proceeds of the IPO in an escrow (trust) account. The funds in that account serve to fund the redemptions of investors who may wish to exit the SPAC at the time of the formation of the business combination and/or to finance the acquisition of the target.

Still relatively rare in Europe, this type of company is quite common in the United States and Asia. In Belgium, to date no SPAC has been listed.

In jurisdictions where this phenomenon exists, market practices have developed regarding the functioning of SPACs. Although the underlying philosophy of SPACs is generally the same everywhere (i.e. raising money to acquire a target), the structure must meet the specificities of each country's national legislation and may also vary from one SPAC to another.

SPACs have features that distinguish them from other companies that go public. For example, right after the SPAC enters the stock market, the founders hold a substantial interest in the company, one that is not proportionate to their own contribution. Furthermore, there is not necessarily a connection between the amount of capital raised through the IPO and the acquisition cost of the target. The valuation of a SPAC is not based on criteria that are customary in the financial markets and familiar to investors. Because dilution is inherent in the structure of a SPAC at various points in its lifespan, profit and loss opportunities may not be the same for all stakeholders. SPACs are a heterogeneous, complex investment product. This makes it difficult for non-qualified investors to make informed judgments about them.

For these reasons, the FSMA is proposing a set of minimum standards, based on academic literature and practical examples from European countries. These standards cover the structure of SPACs, information disclosure and the arrangements for redemption by investors. The FSMA also takes a position on the extent to which SPACs are suited, and should therefore be accessible, to retail investors. The proposed position seeks to strike a balance between the normal, smooth operation of the capital market and the requirements needed to ensure that investors can make informed decisions about investing in SPACs.

The FSMA's proposed minimum standards for the design and trading of SPACs and for information disclosure are included under section III of this document.

Market participants are invited to submit reactions and suggestions regarding this analysis and these proposals to the email address Consult1@fsma.be between 10 and 31 May 2021.

Please note that there are a very wide variety of SPACs. The consultation is based on a non-exhaustive observation of a number of SPACs. The observations and proposals set out below will therefore need to be adapted to the specific nature and organization of each SPAC.

I. SPACs - Special Purpose Acquisition Companies - are on the rise

What is a SPAC?

A SPAC, or Special Purpose Acquisition Company, is a new company established for the specific purpose of raising capital, applying for a stock exchange listing and then, within a brief period - usually a maximum of 24 months - financing a merger with or acquisition of a private company, the target, and incorporating that target into the SPAC to form a business combination and take that company public.

At the time of its formation, the SPAC's sole aim is to find a target and acquire or merge with it. It has no real assets, no cash flow and no operations other than issuing shares and warrants in exchange for cash, which is why it is also known as a "blank cheque corporation". As with any newly founded company, specific historical information is by definition scarce or non-existent.

A. History and recent rise: 2020 saw more than 300 SPAC IPO transactions

SPACs have recently drawn attention as a new phenomenon, but such vehicles have been around for several decades, mainly in the United States. Initially, these were rather opaque over-the-counter transactions intended to finance and organize acquisitions. Since the early 2000s, SPACs have been listed on various stock exchanges in the US[1]. Recently, it is mainly in the US that SPAC IPOs have seen a rapid rise. They now represent one of the main ways to raise capital and take companies public.

The drivers behind the current rise of SPACs include: the bullish stock market and high share prices, an abundance of liquidity, low/negative interest rates, the entry of celebrities and financial institutions into this segment and the hype around SPACs (mainly among investment bankers) as a new way of doing business.

In January and February 2021 alone, 50 completed SPAC merger[2] deals were registered in the US worth a total of around USD 140 billion[3]. However, the phenomenon is not limited to the US. Last year, more than **300 SPAC IPO** transactions were concluded worldwide for an average of USD 330 million per transaction[4].

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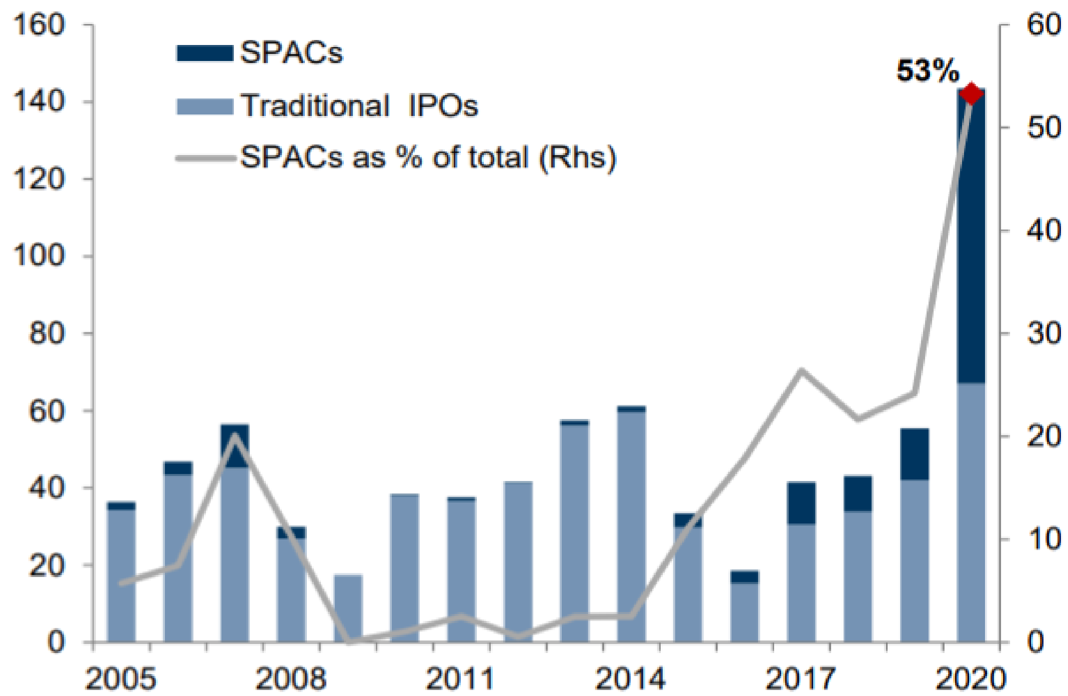
1 https://www.sciencedirect.com/science/article/pii/S0261560616300845

2 This is the newly-formed business combination (i.e. the SPAC after the successful acquisition of the target), also referred to as de-SPAC, post-SPAC or completed business combination.

