



FSMA_Opinion_2021_04 of 21/06/2021

Minimum standards governing the structure of SPACs, the disclosure of information about SPAC shares and trading in those shares on Euronext Brussels

Scope:

This opinion applies to public offers, the admission to trading, and trading on markets operated by Euronext Brussels of shares issued by SPACs as well as the distribution of those shares to retail investors within Belgium, provided that those public offers/admissions entail the obligation, pursuant to Regulation 2017/1129¹ (“Prospectus Regulation”), to the Law of 11 July 2018² or their implementing legislation, to publish a prospectus approved by the FSMA or an information note.

Structure:

This document consists of three parts. The first part sets out the general framework for the opinion. The second part sets out the minimum standards. The third part contains additional recommendations.

Summary/Objectives:

The FSMA defines minimum standards intended to govern public offers, admissions to trading and trading of shares issued by SPACs, as well as the distribution of such shares to retail investors within Belgium. The position taken by the FSMA on these questions has been presented to the sector during a public consultation that ended on 31 May 2021.

I. General framework

A SPAC, or Special Purpose Acquisition Company, is a company whose sole purpose is to raise capital, launch an initial public offering (IPO), and then within a brief period - usually a maximum of 24 months - find and finance a merger with or acquisition of an unlisted company (the target)³ and incorporate the target into the SPAC to form a business combination and thereby in effect to take the target company public.

¹ 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.

² Law of 11 July 2018 on public offers of investment instruments and the admission to trading of investment instruments on regulated markets.

³ At that stage, the decision about the business combination is generally subject to some form of approval.

The company places the net proceeds of the entry into the stock market in the form of liquidities, usually on an escrow, or trust, account. The funds on that account will serve to fund the acquisition of the target and/or to cover the redemptions of investors who may wish to exit at the time of the formation of the business combination.

For a detailed description of the stages and characteristics of a SPAC project, please see the text of the [consultation](#), and especially of section IB, pages 6-13.

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

Market practices have developed regarding the functioning of SPACs within jurisdictions where the phenomenon already exists. Although the underlying philosophy of SPACs is generally the same everywhere (i.e. raising money via a listed vehicle in order to acquire an unlisted target company), 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.

Right after the SPAC enters the stock market, the founders/sponsors immediately acquire a substantial interest that is disproportionate as compared to the economic value of their own contribution, given the more favourable subscription conditions that they enjoy. Moreover, 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, the probabilities of profit or loss may not be the same for all stakeholders. SPACs are a heterogeneous and complex investment product, making it difficult for inexperienced investors to make informed judgements about them.

For these reasons, the FSMA is proposing a set of minimum standards, based on the academic literature and on practical examples from other European countries. These minimum 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. This position seeks to strike the right 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 SPAC dossiers are subject to the usual rules governing stock market operations and their supervision. These rules provide, in particular, for the publication of a prospectus and lays down requirements as regards financial reporting.

The FSMA standards described below are without prejudice to other aspects to which the FSMA will pay particular attention when analysing IPO prospectuses or information notes for SPACs. The standards will inevitably evolve with as the FSMA issues further opinions on the topic and in response to possible initiatives taken at European and/or international level.

The FSMA expects founders/sponsors who do not follow the minimum standards that apply to them to indicate this clearly on the cover page of the IPO prospectus or in the information note⁴.

II. Minimum standards

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 asked to take a decision should hold 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.

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 founders/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 founders/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. Any 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 remaining shareholders, who bear the entire risk of the SPAC.

⁴ In the case of information notes, the FSMA recommends providing that explanation in part 1 of Annex I or II of the Royal Decree of 23 September 2018 on the publication of an information note and implementing the Prospectus Law of 11 July 2018.

C. The SPAC prospectus or information note must offer various dilution scenarios and indicate what level of return will be needed to neutralize the investor's dilution

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

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 founder/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 or information notes⁵ for SPACs, the FSMA will pay particular attention to the way in which the investors are informed of the impact of the dilution at various stages of the project.

The prospectus or information note⁶ 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 founder/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. Like any investment in a start-up, investing in a SPAC always carries a great risk of loss of value. A SPAC is further distinguished by the fact that it entails an immediate transfer of value to the founder/sponsors, which means that the probabilities of profit or loss is not the same for all shareholders.

⁵ In the course of the ex post supervision that the FSMA conducts of information notes.

⁶ For information notes, the FSMA recommends providing that explanation in part 1 of Annex I or II of the Royal Decree of 23 September 2018 on the publication of an information note and implementing the Prospectus Law of 11 July 2018.

Since the valuation of an investment in a SPAC share is thus more complex, the FSMA takes the view that a specific warning must be included on the cover page of the prospectus or in the information note, as the case may be, referring to the section on the dilution.

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 professionals⁷. If they provide investment services in respect of financial instruments issued by SPACs, 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 at the IPO should be reserved for qualified investors within the meaning of Article 2 of the Prospectus Regulation.

The fact that the SPAC shares on Euronext Brussels, or, as the case may be, Euronext Growth or Euronext Access, carry a notice that they are reserved for professional investors does not prevent retail investors from acquiring them.

Retail clients can indeed, 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 risk⁸.

Retail investors 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 product governance rules.

E. Information to include in the prospectus or information note

The FSMA expects founders/sponsors who do not follow the minimum standards that apply to them, that is, standards A, B and C, to indicate this clearly on the cover page of the IPO prospectus or in the information note⁹ as follows: *“The issuer named above does not follow the minimum standards governing the structure of SPACs, the disclosure of information about SPAC shares and trading in those shares on Euronext Brussels/the following standards: [...], as proposed by the FSMA in its opinion of 21 June 2021, available on www.fsma.be. ”*

⁷ Within the meaning of Article 4(1)(10) of MiFID II.

⁸ <https://www.fsma.be/en/mifid-ii-directive-more-protection-investors>.

⁹ For information notes, the FSMA recommends indicating the above information in part 1 of Annex I or II of the Royal Decree of 23 September 2018 on the publication of an information note and implementing the Prospectus Law of 11 July 2018.

III. 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 for this purpose.

The forms of protection they may add include:

- conditions attached to the creation of the business combination 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 its operation;
- the adoption of 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 within a given period) and not to a payment up front by the allocation of nearly free shares.
- ...