Special Purpose Acquisition Companies

Final Report

The Board
OF THE
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Executive summary

Special Purpose Acquisition Companies (SPACs) are publicly listed ‘blank check’ companies without operations that raise money through an Initial Public Offering (IPO), which is then used to finance a merger with, or acquisition of, a yet to be identified private operating company, thereby bringing it onto the public markets.

Between 2019 and 2022 there was a boom in SPACs which led them to become the predominant means of going public in the US and some other markets. However, due to the concerns about market integrity and investor protection raised by these types of companies, several IOSCO members reviewed their Frameworks for the regulation of SPACs, while others considered whether they needed to develop a Framework that regulate SPACs.

In response to these developments, IOSCO set up a SPAC Network in 2021, which, among other activities, circulated a survey to its members. Based on the responses, this Report was drawn up to identify and compare approaches to the regulation of SPACs and to synthesize any lessons that can be learnt.

The Report first describes how SPACs work and outlines the development of SPAC markets. It then describes the regulatory approaches taken to SPACs and shows how these differ from those adopted for traditional IPOs. SPACs may have some advantages and disadvantages compared to traditional IPOs, but both result in the same outcome and share some key risks. Accordingly, their regulatory treatment may be expected to be similar. However, differences in their mechanics (mainly because the SPAC process for bringing a private company onto the public market takes place in two steps compared to the “one step” IPO) mean that the regulatory treatment of SPACs may need to be adapted appropriately, and the survey confirms that in many respects the treatment of SPACs is not identical to that of an IPO.

SPAC Process - Disclosure, Gatekeepers and SPAC-Specific Measures.

The second part of the Report looks at the different stages of the SPAC process, in particular with respect to the disclosure of information, gatekeeper responsibilities and SPAC-specific particularities.

Disclosure: The adequate disclosure of information is a critically important element of bringing a private company onto the public markets. With a traditional IPO, this occurs in one step with respect to an already identified company. With a SPAC, because the Target has not yet been identified at the IPO stage, there is less information compared to a traditional IPO. Nonetheless, most Frameworks apply the standard IPO prospectus/disclosure requirements, although additional disclosure is often required, for example, regarding dilution. However, once a Target has been identified, most Frameworks then take steps to ensure that the investors have sufficient information to make an informed decision on the Business Combination in the second stage of the process. How this is achieved varies; there may be specific rules, requirements may be derived from general law provisions, or a second prospectus, providing the same information as would occur if the de-SPAC were an IPO, may be required

Gatekeepers: The effective functioning of the IPO process also relies on third parties, such as underwriters, who provide advice and take responsibility for certain activities. The survey found that generally similar gatekeeping entities and liabilities apply in the SPAC process, at least in the more active jurisdictions, but with some differences (for example, some Frameworks also require the appointment of a specific party to carry out due diligence or certify valuations).

Other Requirements: Generally, the requirements in the SPAC process achieve similar outcomes with respect to disclosure and gatekeeping as for traditional IPOs. Nonetheless, many Frameworks also apply a number of measures to address investor protection and market integrity objectives at the SPAC-IPO and Business Combination/de-SPAC stage; these measures are set out in the Report.

Areas of Focus

The Report then addresses three areas of focus:

Dilution: One of a SPAC's most distinctive features is that initial investments are likely to be significantly diluted by the time the combination with the Target is completed. However, the degree of dilution is uncertain when the initial investment is made at the time of the SPAC-IPO. To address this, a) the most common approach is to require disclosure of the potential dilution with, for example, a scenario analysis, but b) some frameworks seek to constrain the mechanics of dilution through requirements such as dilution caps, or by controlling or restricting the drivers of dilution, e.g., the Promote and the terms of the warrants.

Retail Participation: SPACs are often promoted as offering retail investors access to investment opportunities that are not otherwise available to them through the traditional IPO or private equity routes. However, many regulators are concerned about the consequences for investor protection. The survey found that retail investor participation in SPACs is relatively low and that a variety of approaches to retail participation and investor protection are taken: a) some Frameworks ban or restrict retail investor participation b) some SPACs choose not to offer to retail investors c) most jurisdictions permit retail participation and apply general and/or specific investor protection measures.

Liquidation: Finally, while the boom in SPAC IPOs has ended, there is a significant backlog of SPACs still seeking Targets or in the process of liquidation. This may raise issues with respect to Target selection, the period to complete the de-SPACs (and the negotiation of extensions) and the process of liquidating SPACs and returning funds to investors.

Conclusions, Lessons Learnt and Considerations

Finally, the Report sets out some conclusions and lessons learnt.

SPAC Framework - Considerations: About half of the respondent jurisdictions permit SPACs, and a significant number of jurisdictions have recently updated their Frameworks. This Report identifies some commonalities in the requirements that apply to SPACs as well as areas where different approaches are taken, although these are normally aimed at achieving similar outcomes. Therefore, while there is no one-size-fits-all model, a set of considerations for SPAC Frameworks has been developed which may be used by IOSCO members looking to review their existing rules or to develop a regime that regulates SPACs. No SPACs came to the market in July 2022 and many existing SPACs may have to liquidate in 2023. This fall has coincided with a more general drop in capital market activity that has accompanied the recent market turbulence. However, in many jurisdictions SPACs remain a viable alternative route to capital markets, and SPAC activity may increase at some point in the future. SPAC Frameworks may therefore need to be monitored, reviewed and updated and, the considerations in this report are a valuable guide to an appropriate framework, in line with IOSCO Principles and Objectives.

SPACs, IPOs and Primary Markets: The Report compares SPACs with traditional IPOs in terms of how they function, the outcomes pursued and achieved, and how traditional IPO rules and regulations are applied to SPACs. The Report concludes that broadly speaking, SPACs have a similar role as IPOs - there are often critical differences, but these may be due to the need to tailor the rules that apply within the IPO framework to suit the different structure of the two-step SPAC process. Consistencies identified between the SPAC rules and IPO rules should help to reduce arbitrage between traditional IPO and SPAC markets, uphold market integrity and maintain investor protection.

1. Introduction

1.1 Background

A Special Purpose Acquisition Company (SPAC) is a company established for the specific purpose of raising capital, applying for a stock exchange listing and then, within a brief period (usually 24 months), financing a merger with or acquisition of an unlisted operating private company to form a Business Combination which thereby becomes a public company. Although SPACs have been around for several decades, especially in the US, there was an explosion of SPAC-IPOs in the past few years, such that between 2019-2021 they represented a majority of the capital raised and the companies going public.

These developments have raised investor protection and market integrity concerns, and in June 2021, the IOSCO Board agreed to establish a SPAC Network to examine these issues. Amongst other things, the Network organized a meeting in December 2021 with academics and external stakeholders to exchange views on SPACs. It then produced an interim report in February 2022, and the IOSCO Board agreed that the SPAC Network should carry out further work, in particular on retail investor participation, dilution and the relationship between SPACs and traditional IPOs. In July 2022, a survey was sent to ordinary IOSCO members and 50 responses were received, with a good spread of responses from around the world. The findings of this survey were used to support the analysis in this Report.

1.2 Report Structure

This Report first describes how SPACs work and outlines the development of SPAC markets. It then sets out the regulatory approaches taken to SPACs and shows how these differ from those adopted for traditional IPOs. The Report looks at the requirements that apply in the first stage of the SPAC process, the SPAC-IPO, in particular in relation to disclosure. It then addresses the requirements in the second stage, the Business Combination, de-SPAC and listing phase, again with a particular focus on the disclosure of information. The third part of the report addresses three critical focus areas: dilution and retail participation and, given the end of the recent boom, the issues around SPAC liquidations. At the end of each section, conclusions and lessons learnt are drawn; based on these, a set of considerations for a SPAC Framework have been developed that may be useful for regulators seeking to develop, review or assess their approach to the regulation of SPACs.

2 SPACs and SPAC Markets

This section describes how the SPAC process works and outlines the development of SPAC markets. It then compares SPACs with the traditional IPO process from an economic and functional perspective and examines the implications this has for their regulatory treatment.

2.1 Description of the SPAC Process

SPACs are initiated and organized by a sponsor (**Sponsor,** also referred to as a promoter or founder). Sponsors are often entities associated with private equity or hedge funds, but they may also be a group of individuals, investment bankers or dedicated SPAC firms. An underwriter is then hired to assist the SPAC in raising money from initial investors (**Investors**) through an IPO (**SPAC-IPO**). Investors usually buy units (**SPAC Units**) comprising shares (**SPAC Shares**) and warrants (**SPAC Warrants**) while the Sponsors typically acquire shares in the SPAC for a nominal or discounted price (the **Promote** or founder shares) as well as warrants (**Sponsor Warrants** or founder warrants). Upon listing, the SPAC does not engage in any commercial activity but has a limited period of time (usually 24 months or less) to merge with or acquire an operating company (the **Target**) and thereby bring it onto the public markets. During this search period, most or all the funds raised from Investors are typically kept in a protected or escrow account (**Protected Account**).

Once a Target is identified, the SPAC negotiates entering into an agreement to merge with or acquire the Target (**Business Combination**). The SPAC managers will then need to make a public announcement, conduct the necessary due diligence, and finalize the terms and corporate actions of the merger or acquisition.

The SPAC's shareholders (and/or board) vote on whether to approve the Business Combination. At this point, the shareholders may also have the option to redeem their SPAC shares (**Redemption Right**) and receive back the IPO price paid per SPAC unit, while retaining their SPAC warrants. The availability of the Redemption Right means that Investors in a SPAC-IPO potentially have only a limited downside risk, although in some markets the Redemption Right may be conditional on them voting to reject or not taking part in the vote on the Business Combination.

The SPAC may also issue additional shares, for example in a private investment in public equity (**PIPE**) (or subject to other conditions), usually to third-party private investors (e.g., hedge funds, family offices) and the Sponsors, in order to supplement the cash that the SPAC needs to complete the Business Combination.

The exercise of the Redemption Rights, the issue of new shares to PIPE investors at a discount and the exercise of warrants issued by the SPAC, as well as the Promote, may result in a reduction in the value of the shares of the remaining investors relative to the price they paid for them (**Value Dilution**), while the issue of new shares may dilute the investors' proportionate shareholding (**Shareholding Dilution**).

Once the Business Combination is completed, the combined entity (**Combined Entity**) becomes a public listed company (**de-SPAC**) under a new ticker.