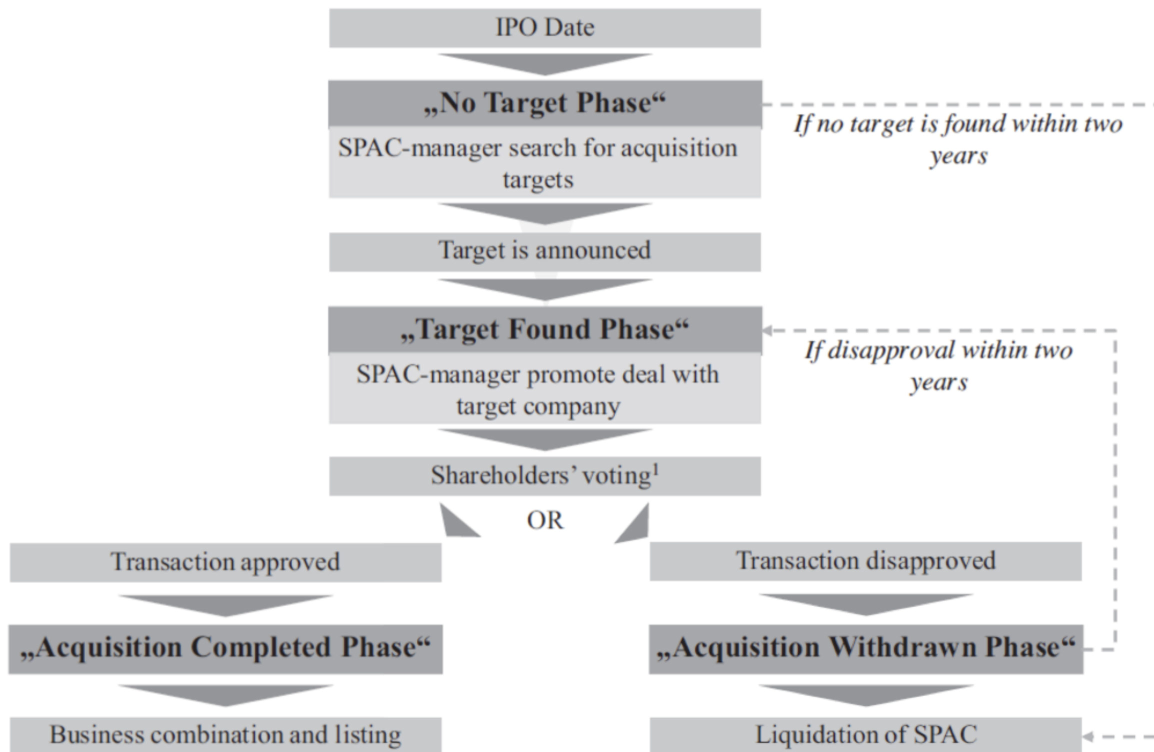
3 https://www.goldmansachs.com/insights/pages/top-of-mind/the-ipo-spac-tacle/report.pdf, list of shell companies in SPAC dossier.

4 Bloomberg.



Source: Dealogic, Goldman Sachs Global Investment Research.

B. Stages and characteristics of a SPAC project[5]



1. The foundation of the SPAC

The founders (also known as managers or sponsors of the SPAC) establish a company. In exchange for a limited investment of their own (sponsors' risk) in the project, they usually receive founder shares and founder warrants in the SPAC. Founder shares and founder warrants can often be converted later into common shares on a one-for-one basis. Other professional parties can sign up for the upcoming IPO on attractive terms.

The sponsors are often experienced individuals from the world of finance with a background in private equity, investment banking, legal or consultancy whose reputation, knowledge, contacts and efforts are considered crucial to guarantee the quality of the envisaged acquisition.

The founding of the SPAC is made possible by a private financing round. The sponsors contribute a modest amount of their own money and, by way of private placement, call upon professional

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5 Figure from: Douglas Cumming, Lars Helge Haß & Denis Schweizer, "The fast track IPO – Success factors for taking firms public with SPACs," *Journal of Banking & Finance*, vol. 47, 2014, 198-213.

parties such as hedge funds, specialized investment funds and, more recently, high net worth individuals, family offices and sovereign wealth funds to subscribe to units consisting of one share and one or more (fractions) of warrants. These parties see participating in the financing of a SPAC as a way to create a securities portfolio that offers private equity-like exposure. In addition, they benefit from the upcoming IPO, thus liquidity, the right to a say about potential acquisitions, and significant earnings potential, including via the warrants.

The remuneration structure of a SPAC is set up in such a way that, in return for their modest investment, the sponsors will own a package (in the form of founder warrants and founder shares, known as their 'promote') that can in the end represent up to 20% of the share capital of the business combination (SPAC+target). Consequently, a modest initial investment by the sponsors can give rise to significant returns.

2. Placement with institutional investors

After the SPAC has been established by the founders, institutional investors are generally offered, via a private placement, the chance to subscribe to units composed of one share and one warrant (or fractions thereof). A unit is commonly valued at USD 10 (or EUR 10 on the European markets). The warrant, whose strike price is usually accompanied by a premium, can be exercised only after the business combination has been completed – with or without a vesting period. Warrants are generally acquired, even for dissenting shareholders (shareholders who at the time of the formation of the business combination ask to redeem their shares)[6].

3. The stock exchange listing, or "SPAC IPO"

Once the SPAC has been set up and the private placement of the units is complete, an immediate listing on a public exchange is requested: the SPAC IPO. This is in fact the start of the secondary market in the securities (shares and warrants) of the SPAC, and other external investors can now participate. From this point on, shares and warrants are traded separately.

Generally speaking, the initial listing of shares is at a fixed introductory price of USD 10, which corresponds to the price *per unit* for institutional investors. USD 10 is also the theoretical redemption value of the shares for shareholders who wish to be reimbursed when the decision on a business combination is made. This introductory share price implicitly values the warrant at zero.

Sponsors can make additional investments during and after the IPO. As a result, right after the IPO, they can sometimes own up to 25% of the total number of outstanding shares in the company. The proceeds of the institutional private placement (or the IPO), minus the costs incurred, are deposited in an escrow account for the duration of the search for a target after the IPO. If for any reason the business combination should fail to go through and the SPAC were to be liquidated, holders of common shares can have their net nominal investment reimbursed from the escrow account. The same is true if they vote against the proposed acquisition and wish to redeem their shares just *before* the formation of the actual business combination. The possibility of drawing

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[6] However, warrants are not always definitively acquired: in some cases, in order to mitigate the dilution of shares, shareholders lose (part of) their warrants if they do not consent to the initial business combination and ask to redeem their shares.

from the escrow account is limited in time and there may be conditions attached to its use. It can serve solely to reimburse the pro rata net nominal portion of the common shares owned.

*Say, for example, that the introductory price of a SPAC's share was USD 10 per unit. An investor purchased 100 SPAC shares at USD 12 per share on the secondary market. That investor is then entitled to a balance in the escrow account of maximum USD 10 per share (less any costs incurred, etc.), and **not** to the USD 1,200 paid for the shares.*

Until the time when the SPAC forms a business combination with the target, several classes of warrants and shares generally coexist: those held by the sponsors, those held by the institutional investors and those held by external investors. These classes determine the sequence in which the shareholders are entitled to redeem their investment, should the sponsors fail to find a target within the set period.

4. Finding a target and the redemption option for investors

Once the SPAC shares are listed, the search for one or more targets begins. Sponsors usually give themselves a maximum period of 2 years to do so.

If the sponsors are unable to carry out their project within that period, the SPAC will be liquidated. In principle, holders of common shares will get their nominal investment back out of the escrow account. Costs incurred may be deducted (possibly with interest) from their investment[7]. In that case, the sponsors lose (part of) their initial investment or their "capital at risk" and suffer reputation loss.

If the sponsors do find a target within the set period, they negotiate the conditions of the acquisition and the organization of the integration of the target with the SPAC. Investors are informed of the acquisition by means of a letter of intent or a similar document.

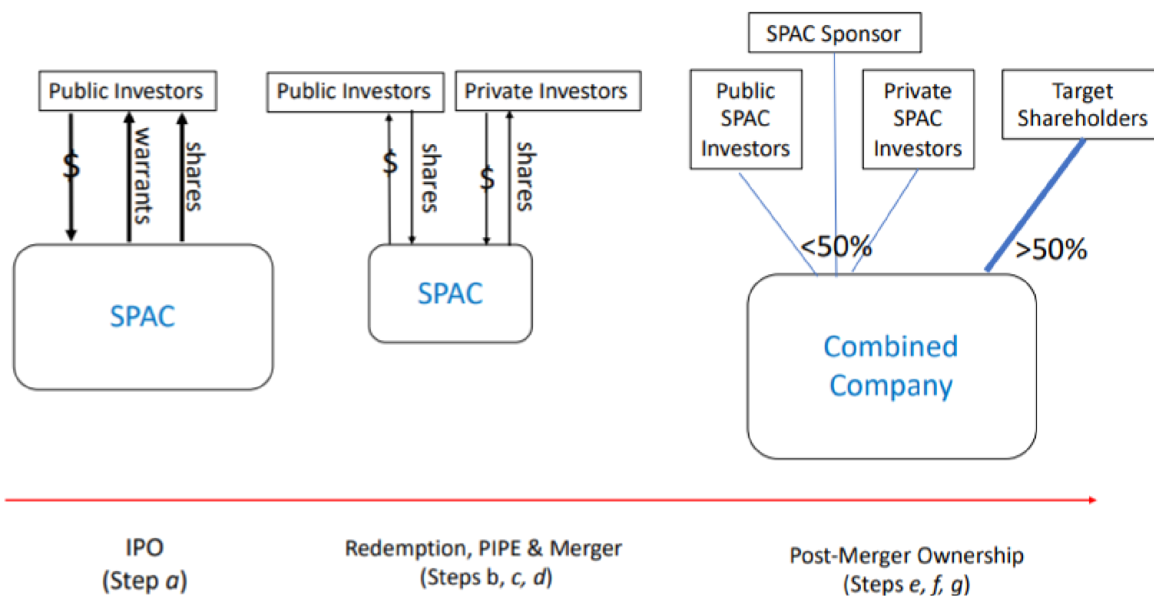
Typically, the acquisition project is submitted for approval to investors with voting rights. At that point, investors can also choose to exit. If they do, they will in principle be paid out the pro-rated nominal value of their holdings in the escrow account. Such a redemption option is a unique feature of SPACs. Sometimes, the pay-out is possible only for those shareholders who voted against the acquisition, or there may be other conditions attached to a redemption[8].

If necessary, a second round of capital can be raised to finance the acquisition of the target, and sponsors have several options in this regard. Sponsors can make an additional investment themselves, or they can invite institutional investors to increase their participation. Third parties (private investing in public equity, or "PIPE" investors) can also be approached for additional

[7] Interest on an escrow account can also be *negative*.

[8] For example, in the event of recourse to the escrow account, any warrants held by those investors could be cancelled.

equity or debt financing. Participation in the project at that point will almost certainly be on favourable terms, and once it reaches this phase of the project, sponsors often receive a deferred fee in the form of cash, shares and/or warrants[9].



5. The listing of the business combination

Given the characteristics of SPACs, in some European countries they are listed on market segments reserved for professionals only.

In that case, once the business combination has been completed, the SPAC regains the features of an ordinary company and could, under certain conditions, enter a segment open to all investors.

6. Quantitative illustration of the remuneration of the sponsors as a result of the formation of the business combination and the impact of dilution on ordinary shareholders

The characteristics of the SPAC investment are such that although **ordinary shareholders** have the right to request a reimbursement, at the time of the business combination, at the introductory price of the IPO, those shares will i**n any case be diluted** after the expiry of the redemption option. The extent of the dilution depends on factors such as the terms – usually very favourable – on which sponsors can subscribe to SPAC shares and the number of redemption requests by other shareholders, that is, the percentage of votes against the business combination.

[9] Summary figure from: M. Klausner & M. Ohlrogge, "A sober look at SPACs", New York University School of Law - Law and Economic Research Paper Series, Working Paper no. 20-48, October 2020.

The order of magnitude of the dilution is illustrated below by means of a fictitious example, intentionally simplified but based on actual transactions.