If a SPAC fails to complete a Business Combination within the requisite period, it is typically liquidated, and the remainder of the funds raised are returned pro rata to the Investors, with the

Sponsors sacrificing any potential Promote they would have earned and/or any investment they have made in the deal (meaning that they have an incentive to try to avoid this outcome).

There may be a number of third parties involved in the SPAC process (such as auditors, brokers, and underwriters) who are responsible and/or liable for certain aspects of the work they perform. In this way, they help ensure the accuracy of disclosures and mitigate the risk of fraud (**Gatekeepers**).

2.2 The Development of the SPAC Market

The current generation of SPACs are descendants of the blank check companies that appeared in the United States in the 1980s. These blank check companies were typically very small and issued 'penny stock', but they came to be associated with many fraudulent – in particular pump and dump – schemes. Regulatory responses[1] in the US effectively closed these down but did not prohibit the creation of cash shells themselves. Rather, it placed penny stock blank check companies within a supervisory and regulatory regime that improved investor protection and increased their transparency.

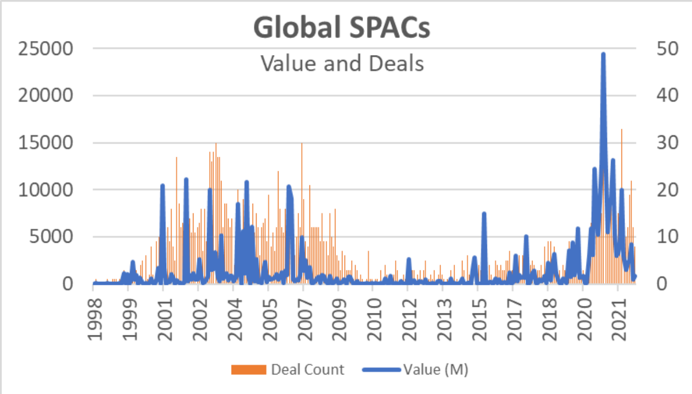

Figure 1 Global SPACs (Bloomberg)

SPACs (which are shell companies that generally do not issue penny stock) started to re-emerge in the 1990's and 2000's and were also adopted in other countries outside the US. In 2005, the first SPAC listed in the UK, with 15 SPACs listed in 2017 alone, raising £1.7 billion[2]. In 2011, the first SPAC joined the Italian market and by 2017, 19 SPACs had been listed. In Asia, a couple of SPAC markets also saw significant growth. Since 2009, South Korea has seen 199 SPAC-IPOs list[3], while in Malaysia a SPAC regime was established in 2009 and has seen 5 SPACs list – two of which successfully completed de-SPACs.

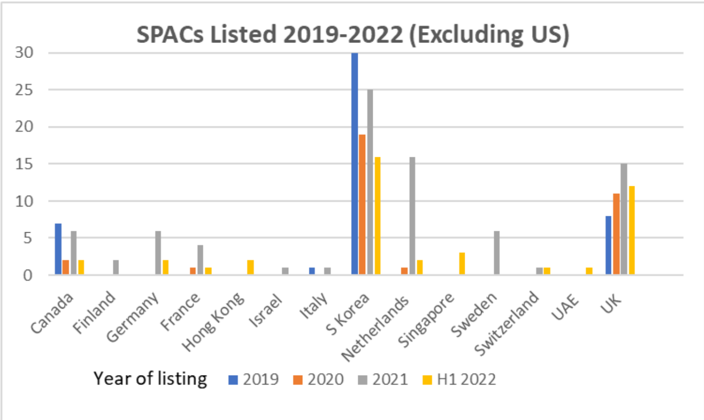

Figure 2 Number of non-US SPAC (IOSCO Survey)

The recent surge centered in the US and began around 2019 when about one quarter of the IPO market in the US was accounted for by SPACs. Then in 2020 and 2021

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1 Penny Stock Reform Act in 1990 and, in 1992, Rule 419 of the Securities Security Act of 1933.

2 https://www.nortonrosefulbright.com/en-gb/knowledge/publications/94734f5e/spacs-the-london-alternative#4

3 https://apac.cib.natixis.com/m-a-pulse-in-apac-articles/australia-editorial/articles/is-the-spac-wave-coming-to-asia-s-exchanges

SPACs accounted for more than half the market for public listings in the US. There was also a boom in the Netherlands, which led the European SPAC market with a total of 16 SPAC listings in 2021, raising approximately €3.7 billion, compared to just 9 traditional IPOs[4] in that year. The South Korean market also experienced significant growth; in August 2022, 20 SPACs were listed, with a further 12 SPACs in the pipeline. Nonetheless, as figure 3 shows, during the boom, US SPACs constituted more than 80% of the total number of SPACs globally, whereas before and after the boom, they made up only 50-60%.

The SPAC market remained buoyant during the COVID crisis but has now significantly slowed down as compared to the peak in 2021. In 2022, equities fell sharply, and the valuations of high growth and tech stocks fell even further. Since these were the types of companies typically targeted by SPACs, SPACs also performed poorly. Waning investor appetite due to changing macro-economic conditions, higher inflation and rising yields further challenged the attractiveness of SPACs. Consequently, just 53 new SPACs were priced in Q1 2022, raising \$8.13 billion, a fraction of the 298 deals worldwide raking in \$93 billion during the same period the year before[5]. No SPACs came to the market in July 2022 and many existing SPACs may have to liquidate in 2023. This fall in activity has coincided with a more general drop in capital market activity that has accompanied the recent market volatility. However in many jurisdictions SPACs remain an alternative route to capital markets, and so SPAC activity may increase at some point in the future.

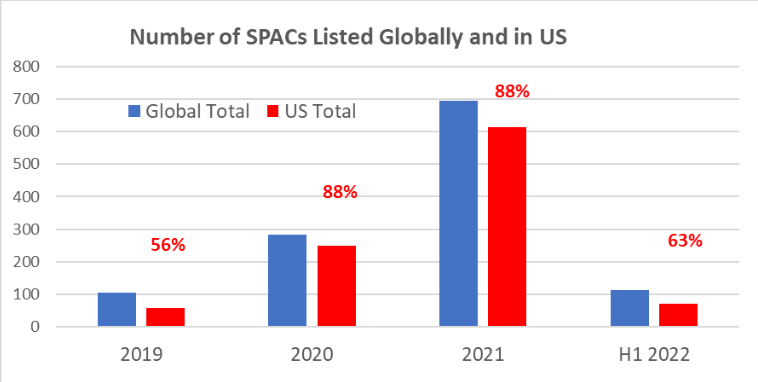

Figure 3 Global and US Number of SPACs (IOSCO Survey)

2.3 **Cross-Border Business Combinations**

SPACs are a popular route for cross-border transactions in some markets. The survey found that there were 438 de-SPACs between January 2019 and June 2022, of which about a quarter were combinations with cross-border Targets.

In the earlier wave of SPACs between 2003 and 2014, 38 out of 105 US SPACs merged with a Target that operated in a foreign country[6], and in the latest boom this appears to have been repeated; between 2019 and June 2022, 23% of US SPACs merged with a foreign Target[7].

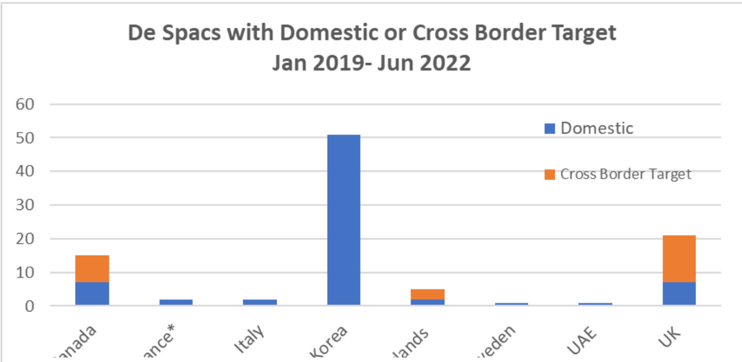

Figure 4 Cross Border De-SPACs (IOSCO Survey)

4 AFM Market Watch afm-market-watch-5-spacs-2.pdf

5 Source: Bloomberg.

6 Vulanovic, M. "SPACs: Post-Merger Survival," Managerial Finance, 43, 6 2016:

7 SPAC Network Survey Data.

Internationally the picture is more mixed; in some markets, such as the UK, Canada, Luxembourg and the Netherlands, cross-border transactions constitute a significant proportion of the total, while in others, such as South Korea, Targets were entirely domestic in the period between January 2019 and June 2022.

Overall, the SPAC route came to occupy a significant portion of international capital markets activity; SPACs accounted for 11% of global cross-border M&A activity in 2021, compared to just 1% in 2020[8].

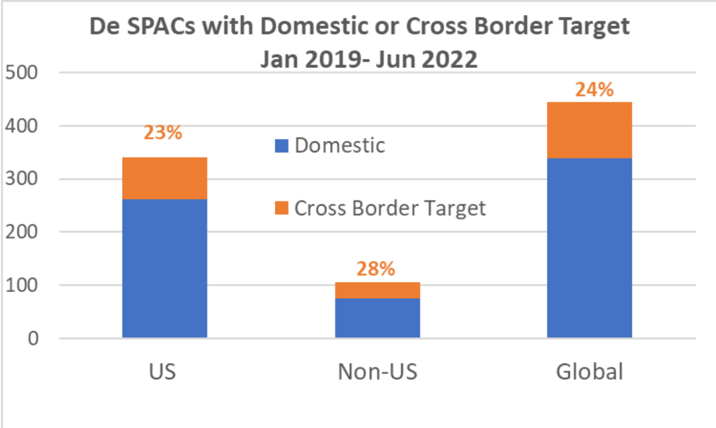

Figure 5 US and Global Cross Border De-SPACs (IOSCO Survey)

Cross-border Business Combinations increase the pool of potential Targets for Sponsors, while for foreign Targets they may provide an opportunity to access a broader investor base and leverage the reputation or expertise of the Sponsors. There are, however, additional challenges to completing cross-border SPAC Business Combinations, such as operational integration problems and valuation, accounting, tax and reporting issues for entities located in different jurisdictions.

Cross-border transactions are part of well-functioning international capital markets, though the evidence shows that SPAC markets can function entirely domestically or with a significant international dimension. The cross-border dimension may, however, create concerns around regulatory arbitrage and raise other issues; for instance, there have been some examples of cross-border trends that may raise investor protection concerns (e.g., Canadian SPACs courting U.S. cannabis start-ups[9]). The SPAC boom also motivated many regulators around the world to consider whether their approach to SPACs was fit for purpose, and where they did not have one, to develop a SPAC Framework. This can be seen in the number of consultations, guidance and new rules that have been issued over the last couple of years.