The assumptions made are as follows:

- Step 1: A company is established by the sponsors. 2,500,000 foundershares and 2,500,000 founderwarrants are issued; each warrant confers the right to buy one share at a price of EUR 11.50. The issue price for one share and one warrant is EUR 0.01.
- Step 2: Private placement, reserved for institutional investors, of 10,000,000 units at EUR 10 per unit, where a unit consists of one share and one warrant.
- Step 3: IPO of shares and warrants, with an introductory share price of EUR 10. This price can be justified by the possibility that shareholders may ask to be reimbursed at EUR 10 per share at the time of the formation of the business combination if they do not wish to remain shareholders following the investment decision.
- Step 4: At the time of the business combination, the impact of redemption requests is analysed under three scenarios (no requests, 2,500,000 shares redeemed and 5,000,000 shares redeemed).

For the sake of simplicity, in this example the IPO fee is set at EUR 3,000,000 and the cost of forming the business combination at EUR 4,000,000. The shares are not divided into classes and there is no second round of financing.

In addition, the warrants – which will probably remain out of the money[10] during steps 1 to 4 – are not included in the dilution calculation. In other words, the dilution shown is a minimum dilution scenario.

Step 1: Formation of a company

The SPAC is formed by the sponsors, who put in EUR 25,000 of their own money and receive 2,500,000 foundershares and 2,500,000 founderwarrants. This relatively symbolic investment will allow them eventually to own at least 20% of the entity. At this stage, each share represents EUR 0.01 of the SPAC's equity.

Step 1	# Shares	Price/share	Costs	Estimated equity	Equity/Share	#Warrants
Founders	2,500,000	0.01 €		25,000 €		2,500,000
Total	2.500.000			25,000 €	0.01 €	

10 Meaning that the warrants have no (intrinsic) value at that point in time, given that the share price is quite far below the strike price of the warrants.

Step 2: Private placement with institutional investors

Units (made up of one share and one warrant) are offered to institutional investors at a price of EUR 10. In this transaction, 10,000,000 new shares and 10,000,000 warrants are issued. It should be noted that after this second step in the formation of the company, each share now represents EUR 8 of the estimated equity value. This is due to the dilutive effect of the shares issued at EUR 0.01 for the founders. The shares of institutional investors who subscribe to a unit at a price of EUR 10 are immediately diluted. This dilution is partially offset by the potential value of the warrant. However, since the warrant is out of the money and the SPAC does not have any activity yet, its value will depend on the future share price.

Step 2	# Shares	Price/share	Costs	Estimated equity	Equity/Share	#Warrants
Founders	2,500,000	0.01 €	0	25,000 €		2,500,000
Institutional investors	10,000,000	10.00 €	0	100,000,000 €		10,000,000
Total	12,500,000			100,025,000 €	8.00 €	12,500,000

Step 3: IPO

The shares and warrants are now listed. The introductory price of the shares is EUR 10. The market could, of course, strike a different balance through the interplay of supply and demand. The right to redeem shares at EUR 10 at the time of the business combination will probably create a future floor price close to EUR 10. The IPO as such has no effect on the equity value other than the impact of the costs of the IPO, here estimated at EUR 3,000,000. Therefore each share represents EUR 7.76 of the estimated equity value at this stage of development of the company.

Step 3	# Shares	Price/share	Costs	Estimated equity	Equity/Share	#Warrants
Founders	2,500,000	0.01 €		25,000 €		2,500,000
Institutional+Public	10,000,000	10.00 €		100,000,000 €		10,000,000
IPO			-3,000,000 €	-3,000,000 €		
Total	12,500,000			97,025,000 €	7.76 €	12,500,000

Step 4: scenario 1

A business combination has been decided on. Its cost is estimated at EUR 4,000,000. In this scenario, no shareholder requests reimbursement from the escrow account. Consequently, only the costs of the business combination impact the estimated equity value, which now amounts to EUR 7.44 per share. Of course, the goal of the SPAC is to create value, and it is possible that the announced business combination will raise expectations such that the share price will exceed the SPAC's equity book value. This is the founders’ hope as well.

Step 4	# Shares	Price/share	Costs/Reimbursements	Estimated equity	Equity/Share	#Warrants
Founders	2,500,000	0.01 €		25,000 €		2,500,000
Institutional+Public	10,000,000	10.00 €		100,000,000 €		10,000,000
IPO			-3,000,000 €	-3,000,000 €		
Reimbursements			0			
Business Combination			-4,000,000 €	-4,000,000 €		
Total	12,500,000			93,025,000 €	7.44 €	12,500,000

Step 4: scenario 2

In this scenario, the business combination does not get the support of all shareholders, and reimbursement is requested for 2,500,000 shares. This reimbursement has a very significant dilutive effect, bringing the estimated equity value down to EUR 6.8 per share. The reason for this is the shares held by the founders represent a relatively higher proportion of the whole, given that they bought their shares at EUR 0.01.

Step 4 scenario 2	# Shares	Price/share	Costs/Reimbursements	Estimated equity	Equity/Share	#Warrants
Founders	2,500,000	0.01 €		25,000 €		2,500,000
Institutional+Public	10,000,000	10.00 €		100,000,000 €		10,000,000
IPO			-3,000,000 €	-3,000,000 €		
Reimbursements	-2,500,000	10.00 €	-25,000,000 €	-25,000,000 €		
Business Combination			-4,000,000 €	-4,000,000 €		
Total	10,000,000			68,025,000 €	6.80 €	12,500,000

Step 4: scenario 3

Finally, in this scenario a redemption request for 5,000,000 shares is assumed, i.e. for half of the shares issued for private placement. The result is an estimated equity book value of EUR 5.74 per share.

Step 4 scenario 3	# Shares	Price/share	Costs/Reimbursements	Estimated equity	Equity/Share	#Warrants
Founders	2,500,000	0.01 €		25,000 €		2,500,000
Institutional+Public	10,000,000	10.00 €		100,000,000 €		10,000,000
IPO			-3,000,000 €	-3,000,000 €		
Reimbursements	-5,000,000	10.00 €	-50,000,000 €	-50,000,000 €		
Business Combination			-4,000,000 €	-4,000,000 €		
Total	7,500,000			43,025,000 €	5.74 €	12,500,000

In sum, depending on the terms of the founders' subscription to shares in the company and on the redemption requests at the vote on the business combination, the implicit dilution per share can be very large, up to 43% in the example above. This means that a shareholder who bought a share at EUR 10 during the IPO will have to wait until the business combination generates substantial profits before the equity value returns to its initial acquisition value. In scenario 3, for the estimated equity value to reach EUR 10 per share, equity would have to increase by EUR 4.26, i.e. a 74% rise in the theoretical value of the estimated equity after the reimbursement of 5,000,000 shares (EUR 5.74 per share). For institutional investors, this dilution may be partially offset by the warrants they will have acquired via the private placement.