2.4 Relationship between SPACs and IPOs

The SPAC process is essentially a mechanism designed to bring a private company, the Target, onto public markets and so is an alternative to the standard IPO. This section compares the two processes to identify the advantages and disadvantages of the SPAC process *vis-à-vis* a traditional IPO. This functional comparison can then help characterize the appropriate regulatory approach to SPACs in comparison to IPOs.

2.5. Economic and Functional Comparison

The latest boom in SPACs occurred during a period when the number of publicly listed companies had fallen in many jurisdictions, and this may have increased interest in developing alternatives to traditional IPOs (such as SPACs and direct listings). However, this raises the

8 Cross-border M&A takes off in Q3 2021 https://www.refinitiv.com/perspectives/market-insights/cross-border-ma-takes-off-in-q3/

9 https://news.bloombergtax.com/daily-tax-report-international/cannabis-spacs-cross-border-push-threatens-tax-hit-on-investors

question of whether SPACs are a more efficient and effective means of going public and what role they play, or should play, in public markets.

IPOs, SPACs and direct listings are the three main routes to the public market for a private company. However, each results in different costs for the private company. For traditional IPOs, the main costs include the direct underwriter costs and the indirect costs resulting from underpricing[10]. For a SPAC, in addition to the direct underwriter costs (including deferred fees) and the indirect costs of underpricing, merging with a SPAC also entails costs from dilution. For direct listings[11], by contrast, the main costs are the financial advisory fees that the company pays to investment banks. Direct listings may be a cheaper route purely from a direct cost perspective, but they may not be the most feasible route for many/most private companies.

Comparing SPACs and other IPO routes is complex, but there is some evidence that SPACs are a more costly way to go public[12] from the Target's perspective. This suggests that the choice may be driven by factors other than costs, such as better and/or more certain valuations, the speed with which a deal can be completed, and marketing opportunities that may not be available to companies engaged in traditional IPOs. In addition, the traditional IPO process suffers from an adverse selection or "*market for lemons*" problem; information asymmetries mean that investors find it hard to distinguish between high-quality and low-quality firms and therefore value them equally, which then discourages better firms from listing. The SPAC process may help overcome this adverse selection problem[13] through features such as contingent Sponsors' compensation, the Redemption Rights and the vote to approve of the Business Combination. In addition, SPAC Sponsors are typically industry veterans[14] and are similar to private equity general partners in terms of the mentoring support they can provide to Targets or their management[15]. However, these advantages are debatable and may be case-specific. It is also worth noting that SPACs tend to target younger, smaller and riskier companies (which may be more susceptible to this adverse selection problem) than those that take the classic IPO route[16].

Therefore, SPACs may provide another gateway to enter the public markets, although there is debate about the degree to which some of these advantages are real or just perceived. The SPAC route seems to be more expensive for Targets and generally seems to result in lower

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10 The practice of listing an IPO at a price below its presumed/intrinsic value in the stock market so that when a new stock closes on its first day of trading, its price is above the set IPO price, allowing the IPO to be deemed a success.

11 Note that recent changes to NYSE and Nasdaq listing requirements now require a named underwriter for certain direct listings.

12 Zhang D, Gahng M, Ritter J SPACs Review of Financial Studies, (2021) finds that for the median de-SPAC, the costs are 15.1% of the market capitalisation, compared to 3.2% for the median IPO and that merging with a SPAC is more expensive than going public via a direct listing, for which the median cost as a percentage of market capitalisation is only 0.3%.

13 S. Chatterjee, N.K. Chidambaran, Gautam Goswami, Security design for a non-standard IPO: The case of SPACs, 69 J. INT'L MONEY & FIN. 151 (2016).

14 Kanis Saengchote, The Tesla Effect and the Mispricing of Special Purpose Acquisition Companies (SPACs) 9 Mar 2021 Department of Banking and Finance, Chulalongkorn Business School.

15 Zhang D, Gahng M, Ritter (2021)

16 Jessica Bai, Angela Ma, Miles Zheng, Segmenting Going-Public Markets and the Demand for SPACs, SSRN 3746490, 2021.

rates of return for (long-term) investors compared to the traditional IPO route. On the other hand, SPACs may address some of the information asymmetry, speed, flexibility and Target mentoring and support issues that arise in the standard IPO process. As such, they may provide a useful alternative route to public markets for certain types of companies – in particular for smaller, riskier but high-growth firms. Moreover, demand for SPACs targeting these types of firms seems to grow disproportionately during bull equity markets, hence booms in SPAC listings are often cyclical in nature.

A second question is the extent to which SPACs are functionally different from IPOs and what this means for the way they should be regulated. It has been argued[17] that the economic reality of the SPAC's role in the de-SPAC is to find investors, not invest its own cash, because the SPAC funds belong to the shareholders and before they decide whether to redeem, SPAC shareholders have merely parked their cash in the SPAC, not yet committed it. Accordingly, the SPAC shareholder's investment is the economic equivalent of purchasing stock in the Target for cash, just as in a standard IPO. On the basis of this argument, if SPACs are functionally equivalent to IPOs, the "same activity, same risk, same regulation" principle suggests that IPOs and SPACs should be regulated in similar ways.

This debate is most pertinent with respect to disclosure and the parties' liability for this disclosure. Both SPACs and IPOs regimes require the eventual disclosure of information about the Target/company going public, in order to allow investors to make an informed decision. However, the different structure of the two-step SPAC process compared to a traditional IPO means that there may be differences in the timing, the information that can be disclosed, and the third parties/Gatekeepers that are responsible for this disclosure. The most obvious example is that only a limited amount of information about the possible Target is available at the SPAC-IPO stage.

Looked at from an outcomes or risk perspective, one of the key risks[18] that IPO issuers face is underpricing, while the main risk to IPO investors involves information asymmetries, fraud, and conflicts of interest[19]. These risks all arise in a similar way in SPACs. This comparison would therefore suggest that the regulatory treatment of SPACs should aim for the same outcomes as IPOs, but the differences in their respective structures mean that certain particularities may need to differ.

2.6 Summary

SPACs represent an alternative route by which a private company can enter the public capital markets. The recent bull market saw a boom in SPACs, such that they became the predominant means of going public in the US and some other markets. SPACs may or may not be cheaper, more flexible or they may address some of the information asymmetries in the traditional IPO for some types of private companies. However, both IPOs and SPACs result in the same outcome; the main risks to investors are almost the same and so at a high level it can be argued that their regulatory treatment should be similar. However, because the SPAC and IPO processes are different, while the rules applicable to SPACs may be similar to those for IPOs,

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[17] H. Halbhuber, An Economic Substance Approach to SPAC Regulation, working paper January 2022, at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4005605.

[18] Michele Lowry et al., Initial Public Offerings: A synthesis of the literature and directions for future research, Foundations and Trends in Finance (2017)

[19] Rongbing Huang, DongHang Zhang, Initial Public Offerings: motives, mechanisms and pricing, 2022.

they differ in some critical ways. The next part of this report looks at how SPACs are regulated in various IOSCO jurisdictions around the world in practice and identifies how some of the approaches are similar to or different from that taken to IPOs.

3 Overview of Risks and Regulatory Frameworks

3.1 Introduction

To support the analysis in this report, a survey was sent to ordinary members and 51 responses were received. The survey revealed that there was a range of approaches to SPAC regulation. In one jurisdiction, Australia, SPACs are prohibited by the competent authority. 16 jurisdictions have no specific Framework for SPACs; some of these accept that SPACs could possibly be listed on their public markets, although this is not certain because they have not had any SPAC listings, while others considered that SPACs were probably not feasible or permissible under their Frameworks. 34 jurisdictions confirmed that they have a Framework that permits SPACs; some of these have an active market but many others have never had a SPAC listing.

3.2 Overview of Regulatory Frameworks

Table 1 provides an overview of the SPAC Frameworks and SPAC Markets in jurisdictions that responded to the SPAC Network Survey. The columns of this table are as follows:

- **No Framework / Uncertain if Permitted:** Many respondents confirmed that they had no express provisions regarding SPACs and in many cases, this meant it was uncertain whether SPACs were possible.
- **SPACs Prohibited:** Respondents confirmed that SPACs are prohibited in their jurisdiction.
- **SPACs Permitted:** Respondents confirmed that SPACs are permitted in their jurisdiction.
- **New or Proposed Framework after 2019**: many jurisdictions have issued new proposed or final rules, guidance or clarificatory statements since 2019 and all these different responses are considered in this column.
- **Has had a SPAC**: Respondents confirmed that at least one SPAC had listed in their jurisdiction.
- **Has or has had an Active Market**: an active market is defined as more than one SPAC in more than one consecutive years over the last 10 years. The lighter shading refers to markets that have implemented regimes that have come into force in the last 2 years and have had some SPACs and so may be on the way to becoming active markets but not yet fulfilled this condition.

Table 1: Overview of SPAC Frameworks and Markets in Respondent Jurisdictions (Source SPAC Network Survey)

Respondent	No Framework / Uncertain if Permitted	SPACs Prohibited	SPACs Permitted	New or Proposed Framework after 2019	Has had a SPAC	Has or has had an Active Market
Algeria COSOB						
Australia ASIC						
Bangladesh BSEC						
Belgium FSMA						
Botswana BSE						
Brazil CVM						
Bulgaria FSC						
Canada AMF & OSC						
Cape Verde AGMVM						
Dubai DFSA						

Egypt FRA						
France AMF						
Germany BaFin						
Greece HCMC						
Hong Kong SFC						
India SEBI						
India IFSCA						
Indonesia FSA OJK						
Israel ISA						
Italy, CONSOB						
Japan JFSA						
Jordan SC						
Kazakhstan AFSA						
Kenya CMA						
Korea FSS						
Kuwait CMA						
Lithuania, BoL						
Malaysia SC						
Malta MFSA						
Mexico CNBV						
Netherlands AFM						
Oman CMA						
Pakistan SEC						
Palestine PCMA						
Peru SMV						
Poland KNF						
Portugal CMVM						
Romania ASF						
Singapore MAS						
Slovenia, SMA						
South Africa FSCA						
Spain CNMV						
Sweden FSA						
Switzerland FINMA						
Thailand, SEC						
Tunisia CMF						
UAE SCA						
U.K. FCA						
U.S. FINRA						
U.S. SEC						

3.3 How SPACs are Regulated

The Frameworks that regulate SPAC listings typically comprise:

a. **The rules of the exchange** on which the SPAC is listed; and/or
b. **The applicable rules of the relevant regulator** (in some cases, SPACs fall within the remit of more than one regulator); and/or
c. **Corporate, listing and other relevant general law** that govern the SPAC processes and entities.