The sponsors on the other hand, regardless of the profitability of the business combination, will see the theoretical value of the estimated equity value of their shares acquired at EUR 0.01 go up, even in the worst case scenario, to EUR 5.74 per share, an increase of 57400%. This profitability estimate does not take into account any potential contribution of the warrants.

It should be mentioned that certain institutional investors may adopt a strategy of purchasing units through the private placement, followed by a request to redeem their shares at the time of the business combination, while retaining their warrants, acquired free of charge, which allow them to profit from the potential success of the future business combination.

Dilution is an intrinsic feature of SPACs and depends partly on factors that cannot be reasonably predicted beforehand, such as the percentage of shareholders who may ask to exit the SPAC at the time of the vote on the business combination.

Indeed, the dilutive effect of the almost free participation by the sponsors during the initial phase amplifies the impact of the redemption of shares by other investors at the time of the business combination. The greater the demand for redemption, the greater the dilutive effect of the almost free participation by the sponsors will be. Furthermore, the dilution will then have to be borne by a reduced number of investors, who will therefore will be disproportionately affected.

The FSMA has calculated the potential impact of shareholders' dilution based on several existing SPACs, applying certain assumptions concerning the information contained in their listing prospectus. **These calculations show that the implicit dilution for shareholders who acquired shares on the stock market at the value of the redemption right can, in the examples examined, be as high as 35%, and the literature shows examples where this implicit dilution is as much as 50%. We have observed that it is quite common practice for sponsors to allocate to themselves 20% of the equity capital of the business combination for a price lower than 2.5% of the book value.**

Finally, it should be noted that certain SPAC projects are organized in such a way that they try to limit this implicit dilution, for example by using share classes, making it obligatory to vote against a proposed business combination in order to be able to exercise the right to redemption, or cancelling the warrants held by shareholders who request redemption.

II. From an investor's perspective, behind the apparent simplicity of a SPAC share lie aspects that can make it difficult to take an informed decision about such an investment

The objective of a SPAC seems straightforward, namely, to establish a company, raise money, look for a target and form a new business combination. The benefits seem countless: stock exchange listing, right to have a say or voting rights, access to a form of private equity, a redemption option, etc.

A. SPACs: advantages and promises

SPACs are often founded and managed by financial experts specializing in complex acquisition deals, and are thought to fill a gap in the market for IPOs and private equity funding.

For example, SPAC IPOs could be an alternative route to going public for targets that would otherwise find it difficult to do so. Targets of SPACs often have specific characteristics or have to deal with complex circumstances, such as (family) succession issues, recapitalization needs, niche players without institutional support or strategic buyers, risky start-ups or foreign companies. The target would also have more certainty about its acquisition price, because it negotiates with the SPAC sponsors as sole counterpart. This way, it avoids the uncertainty of supply and demand conditions on the market.

Another advantage is the speed at which a SPAC project is completed, given the various inherent time constraints. And for some people, time is money... According to some, stock exchange listings organized in this way are *initially* be cheaper than traditional IPOs. It should be noted that certain fees to the sponsors can be deferred and paid out later in the course of the project.

For an investor, a SPAC balance sheet is relatively straightforward. In comparison to private equity participations, the transferable nature of SPAC shares and potentially of the warrants offers investors additional freedom[11].

The investors usually have a say in the acquisition itself, thanks to a voting right allocated to them and explained in the SPAC's articles of association.

Investors are protected by the fact that the net proceeds of the listing are put in an escrow account during the search for a target after the IPO. If for any reason the business combination does not go through and the SPAC is liquidated, they would get their nominal investment back minus costs. The same is true if they vote against the proposed acquisition and would wish to exercise their redemption right just *before* the formation of the actual business combination.

[11] Although, from a strictly accounting perspective, the SPAC share should fall rather than rise after the IPO, since the company has no incoming cash flows and only incurs costs, and it is not clear in advance how liquid the SPAC shares will be.

B. SPACs: disadvantages and risks

The apparent simplicity of a SPAC balance sheet may be misleading. It consists chiefly of cash, which does not say very much. The company has no operations and there are no cash flows; neither is there any history of public information. Without those sorts of observable factors, investors are in fact gambling on the prospect that the sponsors will carry the project to a successful end.

The introductory price of the SPAC share is determined independently of factors such as a business valuation model, historical data, results achieved in the past or an estimate of the future performance of the SPAC or an estimate of the demand for its shares. As a result, the fluctuations of the share price may have little relation to its ultimate economic success.

For investors, the appreciation of the project can soon become complex, for example if the target, whose geographical location and/or industrial sector have not yet been precisely determined, or if it is a cross-border business combination and/or if the target is a start-up, whose valuation is much less straightforward.

SPACs come in all shapes and sizes, and so it is important for investors to examine carefully both the economic and the legal aspects of the prospectus for every project, since:

- there are various types of shares and warrants,
- voting procedures can vary,
- there may be quantitative and time constraints attached to the option of reimbursement from the escrow account and to the possibility of exercising warrants,
- the nature of the participation by the various stakeholders in the equity of the SPAC changes over time, and
- the hidden total cost, as a result of dilution, may make it difficult to assess a SPAC investment.

There is an immediate dilution after the IPO. Thereafter, ordinary shareholders who opt to go along with the merger or acquisition plan will see a substantial but hard to anticipate dilution at various times. That dilution may not be offset by the expected increase in the value of the new business combination.

1. Risk of poor governance and conflicts of interest

A scenario in which *no target* company is found places great pressure on the sponsors, not only because in that case they have to absorb their losses, but mainly because their reputation is at stake. To prevent this from happening, sponsors may hastily suggest acquiring a company that is not, or not sufficiently, in the investors' interest.

Sponsors may already be active at other companies. There is a risk that they may not devote sufficient time to the SPAC because of their other projects, or that they may reserve better investment options for their private businesses. Via the SPAC, contracts or acquisitions may

be entered into with parties related to the sponsors. SPACs are established and led by financial experts who may not be able to avoid conflicts of interest: it is in the personal interest of the sponsors that the SPAC succeed within the defined period, possibly without paying sufficient attention to the conditions of the transaction. Although other types of companies are also subject to the risk of poor governance and conflicts of interest, the risk is even more likely in the case of SPACs[12].

The sponsors alone negotiate acquisitions and the acquisition price with the target company. There may be a temptation to *under*value the target company so as to make it easier to secure a positive vote by the investors, thereby increasing the likelihood of concluding a transaction within the given time period. There is nothing to stop the founders from buying voting shares on the secondary market just before the date when the decision has to be taken, which they may well do in order to be able to neutralize any potential negative votes. The shares they may acquire at that time are not blocked and could be resold shortly after the acquisition. Any losses on the sale would be more than offset by the 20% shareholding that the founders have acquired at nominal cost. And if, even after they buy the shares of those investors who oppose the decision, the acquisition is rejected, the founders will recover that part of their nominal investment, since these shares (unlike founder shares) are entitled to their pro-rated portion of the funds in the escrow account[13].

2. The sponsors' remuneration structure raises the risk of disparity between the interests of the sponsors and of the investors

The risk of proposing an insufficiently high-quality transaction is further heightened by the fact that the sponsors, thanks to their remuneration (in (almost) free shares and warrants), may earn a significant return from the beginning of the project as well as subsequently, even if the acquisition is not of sufficient quality to offset (within reasonable time) the significant dilution that retail investors will sustain.

If the acquisition deal is concluded within the set period, a second round of remuneration may ensue. The sponsors' warrants give them significant earnings potential. It is worth remembering that the sponsors have themselves drawn up the conditions in the articles of association, and they receive warrants at a symbolic price while the other investors receive fractions of warrants as part of the units sold at the time of the IPO.

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12 Protection mechanisms are available against this risk, such as a fairness opinion by an independent expert appointed by the independent directors, or a 'first review right' for the SPAC if the sponsors have an investment opportunity outside the listed company: the proposed investment must first be made to the SPAC. There is no obligation, however, for the sponsors to obtain a first review right, and, if one is planned, the circumstances in which such a right may be exercised can be made more or less restrictive.

13 T. Jenkinson and M. Sousa, "Why SPAC investors should listen to the market", *Journal of Applied Finance*, vol. 21, no. 2, 2011.

An anonymised example from practical experience: ABC SPAC raised USD 200 via an IPO. The sponsors received 5.8 million founder shares for their management role in the SPAC, and purchased 5.8 million in warrants at USD 1 per warrant. The total amount raised by the IPO + warrants thus came to USD 205.8 million. With the sponsor's promote, their investment of USD 5.8 million is thus immediately worth around USD 42 million.

3. Decision-making about the business combination

A typical feature of SPACs is that investors have a say in the formation of the business combination. Investors also play an active role during the lifespan of the SPAC. Gaining the consent of the investors for the next stage of the project can be organized in several different ways. The proposal may be put before the general meeting (for example, in the case of a merger or other transaction that requires a decision by the general meeting, or where a decision in principle has to be taken about the management of the SPAC). Alternatively, the investment decision may be taken by the board of directors (with the approval of a qualified majority of the directors, unless the acquisition is of a company that is related to the sponsors, in which case unanimous consent is sometimes required). In other words, given the different ways in which these various matters may be organized, the investors have no assurance that as shareholders, they will always be able to take part in the decision about the proposed acquisition.

4. Placing the proceeds of the SPAC listing in an escrow account offers investors no absolute certainty that they can recover their investment in full

The funds raised before the SPAC is listed are kept in cash in an escrow account in order to be able to reimburse investors in the event that no project is proposed within the set time period or if investors exercise their right to redeem their shares at the time of the proposed acquisition.

The escrow account also does not ensure that investors are always fully protected against risk. Besides the fact that the possibility of drawing on the escrow account is subject to certain conditions and limited in time, namely, to when the vote is taken on the business combination, investors must also bear their share of the costs of managing the company, of the IPO and of the analysis of the acquisition dossiers (and of the IPO). The conditions governing the escrow account may vary (the purposes for which it can be used, the financial instruments in which the funds may be invested, etc.) and the interest rate on the escrow account is not always positive. There can also be various conditions attached to the redemption of shares, such as limits in time and quantity, or exiting the SPAC may give rise to the loss of other rights. The party who holds the escrow account may go bankrupt, or third parties may enforce their rights on the account.

In the best case, investors are entitled to reimbursement on a pro rata basis of the introductory share price in the escrow account. A share purchased on the secondary market *above* the introductory price entitles the buyer only to its face value in the reserve account.

The investor therefore needs to pay particular attention to the information about this account provided in the prospectus and, among other things, to the fact that that the funds belong to the company and therefore carry the risk of bankruptcy and of claims made by third parties, and they are not covered by the Belgian Guarantee Fund in the event of the insolvency of the financial intermediary. Confirmation by an independent expert that the funds on the escrow account are sufficient for the acquisition and the reimbursement of those investors that wish to redeem their shares is an important piece of information for the investor.

5. Dilution is inherent in the SPAC structure

There is immediate dilution after the SPAC IPO. Ordinary shareholders who opt to go along with the acquisition plan will see a substantial but hard to anticipate dilution at various times in the lifespan of a SPAC. That dilution may not be offset by the expected increase in the value of the new business combination. The warrants, one of the keystones of the design of a SPAC, are responsible for further dilution during the life of the SPAC.

This feature gives the investment a certain degree of complexity, as it is impossible for shareholders to foresee the extent to which their shares will be diluted at the time when they have to take the decision to remain or to redeem their shares.

6. SPACs are valued by means of projections, estimates and scenarios

As mentioned above, the introductory price of the SPAC share is determined independently of factors such as a business valuation model, historical data, results achieved in the past or an estimate of future performance of the issuing institution or an estimate of the demand for the shares.

There is the risk that the SPAC, after the IPO, may fall (far) below the introductory price, certainly if there is no indication of a planned acquisition or if the deal is complex, the sponsors will incur substantial costs[14], or if the target is a start-up...