Often the rules governing the existing listing regime or IPOs have been amended or modified to accommodate SPAC structures. In other cases, SPACs are not specifically defined or regulated but are permitted under the existing listing regime and this may be complemented by regulatory guidance or supervisory communication. In other cases, the framework is a standalone set of rules that apply to SPACs. Overall, the framework is normally embedded throughout the relevant jurisdiction's laws and rulebooks and there are often overlapping rules that apply to both SPACs and IPOs. In this Report all of these approaches are encompassed in and referred to as "Frameworks".

3.4 Main Risks of SPACs

Generally, these Frameworks have been developed in response to the features and risks that SPACs pose, and the survey identified a wide range of risks related to SPACs which can be summarized as follows:

A. The SPAC Structure – Complexity and Uncertainty

- **SPAC's inherently complex structure and potential dilution is difficult to understand:** As many respondents observed, the inherent complexity of the SPAC structure and potential Value Dilution to Investors means that investors may require a high level of expertise to understand them. Others highlighted in particular the complexity of Sponsors' remuneration structure and how this impacts incentives, a risk that is heightened by the lack of transparency.
- **Uncertainty**: Another significant risk is that the SPAC has no operational or financial history and, given the uncertainty about the Target, any investment decision at the IPO stage can only be made by reference to projections, estimates and future scenarios or the track record of the Sponsors, if any.
- **SPAC's share price volatility**: Some raised concerns about the price volatility of SPAC shares in the period between the SPAC-IPO and de-SPAC. During this period, the SPAC has no operations, assets or past financial performance, meaning the share price is vulnerable to being driven by speculation, rumors and celebrity endorsements.
- **Cross border issues**: In cross-border de-SPACs, there may be risks and uncertainty arising from the different legal requirements applicable to the SPAC and the Target.

B. Information Asymmetries and Due Diligence

- **Information asymmetry**: Another key risk arising from the complexity of the SPAC process is information asymmetries. There are numerous asymmetries, such as between the initial SPAC investors and PIPE investors, and, for retail market participants (which may be accentuated by aggressive advertisements and celebrity endorsements).
- **Due Diligence:** The short period for completion of the Business Combination means there is a risk of poor due diligence on the Target, or that the level of due diligence is not as high as in a traditional IPO.

C. Conflicts of interest

Conflict of interest, in particular between Sponsors and SPAC investors, are another risk arising from the complexity of the SPAC structure and process which was identified by the majority of the survey respondents. These risks include:

- **Security of the Protected Account**: There may be a risk of mismanagement of the funds in the Protected Account, and in particular, that the Protected Account does not give certainty that the investors can fully recover their initial investments.
- **Decision-Making Process on The Business Combination**: the risk that Sponsors propose merger with any Target because they have a strong incentive to complete a transaction and avoid a liquidation, as they only get the benefit from the Promote (and other remuneration) if a transaction is completed.
- **Decision on Target acquisition**: the risk that the process does not allow investors to participate properly in the decision on the acquisition of the Target. Shareholders may be disincentivized to vote against the de-SPAC, as the refund received from redemption (when exercised) may be less than their initial investments in some markets or cases. In other markets or cases, even if investors can get a full refund, they may also be disincentivized to vote against the de-SPAC because the warrants they hold will become worthless if the transaction is voted down.
- **Choice of Targets**: the risk that Sponsors have better information about the Target than the investors, and that the choice of the Target and terms of the Business Combination or de-SPAC will not be on terms favorable to all the SPAC investors. Instead, they may favor the Sponsor or PIPE investor shares.

D. Other Risks

Other risks that were highlighted by survey respondents include:

- **Poor Targets**: Some identified a lack of quality Targets (which do not offer real growth prospects or have the maturity to be a listed company). SPACs could also become vehicles for the backdoor listing of Targets that do not meet the standard listing requirements. Furthermore, some respondents expressly mentioned the risk of underperformance of the Target after the Business Combination stage.
- **Execution risk**: The risk that the SPAC may not be able to find a Target within the prescribed time limit and the consequent liquidation risk that investors will then receive less than their initial investment.
- **Gatekeepers' liability:** concerns that there may be fewer Gatekeeper responsibilities and liabilities in the SPAC process compared to an IPO, resulting in a lower level of protection for SPAC investors.
- **Costs**: the potentially higher costs of the SPAC process for investors compared to a traditional IPO.

3.5 Measures to Mitigate these Risks

To address these risks, a range of measures were identified by survey respondents, which may be categorized as follows:

A. **To address the inherent complexity of the SPAC structure:** Prohibiting or discouraging retail investors from investing in SPACs. Alternatively, initiatives to educate investors may be a useful way to address the challenges posed by SPAC complexity.

B. **To address information asymmetries**: The main measure identified to address information asymmetries is enhanced disclosure by issuers and scrutiny of such disclosure by the relevant authority – in particular the information provided in prospectuses and also the price-sensitive information disseminated when the de-SPAC is announced and submitted to shareholders' approval. This enhanced disclosure may cover: (i) conflicts of interest and related mitigation measures, (ii) Target's sector or activity, (iii) investors' rights and the approval process and details of the estimate of the expenses, (iv) any potential future dilution, such as dilution arising from the Sponsor's Promote or the payment of the Sponsors' fees in shares, the exercise of warrants and/or in relation to the financing of the acquisition (e.g. PIPE investments), (v) potential scenarios that may arise if the Sponsor fails to find a suitable Target company. Requirements for the information provided to shareholders are important to ensure that they can make an informed decision on whether to approve the Business Combination.

C. **To address conflicts of interest:** In addition to enhanced information requirements, described in B above, a few respondents identified measures that include fit and proper criteria for SPAC Sponsors and managers as well as restrictions on voting rights for Sponsors, managers and promoters in de-SPAC decisions and lock-up periods for shares held by them.

D. **To address the risk of mismanagement of funds, decision on Target acquisition and poor Targets),** the following measures were identified:
   - The requirement that funds must be held in a Protected Account.
   - The granting of Redemption Rights to SPAC shareholders.
   - A requirement on the minimum size of the Target relative to the sums in the Protected account.
   - Requirements that the Sponsor shareholders' participation in any liquidation distribution be subordinated to the other shareholders.

E. **To address dilution risk:** The most frequent measure identified to mitigate the dilution risk was disclosure of dilution scenarios (see Section 11).

F. **A Comprehensive Approach:** To address all the risks inherent in SPACs, many respondents considered that the appropriate application of multiple rules was necessary. For example, in EU Member States, Transparency[20], Market Abuse Regulation[21], and MiFID[22] rules are all applied. Other respondents referred to the Listing/Stock Exchange rules, for example that, because the de-SPAC is considered as a reverse takeover, the Combined Entity must meet all new listing requirements.

3.6 Comparison of Regulatory Treatment of SPACs and IPOs

While respondents generally consider SPACs to be subject to the same regulatory treatment as traditional IPOs, most also identified specific rules that apply to them. The difference in

[20] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32004L0109

[21] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32014R0596

[22] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32014L0065

regulatory treatment generally arises due to the different structure of the SPAC process, and in particular, the sequencing of the "two-step" SPAC process compared to the "one-step" IPO.

From a regulatory perspective, the SPAC process can be divided into the following stages:

a) The Initial **SPAC-IPO Stage** when the SPAC is established, and capital raised.
b) **The Business Combination and the de-SPAC Stage** when the Target is found, and the merger or acquisition is completed.
c) **Listing and Post De-SPAC Stage** and the subsequent trading of shares thereafter, or the liquidation of the SPAC if it fails to find a Target or complete the Business Combination within the required time period.

The next sections describe the issues and regulatory approaches at each of these stages in light of the findings of the survey and, where relevant, compares the approaches taken to SPACs and IPOs.

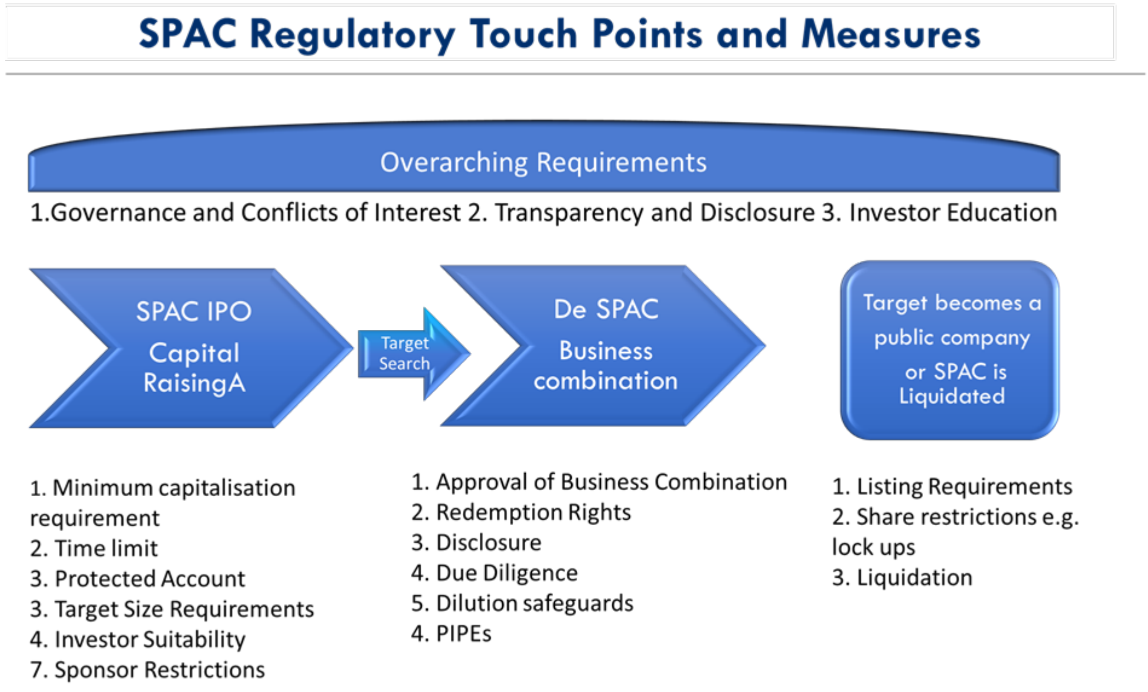

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Figure 6 Regulatory Measures during the SPAC Process

4 The First Stage – The SPAC-IPO

4.1 Introduction

The SPAC process begins with the Sponsor forming a company, at which point the Sponsor normally acquires shares in the SPAC at a nominal value or at a discount (the Promote). An underwriter is often hired to assist the SPAC in raising money from initial investors through the SPAC-IPO and the listing of the SPAC on an exchange or trading venue.

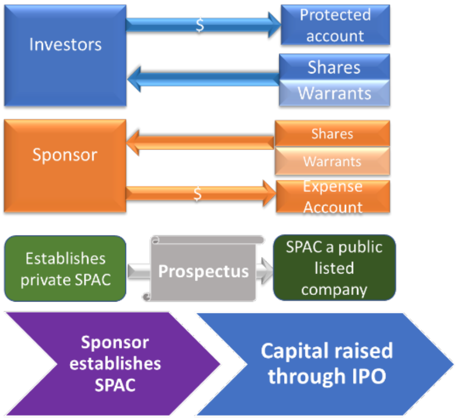

Figure 7 The SPAC-IPO Process

At the SPAC-IPO, Investors are offered SPAC Units comprising shares and warrants; one of the key information documents in this offering is a prospectus. One distinctive feature of SPACs is that the proceeds from the sale of the SPAC Units are usually kept in a Protected Account until a Target is acquired or the SPAC is liquidated. At the SPAC-IPO, the Sponsor usually purchases SPAC Units, Promote or Sponsor Warrants and the proceeds of these sales are used to cover the IPO and SPAC operating costs while the SPAC is searching for a Target.

IPOs are the typical process by which private companies become public, and are subject to well-established exchange and regulatory rules which typically include:

a) **The provision of information/disclosure**:
   i) to the regulators and/or the listing exchange (e.g., through filings); and
   ii) to the public, typically, through a prospectus or other information package.

b) **The involvement of Gatekeepers** e.g., an underwriter who may initially purchase the shares in the IPO.

Most private companies seeking to go public have pre-existing operations and assets, a history as a private company, and plans for how they will operate as a public company. By contrast, at the SPAC-IPO stage, a SPAC has no operations, no history and until a Target is acquired, indeterminate future plans. Therefore, the depth and usefulness of any disclosure is inherently more limited compared to a standard IPO. However, there are still many areas where investors in the SPAC-IPO would benefit from information; for example, the management of the SPAC, the SPAC structure, warrants and shareholder Redemption Rights, the potential Target, potential dilution, etc. Similarly, regulators and exchanges may also want information to vet the transaction, both for investor protection purposes and to ensure that the SPAC and potential SPAC Target/Combined Entity do not undermine market integrity.

One of the first questions is whether the standard IPO information requirements apply to the SPAC process and whether these requirements are supplemented or amended by additional or SPAC specific requirements, such as SPAC-specific prospectus/information requirements.

4.2 The Prospectus and SPAC-IPO Information Requirements

Nearly all respondents require a prospectus or other information document at the SPAC-IPO stage, and in about half of these cases, the information required is the same as for an IPO.

However, even where the standard IPO information requirements apply, the different nature of SPACs means that **in practice, different information has to be provided in a SPAC prospectus**. A description of risk factors is normally required in a standard IPO prospectus; however, for a SPAC-IPO, this description may need to cover the type of business the SPAC is targeting and other characteristics specific to the issuer[23]. In some cases, guidance is provided on how SPAC-IPOs should meet the standard IPO requirements. In Europe, the European Securities and Markets Authority (ESMA)[24] expects SPAC-IPO prospectuses reviewed by EU NCAs to disclose information such as:

- Detailed information about the issuer's investment policy/strategy, and the criteria for the selection of the Target company.
- Escrow account or the reinvestment of the proceeds of the offering in the period before the acquisition of the Target company, including any reliance on third parties and/or investment policy.
- Information on conflicts of interest, including those arising from the fact that the Sponsors and their affiliates are not obligated to share any potential Targets they identify with the SPAC and may acquire these Targets themselves; and
- Detailed information on the share and warrant structure, including information on any redemption, withdrawal rights and information about any rights that the shareholders' meeting must approve concerning acquisition of the Target company.
- Relevant experience and principal activities of the administrative, management and supervisory bodies.
- Related party transactions.
- Information about the financing of the acquisition of the target company in the event that the proceeds do not cover the entire acquisition price.
- Information on the intention of major shareholders to subscribe to the offer.
- Information on the offer price.

Even in jurisdictions where the same prospectus requirements are applied to a SPAC-IPO as to a standard IPO, such as France, Italy, Netherlands and the UK, **the unique features of SPACs may still be taken into account when reviewing SPAC-IPO prospectuses** to ensure that investors are properly informed.

4.3 Additional or Specific Disclosure Requirements

Some Frameworks have additional or specific disclosure requirements for SPAC-IPOs which are framed either in terms of disclosure of risks or disclosure of particular factors or issues that may be particularly relevant to SPACs. These requirements **may mandate the prominent disclosure of material risks**. For example, in Hong Kong and Israel, the listing documents

[23] For example, SPACs in the US typically include a risk factor that discusses their risk of being an investment company subject to regulation under the Investment Company Act. The SEC has proposed a new rule that would address the status of SPACs under the Investment Company Act.

[24] https://www.esma.europa.eu/sites/default/files/library/esma32-384-5209_esma_public_statement_spacs.pdf

must prominently disclose, or disclose on the cover page of the prospectus, material risk factors relating to an investment in a SPAC.

Alternatively or in addition, the rules may require **the specific disclosure of factors that give rise to risks;** for example:

- Hong Kong also specifically requires the disclosure of risks relating to the liquidity and volatility of the SPAC's securities and the impact of dilution.
- ESMA requires that all European authorities ensure that the risk factors in the prospectus provide an overview of 1) the amount of possible dilution in different scenarios (by using a table or diagram) and 2) conflicts of interest inherent to the SPAC transaction, 3) the governance of the SPAC, (4) the decision-making process concerning the business combination.
- Belgium requires additional disclosure in a SPAC-IPO prospectus on various dilution scenarios and the level of return that will be needed to neutralize the Investors' dilution, and disclosure of the areas where the minimum standards it has set are not followed by the Sponsors.
- The UAE has imposed a general requirement for SPAC issuers to specify the factors that make investment in a SPAC different from investment in other companies, and in particular, to identify the risks associated with investment in the SPAC. This includes the restrictions on the use of investor funds and the fact that investors' ability to recover those proceeds may be limited.
- While information about the Target may not be mandatory or possible (because the Target is not known at the time of the SPAC-IPO), in some cases, such as in Canada and Malaysia, where a SPAC has identified a target industry sector or geographical region, disclosure about the industry and/or geographical region that the SPAC will be targeting is required.

The following **supplementary disclosure in a SPAC-IPO prospectus** may be required in some Frameworks:

- The future remuneration of the Sponsors and their possible role after the acquisition of the Target company.
- Information about the future shareholdings of the Sponsors and other related parties, and information about possible changes to the governance after the acquisition of the Target company; and
- In Italy and the Netherlands, detailed information about the possible scenarios that may arise if the Sponsors fail to find a suitable Target company to acquire, including possible scenarios such as the winding up of the issuer and de-listing of the shares.

4.4 No Prospectus Requirement

A standard prospectus is not always required. For example, if SPAC shares are offered to qualified/institutional investors only, no approved prospectus may be required; this is the usual practice in some jurisdictions. Nonetheless, for admission to trading on a regulated market in the EU, a prospectus is required and the general requirements for IPO prospectuses apply.

4.5 Review of SPAC by the Regulator and/or the Stock Exchange before Listing

In addition to the disclosure/information requirements described above, many SPAC-IPOs are subject to a review and/or supervision by the regulator and/or the relevant exchange before listing. However, the aspects of the SPAC that are reviewed differ from one jurisdiction to the next; for example, the SPAC may be reviewed with respect to statutory rules by the regulator, or the exchange-specific listing rules by the exchange. An example is provided in Box 1.

Box 1 SPAC Review in Malaysia: SPACs are subject to review and approval before listing with respect to disclosure in the prospectus and suitability of the SPAC, taking into account any factor it considers relevant, including but not limited to:

(i) experience and track record of the management team, nature and extent of the management team's compensation

(ii) extent of the management team's ownership in the SPAC

(iii) amount of time permitted for completion of the Business Combination period to the mandatory dissolution of the SPAC

(iv) percentage of amount held in trust account that must be represented by the fair market value of the Business Combination

(v) percentage of proceeds from the initial public offering that is placed in the trust account

4.6 Conclusions

- Disclosure at the SPAC-IPO stage is difficult because there is less useful information that can be provided compared to a standard IPO.
- Frameworks normally apply the standard IPO prospectus and information requirements or expectations, but additional disclosure requirements may also be imposed in light of the different structure and risks in the SPAC process. These additional information requirements typically cover subjects such as risk factors, dilution and conflicts of interest, or particular issues such as the Target sector.
- The requirement may also specify how the information in the prospectus should be presented, e.g., a prominent disclosure of risks on the cover page or disclosure of dilution scenarios.
- However, a prospectus may not be required if the offering is made solely to professional investors; this is a standard approach in some jurisdictions. In some cases, a SPAC may be reviewed by the relevant regulator and/or the exchange before listing.

5. Other Requirements at the SPAC-IPO Stage

Other measures which may also be applied at the SPACs IPO stage include:

5.1 Protected Account

Many jurisdictions have a requirement to deposit the proceeds of the SPAC-IPO offering in a Protected Account – typically an escrow account or trust – to prevent the mismanagement of the funds raised in the SPAC-IPO. Normally, only a percentage (most often about 90%) of the IPO proceeds need to be deposited in this account. The nature of the Protected Account depends on the law of the relevant jurisdiction, but some regimes, such as that of the UK, offer greater flexibility in how the "ring-fencing" is achieved and what proportion of the proceeds must be in the Protected Account, provided that these matters have been clearly disclosed to investors at the outset.

5.2 Time Limit for Completing the Business Combination / de-SPAC

The SPAC process creates a duration and reinvestment risk for the Investors because their cash is tied up while the SPAC seeks a Target. Moreover, allowing an endless search for a Target may not be in the Investors' interests, and there is evidence that restrictions on the search period are beneficial to Investor outcomes, as SPACs that announce Business Combinations earlier tend to perform better than those that find a Target after a longer search period. As such, frameworks normally specify a time limit for SPACs to find a Target and complete the de-SPAC - typically 24 months. An extension is sometimes possible under specific conditions, such as where a) the SPAC demonstrates that an acquisition is imminent or b) the extension is subject to the approval of shareholders.