As is the case with many trends on the financial markets, there is the risk of hype about SPACs, the risk that investors are not, or only insufficiently, informed before they decide to invest in a scheme that is not suited to them, for fear of missing the boat. As is often the

[14] Cross-border business combinations risk being extremely complex, as a result of which the ultimate transaction structure will in part depend on factors such as the tax, accounting and business law in the jurisdictions of the SPAC, the target company and the stock exchange.

case with hypes on the financial markets, there is a lot of nonsense making the rounds when it comes to SPACs, such as overly optimistic or unrealistic promises of returns or insufficient financial underpinnings.

An inauspicious sign is if sports celebrities or other famous people with many followers on social media are invoked as stock influencers to promote and market SPACs. These stars often do not have the right background for SPACs and may spread confusion among the public regarding the nature of the investment[15] [16].

If the SPAC rises *far above* the introductory price, that can be evidence of this kind of hype, since the share price should, in theory, remain around the cash value (i.e. the introductory price less the costs incurred per share) of the company.

7. Academic research points to constantly disappointing performance of post-business combination SPACs

Data gathered via https://stockmarketmba.com/listofshellcompanies.php indicate that more than 40% of the SPACs established *before* 2020 have not yet been able to complete an acquisition (announcement), which is remarkable given that making an acquisition is the sole objective of such a company[17] [18].

The results in the following table indicate that post-merger business combinations almost always perform disappointingly or have *negative returns in comparison with a benchmark*. In the research conducted for this proposal, a comparison was made between SPACs and the Russell 2000 index on the one hand, and the Renaissance Capital IPO index on the other. A distinction has been made among SPACS between "HQ" (high-quality sponsors, i.e. well-known specialists) vs. "non-HQ" (non-high-quality sponsors).

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15 https://www.bloomberg.com/opinion/articles/2020-12-09/hedge-funds-love-spacs-but-retail-investors-should-watch-out;, "SPAC invasion: Why SPACs are Wall Street's latest craze", *The Economist*, February 18th, 2021: *"*...unlikely trio sponsors a special-purpose acquisition company (SPAC), a listed pot of capital that seeks a firm to take public through a merger. O'Neal is not the only sportsman turned SPACman. Colin Kaepernick, the former quarterback famous for kneeling during America's national anthem to protest against racism, has teamed up with a private-equity firm to launch a 'socially conscious' SPAC. Alex Rodriguez, a former baseball player, plans to raise up to $575m for a SPAC targeting sports-related firms".

16 Kanis Saengchote, "The Tesla effect and the mispricing of Special Purpose Acquisition Companies (SPACs)", Chulalongkorn Business School, 2021.

17 For other anecdotal evidence, according to Renaissance Capital: "of the 313 SPAC's of 2015, 93 have completed mergers and taken a company public. Of these 93, the common shares have delivered an average loss of -9.6% and a median return of -29.1 % compared to the average aftermarket return of 47.1% for traditional IPOs since 2015. Only 29 or nearly a third of the SPAC's in this group had positive returns".

18 Recently, information has come to light that hedge funds that were not involved in the initial financing of certain SPACs began to short certain de-SPAC combinations, thereby anticipating sharp decreases in the value of certain business combinations formed by this mechanism (Bloomberg).

Table 6: Post-Merger SPAC Returns – 2019-2020 Merger Cohort

	Three-Month			Six-Month			Twelve-Month		
	All	**HQ**	**Non-HQ**	**All**	**HQ**	**Non-HQ**	**All**	**HQ**	**Non-HQ**
Mean Return	-2.9%	31.5%	-38.8%	-12.3%	15.8%	-37.6%	-34.9%	-6.0%	-57.3%
Median Return	-14.5%	-4.6%	-46.9%	-23.8%	-15.9%	-43.0%	-65.3%	-34.6%	-66.3%
Mean Return (Excess over IPO Index)	-13.1%	25.1%	-53.0%	-33.0%	0.4%	-63.1%	-47.1%	-11.8%	-74.6%
Median Return (Excess over IPO Index)	-32.8%	7.1%	-52.1%	-43.2%	-31.0%	-56.3%	-56.5%	-54.8%	-89.9%
Mean Return (Excess over Russell 2000)	-1.3%	37.5%	-41.9%	-10.9%	22.5%	-41.0%	-21.5%	9.7%	-45.7%
Median Return (Excess over Russell 2000)	-16.1%	16.9%	-47.2%	-17.5%	-2.4%	-57.0%	-44.9%	-36.3%	-55.0%
N SPACs	47	24	23	38	18	20	16	7	9

"We find, first, that for a large majority of SPACs, post-merger share prices fall, and second, that these price drops are highly correlated with the extent of dilution, or cash shortfall, in a SPAC. This implies that SPAC investors are bearing the cost of the dilution built into the SPAC structure, and in effect subsidizing the companies, they bring public. We question whether this is a sustainable situation"[19].

19 M. Klausner & M. Ohlrogge, "A sober look at SPACs", New York University School of Law - Law and Economic Research Paper Series, Working Paper no. 20-48, October 2020, p. 1, p. 34 (for Table 6 above). Please consult the attached selected bibliography as well.

III. The FSMA proposes measures to ensure there is equilibrium between the smooth operation of the capital market and the interests of investors

SPAC dossiers are subject to the stock exchange and supervisory rules in force, such as the obligation to publish a *prospectus* and *financial reporting obligations*. The prospectus describes, among other things, the limited financial balance sheet, the management and governance, the targeted sector and the strategy for the proposed merger and/or acquisition.

From the foregoing it seems that behind the apparent simplicity of the SPAC share, there lie aspects that can make the assessment of the investment potential very complex.

As an extension of the steps the FSMA has already taken, including the banning of certain overly dangerous products via two regulations[20] or the limits set on the complexity of structured products via a moratorium on the distribution of overly complex products[21], it considers it necessary to define minimum standards for the offer and distribution of shares issued by SPACs.

The FSMA has therefore drawn up four measures governing the structure of SPACs and the information about and trading of SPAC shares. These standards are without prejudice to other aspects to which the FSMA will draw particular attention when analysing the prospectus for SPAC IPOs. The standards will inevitably evolve as the FSMA gains further insights and in response to possible initiatives at European and/or international level.

The FSMA expects sponsors who do not follow these minimum standards to state this explicitly on the cover page of the IPO prospectus.