5.3 Governance and Fit & Proper Requirements

Most SPAC Frameworks include governance and conduct rules aimed at mitigating against conflicts of interest between Investors and Sponsors, as well as at ensuring the skill and competence of SPAC management and their good governance. Listing rules may require that SPAC board members have professional experience relevant to the management of the SPAC's target investments.

There may be provisions intended to mitigate conflicts of interest, such as disclosure, codes of conduct as well as duties such as a requirement that a SPAC's board must act in the best interest of shareholders when selecting the Target and must inform shareholders accordingly. Requirements may be imposed to ensure the independence and expertise of directors and to stipulate how they should deal with possible conflicts of interest and how to act in the interests of shareholders. These requirements may be similar to or derived from the standard IPO governance requirements, but specific SPAC requirements need to be developed.

5.4 Retail Investors Participation

In some jurisdictions, rules aimed at limiting retail investors' subscription for SPAC units (shares and warrants) apply at the IPO stage (see section 9).

6. The Business Combination and de-SPAC Stage

Once the Target has been identified, the approval of the Business Combination is the next critical step. At this point, the SPAC shareholders must decide whether to approve the SPAC's Business Combination and whether to vote for the merger and/or redeem their investment. However, there are also significant conflicts of interest with the Sponsors and management in the decision-making process, since they:

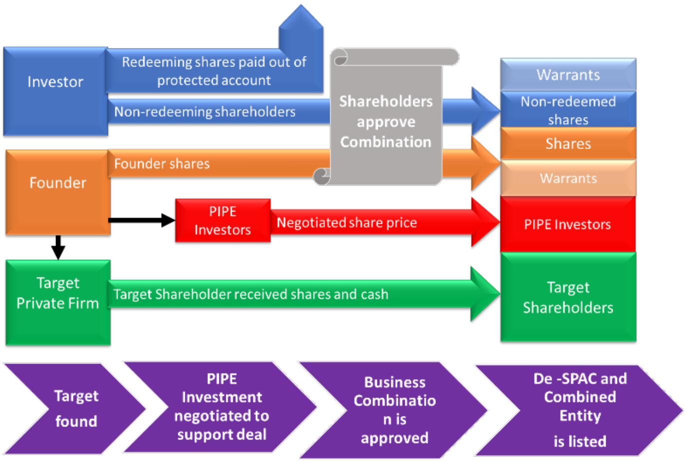

Figure 8 Business Combinations and de-SPAC Stage

- Typically have better information about the Target than the Investors, because they selected the Target, negotiated the terms of the initial Business Combination and likely performed some due diligence on the Target.
- Have a strong incentive to complete a transaction and avoid a liquidation of the SPAC. The Sponsor shares do not generally participate in any liquidation, so the Sponsor may lose its investment and its potential Promote if the SPAC is liquidated. The Sponsor only gets the benefit from the Promote (and other remuneration) if a transaction is completed.

Accordingly, disclosure and the rules around decision-making on Business Combinations are of critical importance in protecting investors against these conflicts of interest and information asymmetries.

The next 3 chapters therefore look at a) requirements in relation to disclosure of information, b) due diligence and the liability of Gatekeepers for the information that is disclosed as well as c) other requirements that are imposed at the Business Combination stage.

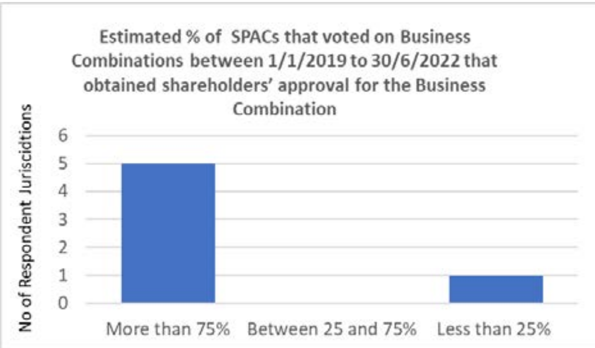

Figure 9 Business Combinations (IOSCO Survey)

7. Information Disclosure

7.1 Information Disclosures when the Business Combination is proposed

While most respondents do not have specific requirements regarding disclosure at the Business Combination stage, in nearly all jurisdictions, SPACs must disclose some information about the proposed Business Combination. In accordance with company law, **SPACs must typically present information to the shareholders' meeting to approve the Business Combination**. Most authorities also require SPACs to disclose detailed information about the transaction and the Target on the basis of company law and/or listing transparency rules (where a prospectus is not required). This information typically covers the risks, conflicts of interest, historical financial information, additional financing (e.g., PIPEs), major shareholders, exchange ratios, dilution, and other relevant and/or material information.

In EU member states, listed companies such as SPACs are **required**, in accordance with the *Market Abuse Regulation,* **to publicly disclose as soon as possible inside information** that would likely have a significant effect on the valuation of the issuer's shares. In EU member states, national competent authorities ensure that SPAC-IPO prospectuses contain a detailed description of the disclosure that the issuer will provide to the shareholders' meeting about the Business Combination[25]. Regulators usually verify whether these disclosure requirements are met, but in some cases it is the exchange that carries this out.

In Switzerland, the *Directive on the Listing of SPACs* requires SPACs to disclose appropriate information about the proposed de-SPAC to Investors at the shareholders' meeting.

7.2 Requirements for a Prospectus at the Business Combination/de-SPAC stage

Whether the publication of an approved prospectus is required at the Business Combination stage varies and often depends on the transaction structure, e.g., whether a new share offer to the public is made or new shares are admitted to trading.

In Canada, **a non-offering prospectus is required at the Business Combination stage** that contains the same information that would be required of an issuer seeking to complete an IPO (see Box 2). In the UK, an approved prospectus is always required when the shares in the enlarged entity after the de-SPAC are admitted to trading, irrespective of whether any further shares have been issued.In EU member states, an approved prospectus is only required in certain circumstances under the Prospectus Regulation; for example, when the Business Combination constitutes an offer of shares to the public with an amount exceeding €1-8 million (the amount varies by member state) and/or when the new securities to be admitted to trading on a regulated market represent more than 20% of the securities already admitted or if the securities issuance leads to a reverse acquisition, when the listed issuer is an empty shell and not a business (as generally is the case of a SPAC).

[25] In EU member states, such disclosure requirements supplement the information package to be provided to shareholders ahead of the shareholders' meeting in accordance with the Shareholders' Rights Directive, national company law and the relevant EU company law directives.

In practice, the additional shares issued with respect to the PIPE financing can trigger the requirement to publish a prospectus.

In Hong Kong, the stock exchange will vet the listing document issued for the de-SPAC to ensure that it meets the relevant listing document requirements. In the US, documents regarding the transaction and the Target company are required to be filed with the SEC.

Box 2: Prospectus and non-offering prospectus requirement in Canada: A prospectus must be filed with the relevant securities commission or authority at the time of the IPO, and a non-offering prospectus must be filed and receipted by the regulator before shareholders vote on the business combination. The non-offering prospectus must comply with the disclosure requirements set out in the rules applicable to IPO issuers and must contain full, true and plain disclosure of all material facts, including forward-looking information, in accordance with Canadian securities law. There is statutory liability against the issuer, underwriter and every other person or company who certifies the prospectus (which includes any founders) at the IPO stage, and contractual liability that mirrors the above-noted statutory liability against the issuer and every person who certifies the prospectus (which again, includes any founders) at the business combination stage. Please see the discussion under section 8.2 *Gatekeeper Liabilities* for additional information.

7.3 Forward-looking statements

An important information asymmetry relates to the forward-looking statements that may be provided once a Target is identified. On the one hand, these statements could be useful for the Investors when deciding whether to approve and remain invested in the transaction. On the other hand, the Sponsors and SPAC management have a clear incentive to paint a positive picture of the Target. **In general, forward-looking statements are allowed but must usually meet strict conditions,** such as disclosure of the underlying assumptions and consistency with the Combined Entity's accounting standards. In some jurisdictions, confirmation of the forward-looking statement by an external auditor is required.

7.4 Summary

- The disclosures at the Business Combination stage are of critical importance in protecting investors from conflicts of interest and information asymmetries. However, while many regimes do not have specific rules on disclosure, generally the more active SPAC markets and newer Frameworks do. Nonetheless, in accordance with corporate law and/or at the regulators' request, in most jurisdictions SPACs are required to disclose relevant information on the Business Combination at the shareholders' meeting.
- In some jurisdictions, if certain conditions are met (e.g., if a new offer to the public is made or new shares are admitted to trading), an approved prospectus may be required. In some jurisdictions, a non-offering prospectus or listing document must be published at the de-SPAC stage that must disclose the same information that would be required of an issuer seeking to complete an IPO.
- Generally, forward-looking statements are permitted, subject to conditions and in certain cases to auditor approval.

8. Due Diligence and Gatekeepers

8.1 Due Diligence and Gatekeeping at the Business Combination

Just as in an IPO, there may be several parties (Gatekeepers) involved in the SPAC process (such as underwriters, auditors, brokers) who are responsible and/or liable for certain aspects of the transaction. These Gatekeepers may help ensure the accuracy of disclosures, mitigate fraud or misrepresentations and provide advice. However, the different structure of the SPAC process means that it may be difficult to map the standard IPO Gatekeeper requirements onto SPAC processes and entities. Traditional IPOs are a one-stage process and disclosure, and due diligence and Gatekeeper obligations are set around this one stage. SPACs have two stages, and perhaps the most important and useful disclosure and due diligence occurs at the second, Business Combination stage, rather than at the SPAC-IPO. There may also be some confusion in the market about who the Gatekeepers are in SPAC mergers, what their responsibilities and liabilities are and whether these are similar to those in a traditional IPO[26]. Consideration therefore needs to be given as to whether and how to align the IPO and SPAC routes to the public markets.

Most survey respondents confirmed that **there are entities in the SPAC process that are subject to Gatekeeper obligations** - most commonly auditors/accountants, Sponsors, underwriters and advisors or listing agents (of various types), as well as the escrow account trustees and the trading venues.

In some jurisdictions, **the traditional IPO Gatekeeper obligations are applied in a similar way to SPACs.** An example of this can be seen in jurisdictions such as the Netherlands or Italy: during the SPAC process, there are several third parties involved that can be considered to be Gatekeepers, such as legal advisors, auditors, banks/investment firms and stock exchanges. The involvement of these parties can increase the accuracy of disclosure and may mitigate the risk of fraud. For example, auditors are responsible for the audit of the financial statements. If the Combined Entity is required to publish an approved prospectus before the completion of the Business Combination, audited financial statements must be included. If a prospectus is not required, SPACs are still expected to publish a circular including (audited) financial statements. In practice, all de-SPACs in the Netherlands have included audited financial information. Usually, third parties (excluding the issuer and relevant auditors) are not responsible or liable for the prospectus. However, there is a major reputational risk for these third parties should a SPAC disclose misleading information or involve fraud. The provision of audited financial information may thus mitigate the risk of any wrongdoings and increase the accuracy of the disclosure.

In some Frameworks, **SPACs are obliged to appoint a Gatekeeper at the Business Combination stage to perform due diligence and other Gatekeeper functions**. For example:

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[26] "In traditional IPOs, issuers usually work with investment banks. Thus, a lot of people think the term 'underwriters' solely refers to investment banks. The law, though, takes a broader view of who constitutes an underwriter. There may be some who attempt to use SPACs as a way to arbitrage liability regimes. Many gatekeepers carry out functionally the same role as they would in a traditional IPO but may not be performing the due diligence that we've come to expect. Make no mistake: When it comes to liability, SPACs do not provide a 'free pass' for gatekeepers." SEC Chair Gary Gensler, Remarks Before the Healthy Markets Association Conference (9 Dec 2021) https://www.sec.gov/news/speech/gensler-healthy-markets-association-conference-120921

- The Singapore Framework provides that financial advisers (who must be issue managers accredited by SGX) are responsible for preparing and managing the listing of the Combined Entity. This includes ensuring adequate due diligence is conducted.
- Although there is no mandatory regulatory due diligence Framework in the UK regarding SPACs, at the Business Combination stage SPACs seeking a "premium" listing should provide confirmations to the FCA from an appropriate independent adviser regarding the extent of the due diligence.
- Hong Kong requires the Combined Entity to appoint at least one IPO sponsor to conduct due diligence and to make a declaration regarding, amongst other matters, compliance with applicable IPO requirements under the listing rules and the sufficiency and accuracy of information in the listing document.
- Switzerland requires the appointment of an independent body, such as a recognized audit firm, to review the appropriateness of the de-SPAC offer and to prepare a report, which the SPAC must then publish.
- In Italy, at the Business Combination stage in the case of a merger, a prominent gatekeeper role is assigned by the Civil Code to an independent expert appointed to prepare a report on the fairness of the exchange ratios of the shares of the merging companies.
- In the United Arab Emirates, SPACs are required to appoint an independent advisor, appointed by UAE Securities and Commodities Authority, to determine the fair market value of the Target.

Corporate law on mergers and acquisitions in certain markets may require **an auditor or an independent expert to issue a fairness opinion on the Business Combination and/or the valuation of the Business Combination transaction**. These valuations must be presented to the shareholders' meeting in order for shareholders to make an informed decision regarding the approval of the Business Combination. Some jurisdictions (e.g., Hong Kong, Israel and the United Arab Emirates) require that the fair market valuation of the Target represents at least 80% of the funds raised by the SPAC at the initial offering.

Auditors are also usually responsible for auditing the historical financial statements of the Target that are disclosed in the prospectus and/or other types of documentation published with respect to the Business Combination transaction in certain markets (e.g. pro-forma financial statements of the Combined Entity).

8.2 Gatekeeper Liabilities

The most commonly reported **Gatekeepers' liability was for misrepresentation in the prospectus or for advice.** For example, the listing advisor is required to ensure that its clients understand and are advised on the scope of their obligations under the relevant listing rules.

In Canada, at the SPAC-IPO, issuers, underwriters and promoters are subject to Gatekeeper obligations which are primary market liability for misrepresentations in a prospectus. At the Business Combination stage, the Gatekeeper liabilities take the form of a contractual right of action for rescission and damages against the resulting issuer as well as for damages against the directors and every person who signs the prospectus, which includes promoters. However, there are no Gatekeeper obligations applicable to underwriters and experts at the Business Combination stage.

In most jurisdictions there are no differences between the liability regimes that apply to de-SPAC entities and those involved in a traditional IPO[27].

However, several regimes impose additional or specific liabilities; see Box 3 for an example. Others include:

- In Canada, issuers are subject to contractual liability that mirrors primary market liability for misrepresentations in the prospectus to incentivize them to ensure that disclosure in the non-offering prospectus is accurate at the Business Combination stage.
- In the United Arab Emirates, the signing founders, the board of directors, consultants and third parties are held responsible for the validity of the data included in the SPAC listing.
- In the US, there is a proposal to amend certain registration statements so that the SPAC and the Target would be treated as co-registrants in certain transaction structures and thus could both be held civilly liable for disclosures in de-SPAC registration statements.

Box 3 South Korea Gatekeeper Liability: Under article 125 of the Financial Investment Services and Capital Markets Act, persons involved in a SPAC shall be liable for damages caused to purchasers of securities due to a false description or misrepresentation of any material fact in a registration statement and a prospectus or an omission of a material fact therefrom. Persons liable for the damages are as follows:
1. The registrant of the registration statement and the director (promoter) of the issuer at the time of filing the registration statement;
2. A person who instructed or executed the preparation of the registration statement;
3. A person specified including a certified public accountant, a certified public appraiser, a lawyer, or a patent attorney (including an organization with which each of them is affiliated), who certified that the descriptions of the registration statement or the accompanying documents were true and accurate by affixing his or her signature thereto;
4. A person who concludes an underwriting contract, and a person who prepared or delivered a prospectus. In other legal proceedings, SPACs assume the same liabilities under the commercial law and the civil law as traditional IPOs.

8.3 Summary

- Most SPAC Frameworks impose Gatekeeper obligations on certain entities involved in the SPAC process. The Gatekeeper entities differ, but generally they are responsible and liable for misrepresentation (in the prospectus or other relevant information documents), for providing advice and conducting due diligence. In some cases these Gatekeepers and their obligations are derived from traditional IPO frameworks or general law, but in other cases there are specific requirements to appoint a Gatekeeper at the Business Combination stage that will perform due diligence and other Gatekeeper functions. Nonetheless differences in Gatekeeper obligations at the SPAC IPO stage and the Business Combination stage may exist in some jurisdictions.

- Frameworks in the more active markets normally impose specific due diligence requirements. Others do not, but corporate law and/or listing rules usually require an auditor or an independent expert to issue a fairness opinion on the Business Combination and/or a valuation of the Business Combination transaction. The opinion

[27] Included in the routine liability rules are those from prospectus rules, national Companies Acts, other statutory law applicable to stock market companies, as well as rules made applicable through the listing agreement and other self-regulations (SE).

must be presented to the shareholders' meeting for the approval of the Business Combination. Some Frameworks require the appointment of a specified party or Gatekeeper to carry out due diligence or opine on any valuation.

9. Other Requirements at the Business Combination Stage

9.1 Introduction

In addition to the requirements around disclosure, Gatekeepers and due diligence, there are a number of other important requirements that are often imposed at the Business Combination stage.

9.2 Restrictions on the Sponsor's share and warrant dealings

Typically, the Sponsors of the SPAC acquire shares and warrants in a SPAC; the Promote is normally granted on favorable terms, i.e. for limited or no consideration, while shares and warrants acquired at the SPAC-IPO stage are generally granted at full consideration.

However, the Sponsors of the SPAC have better information and control over the whole SPAC process as a Target is sought and acquired. Addressing this conflict and aligning the interests of the Sponsors of the SPAC with those of the Investors / shareholders is therefore a key issue.

Many SPAC regimes therefore impose minimum requirements on the size of the Sponsor shareholdings (acquired at full consideration and not including the Promote shares) to ensure that they have appropriate "skin in the game". **Some regimes also impose lock-up requirements on the Sponsor shareholdings** to ensure that their interests are better aligned with those of the shareholders. For example, the South Korean Framework sets out specific measures for the protection of investors, requiring that promoters' shares be held for a certain lock-up period.

9.3 PIPEs are a common feature but subject to requirements only in some regimes

SPACs may supplement the money raised through the SPAC-IPO with additional cash from private institutional investors – PIPEs. PIPE transactions are a common feature; of the 153 exchange-listed US de-SPAC mergers since 2015 that were completed by March 2021, 105 included PIPE investments. Unlike the cash raised through the SPAC-IPO, which is uncertain given that it can normally be redeemed, PIPE capital is generally committed cash and so provides more certainty that the SPAC can satisfy minimum cash conditions in the de-SPAC.

Box 4: Mandatory PIPE investment in Hong Kong Framework

In Hong Kong, requirements under the Listing Rules are imposed for independent PIPE investments to support the valuation of the Target and the level of investor interest in the Combined Entity:

a. All independent PIPE investors must be Professional Investors.
b. The amount to be raised from independent PIPE investors must constitute at least a prescribed percentage of the negotiated value of the Target (which ranges from 7.5% to 25% in staggered bands, depending on the value of the Target).
c. Significant investment from independent sophisticated investors – at least 50% of the independent PIPE must come from at least three sophisticated investors, i.e., an asset management firm with assets under management of at least HK$8 billion or a fund with a fund size of at least HK$8 billion. A fund managed by a fund manager that has assets under management of at least HK$8 billion qualifies as a sophisticated investor for this purpose.

There is also evidence that PIPE engagements may reduce the level of redemptions[28] and therefore cause Value Dilution, by signaling the deal quality or fair valuation of the Target[29], which in turn may also support better valuations. However, **explicit requirements in relation to PIPEs are not common** in SPAC Frameworks, although Hong Kong imposes minimum thresholds on PIPEs (see Box 4) to support the fair valuation of the Target.

9.4 Restrictions on the trading of SPAC Shares between the Business Combination and de-SPAC

Once a Target is identified, the SPAC publicly announces it has found a Target and has entered into an agreement. However, from that point onwards, the SPAC shares may be perceived to be shares in the still-private Target company and often start to trade as such. This may create a trading window when shares in a private company, subject to private disclosure requirements, are effectively treated as public shares and where there are significant information asymmetries between those who negotiated the deal and the wider group of investors in the shares. Accordingly, while most jurisdictions do not impose specific trading restrictions on SPAC shares during this period, some authorities impose restrictions to preserve market integrity, protect investors, and avoid market volatility. These restrictions may take three different forms.