A. The governance structure of a SPAC and the rules governing decision-making on business combinations must offer investors maximum protection against conflicts of interest

The FSMA takes the view that the investment decision on a business combination is to be taken by the general meeting of shareholders, and not by the SPAC's board of directors.

Taking into account the various classes of shares, the general meeting should be asked to take a decision by organizing votes in each category, with, at minimum, a quorum of 50% and a majority of 50% plus one vote, on the understanding that if the nature of the proposed transaction requires a more restrictive quorum or majority, these be applied to each class of shares. It is also important to avoid that the founders who have acquired shares on the market be able to participate in the vote in the other category of shareholders and to influence their vote.

[20] https://www.fsma.be/en/faq/2-what-prohibited-under-regulation

[21] https://www.fsma.be/sites/default/files/public/sitecore/media%20library/Files/fsmafiles/press/2011/nipic/en/fsma_2011_02.pdf

To mitigate the risk of conflicts of interest inherent in SPACs, the FSMA takes the view that in the event that the founders/sponsors have an investment opportunity outside the SPAC, that investment proposal must be made first of all to the SPAC (a broad right of first review).

If the acquisition of a company related to the sponsors is under consideration, a unanimous decision by the directors who are not in a conflict of interest should be required to propose the acquisition to the general meeting, which will then vote on the basis of the rules on the quorum and majority set out above.

Lastly, the SPAC will have to adopt a strict dealing code, which will notably prohibit the sponsors from trading in securities on the stock exchange during the period when the business combination is being negotiated.

B. The SPAC's redemption option must offer investors who choose to retain their shares maximum protection against dilution

The FSMA considers it useful to reserve the redemption of shares during the business combination to shareholders who voted against it. As the above example demonstrates, every redemption has an immediate dilutive effect. To allow one and the same investor to cast a positive vote and also request redemption would result in a substantially greater dilution for the other shareholders. Moreover, it is illogical for investors who hold shares and warrants, for example, and who cast a positive vote to seek to redeem their shares and continue to benefit from their warrants, thereby strongly diluting the shares of the other shareholders, who bear the entire risk of the SPAC.

C. The SPAC prospectus must comprise various dilution scenarios and indicate what level of return is needed to neutralize the investor's dilution

The listing prospectus for the shares constitutes the basic information for investors who wish to acquire securities on the market. The prospectus must therefore contain all the information necessary to understand the SPAC's structure and operating mechanisms.

As indicated in section I, C, 6 above, those shareholders (in particular, retail investors who buy shares on the secondary market before the business combination) who decide not to redeem their shares at the time of the business combination may undergo significant dilution (depending on several factors such as the percentage of negative votes and the conditions under which sponsors can be reimbursed), with the risk that the acquisition may not allow for the creation of sufficient value (within reasonable time) to offset the dilution.

While examining the prospectuses for SPACs, the FSMA will pay particular attention to the way in which the investors are informed of the impact of the dilution.

The prospectus should, in particular, provide a quantitative analysis based on the conditions of the offer, which should include the following information:

- the dilution of the share value as a result of the difference in the conditions of the offer to the public, to qualified investors and to sponsors;
- the additional dilution of the remaining investors' shares after reimbursement of the dissenting shareholders;
- a calculation of the annual return that the company needs to generate for the remaining investors in order, at a minimum, to break even in terms of the expected redemption value when the business combination is formed, taking into account the costs linked to the *structure* and to the *acquisition process*.

Several scenarios should be presented, in the form of a sensitivity analysis that looks at various rates of redemption at the time of the formation of the business combination.

Nevertheless, the dilution simulations inevitably remain a theoretical exercise, since the actual dilution will depend on various uncertain factors and are therefore simply impossible to predict. An investment in a start-up always carries a great risk of loss of value, but a SPAC is further distinguished by the fact that it entails an immediate shift in value to the sponsors. As a result, profit and loss opportunities are not the same for all shareholders.

Because this renders the valuation of an investment in a SPAC share more complex, the FSMA will require a specific warning to be included on the cover page of the prospectus.

D. SPAC shares listed on Euronext Brussels will have to carry a notice that they are reserved for professional investors

The FSMA considers that, in light of their complexity, SPACs should be traded on a group that is reserved for professionals[22]. Intermediaries should take into consideration what this means for the application of conduct of business rules to transactions carried out on the market. By the same token, the FSMA takes the view that the offer of units should be reserved for qualified investors within the meaning of Article 2 of the Prospectus Regulation[23].

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22 Within the meaning of Article 4(1)(10) of MiFID II.

23 Regulation (EU) 2017/1129 of the European Parliament and of the Council of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Directive 2003/71/EC.

The fact that the SPAC shares on Euronext Brussels carry a notice that they are reserved for professional investors does not prevent retail investors from acquiring them.

Retail clients can, on their own initiative, place buy and sell orders for SPAC shares with their financial institution, which will then execute the orders on their behalf. For the reasons set out above, the FSMA considers that in that case an appropriateness test must be carried out before execution. This means that the financial institution asked to execute the orders must determine whether the client has sufficient knowledge and experience. If the client does not, the financial institution must inform him or her that the transaction is not appropriate. If the investor nevertheless wishes to proceed with the transaction, he or she fully assumes the risk[24].

Retail clients can also acquire such an investment under discretionary portfolio management or investment advice, provided that all the conditions for suitability are met: knowledge, experience, financial situation (including the ability to bear losses) and investment objectives (including risk tolerance), and without prejudice to the product governance rules.

E. Additional recommendations

As indicated above, SPACs may take different forms and offer investors different levels of protection. The FSMA encourages issuers of SPACs to provide maximum protection in the vehicles they establish in this form.

The forms of protection they may add include:

- attaching conditions to the investment in terms of the minimum percentage of the funds that may be used, confirmation by an expert of the availability of the cash necessary for the investment and for the structural and the acquisition fees;
- requiring a very high rate of positive votes needed to accept the business combination in the general meeting;
- linking the founders' remuneration to the value creation (such as the requirement that a set share price be reached) and not to a payment up front by the allocation of nearly free shares;
- etc.

Market participants are invited to submit reactions and suggestions regarding this analysis and these proposals to the email address Consult1@fsma.be between 10 and 31 May 2021.

24 https://www.fsma.be/en/mifid-ii-directive-more-protection-investors

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