Some jurisdictions **restrict all trading** in the SPAC shares at different points in time:

- In South Korea, trading of shares is restricted from the time the board of directors pass a resolution on the merger up to the date of notification of the results of a preliminary review for listing.
- In the UK, when a Business Combination is announced or has leaked, the FCA will consider a suspension of the listing of SPAC shares to be appropriate, but this is subject to exceptions[30].

Rather than restricting all share trading, some Frameworks take a targeted approach and impose **trading restrictions only on certain shares,** for example:

- In Israel, there is a restriction on Sponsors' shares during the lock-up period.
- In Switzerland, prohibitions are imposed on founding shareholders, members of the board of directors, the executive committee.
- In Kenya, similar restrictions apply to controlling investors.
- In Pakistan, restrictions may apply to the shares of dissenting shareholders.

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[28] The average one-year de-SPAC return for PIPE investors is 15.5% for deals with low redemption ratios, compared with the 2.9% for deals with high redemption ratios, suggesting that the presence of PIPE investors can lower redemption rates. M.L. Passador. In Vogue Again: The Re-Rise of SPACs in the IPO market. (April 4, 2021). Brooklyn Journal of Corporate, Financial & Commercial Law, 2022, vol. 16, 105-162., Bocconi Legal Studies Research Paper No. 3820957; University of Luxembourg Law Working Paper No. 2021-005, Available at: SSRN: https://ssrn.com/abstract=3820957 or http://dx.doi.org/10.2139/ssrn.3820957 (April 4, 2021).

[29] Passador. In Vogue Again: The Re-Rise of SPACs in the IPO market (April 4, 2021) found that those SPACs that used a PIPE had a median performance of 46% one month after the deal is concluded, while those without PIPEs only gained 21% over the same period.

[30] An exception is where a SPAC is an issuer which falls within LR 5.6.5AR(2) and confirms that it meets certain conditions and has made certain disclosures in its admission prospectus such that the FCA are satisfied that the shell company has sufficient measures in place to protect investors and so that the smooth operation of the market is not temporarily jeopardised (LR 5.6.8G and LR 5.6.18AG to LR 5.6.18FR).

Other Frameworks **link any suspension of trading to particular conditions or events.** For example, if any infringement of the *European Market Abuse Regulation* (or other legislation such as the Transparency Directive, Shareholders' Rights Directive, etc.) is suspected or identified.

9.5 Summary

- Restrictions on the Sponsors' shares and warrant dealings are often imposed to better align the interests of the Sponsors with those of the Investors. These may include lock-up requirements and requirements regarding the minimum size of the Sponsor shareholdings acquired at full consideration.

- PIPE investments are a common feature of SPACs, but few Frameworks have express provisions regarding PIPE investments.

- Most Frameworks do not impose specific trading restrictions on SPAC shares during the period between the announcement of the Business Combination and completion of the de-SPAC. However:
    a) Some Frameworks restrict all share trading for a certain period.
    b) Other Frameworks restrict just the share trading of certain parties, e.g., Sponsors.
    c) Other Frameworks link any suspension of trading to particular conditions or events, e.g., market abuse.

10. Listing

10.1 Introduction

The outcome of the SPAC process is that the Combined Entity is then listed on a public market or exchange. This raises the question of how the listing requirements are applied to the Combined Entity.

10.2 Applying the same listing requirements to the Combined Entity as to a traditional IPO

The survey found that **most jurisdictions apply essentially the same listing requirements to de-SPACs / the Combined Entity as to traditional IPOs**. However, many apply different listing rules to SPACs. Some jurisdictions allow derogations or exemptions; for example, exemptions may apply to start-ups or companies operating in promising sectors. In some jurisdictions, the exchange may impose discretionary or formal rules. There may also be exchange rules regarding the transfer of listing to another market segment which apply prior to the completion of the Business Combination or after the incorporation of the Combined Entity.

10.3 Review by the Regulator and/or the Stock Exchange

In about half of the jurisdictions, **the Combined Entity is subject to review before it is listed on the exchange.** These reviews may be carried out by either the regulator, the exchange, or both and can take a variety of forms such as a review of deal terms and financial statements of the combined entity as in the US or a review of the consistency of the initial prospectus/listing, as in Singapore.

10.4 Summary

- Most jurisdictions apply essentially the same listing requirements to SPACs as to traditional IPOs, while others apply different listing rules to SPACs, either through regulation or via exchange rules.
- In around half of the Frameworks, the Combined Entity is subject to review before it is listed on the exchange, although the terms of this review differ.

Areas of Focus

11. Focus on Dilution

11.1 Introduction

Dilution is embedded in the design of SPACs, is often significant[31] and is therefore a key concern for Investors. The risk of Dilution is partly mitigated by the Redemption Right, which serves to limit the downside risk for any redeeming investors. However, Investors who do not exercise their Redemption Right at the de-SPAC stage may be at greater risk of dilution of their investment compared to Investors in an IPO. This dilution can take two forms, Shareholding Dilution and Value Dilution.

11.2 Sources of Dilution

Shareholding Dilution is dilution of an Investor's proportion of the shares held in a SPAC (or Combined Entity). This means, amongst other things, that they have less control. More importantly, Investors may be exposed to Value Dilution, i.e., reduction in the net asset value per share[32]. This dilution can occur due to:

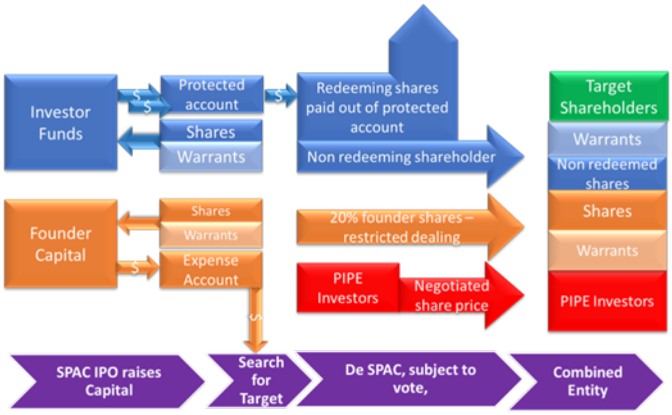

Figure 11 Dilution during the SPAC Process

- **The Promote**: The Promote is typically issued at a nominal price to the Sponsors. As the Promote is typically converted into ordinary shares following the de-SPAC without the Sponsor providing any additional funds, the conversion results in Value Dilution for non-redeeming investors. SPACs also need to pay a number of costs, such as underwriting fees, during the SPAC process which may also cause Value Dilution.

- **Redemption:** At the de-SPAC stage, Investors typically have a Redemption Right (the right to redeem their shares for cash in the Protected Account). The redeeming shareholders can typically retain their warrants, which they can exercise despite not having contributed economically to the Business Combination, but this results in further dilution for the non-redeeming shareholders. The more shareholders redeem, the greater the Value Dilution for the non-redeeming shareholders, as (a) each redemption leads to an increase in the proportion of SPAC Warrants, Sponsor Warrants and the Promote relative to unredeemed SPAC Shares; and (b) most costs associated with the SPAC-IPO and the Business Combination (such as the underwriting fees) are fixed and do not reduce in proportion to the redemptions.

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[31] Academic studies on earlier rounds of SPACs, such as that of Lakicevic and Vulanovic (2013), observed that SPAC investors owned, on average, 78% of the shares in a SPAC but provided nearly 97% of the cash. More generally, they found dilution levels of around 33%, while for SPACs since 2010, dilution has reached more than 90%.

[32] A quantitative scenario is set out in Annex 1 that illustrates how dilution works.

- **SPAC Warrants (normally included in SPAC Units) and Sponsor Warrants**: SPAC Warrants and Sponsor Warrants, when exercised, result in the issue of new shares. The Warrants are usually exercised with an exercise price that is higher than the IPO price of a SPAC Unit (typically US$11.50 per share in the US, compared to an issue price of US$10 per unit). Consequently, when warrant holders exercise their right to purchase a newly issued share at this exercise price, the extent of Value Dilution for shareholders will depend on the difference between this exercise price and the current trading price of the shares into which they are converted. In any event, the exercise of the SPAC warrants will result in Shareholding Dilution.

- **PIPE**: If a PIPE investment is raised at the de-SPAC stage[33], dilution due to the above factors may either be partly offset or exacerbated, depending on the number and issue price of the new shares issued to the PIPE investors. PIPE investors may subscribe for the new shares at a discount or at the IPO price, with or without any warrants. If PIPE shares are issued at a discount or with warrants, this might result in further Value Dilution. On the other hand, if PIPE shares are issued without any discount to the IPO price, this may partly offset the extent of dilution resulting from the above factors[34].

- **Target Company:** SPACs typically target companies that are two to three times their size[35]. This means that the shareholdings of SPAC-IPO investors will often be significantly diluted as the shareholders of the Target normally receive shares (and/or cash) as compensation for the merger with the SPAC[36]. The extent to which the merger with the Target offsets (or exacerbates) Value Dilution will depend on the number and issue price of the consideration shares issued to the shareholders of the Target. If consideration shares are issued without any discount to the IPO price, this will partly offset the extent of dilution caused by other factors such as redemptions.

Together, these factors can dilute the value of shares at various stages of the SPAC, often substantially. Klausner, M. & Ohlrogge, M (2022) found that the median SPAC holds cash of only US$5.70 per share at the Business Combination stage, despite the initial offering price of US$10. To allow an Investor to make a properly informed decision regarding the Business Combination, they proposed that SPACs should disclose to Investors the SPAC's net cash per share value at the time of the Business Combination and specify how that calculation is done, taking into account all sources of dilution.

Addressing dilution is complicated by the fact that there seem to be two types of investors. The first group are “short-term investors”, who buy into a SPAC’s IPO but have no intention to stay invested in the Target. These Investors usually redeem their shares at the time of de-SPAC and receive their escrowed cash and any net investment income[37]. Their returns are further enhanced because at the SPAC-IPO stage, they also receive warrants which may be exercised

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33 PIPE investments seem to have been quite ubiquitous during the boom; in 2021, approximately 95% of de-SPAC transactions included PIPE financing - https://blog.freshfields.us/post/102hgzy/2021-de-spac-debrief - but the tighter financing conditions at present may have made PIPEs harder to source.

34 In any event, the exercise of the SPAC warrants and the PIPE will both result in a Shareholding Dilution.

35 https://www.ey.com/en_us/ipo/spac-target-company-readiness

36 In 2021, out of the 199 closed de-SPACs in the US, 64% were paid in shares only, 35.5% in both cash and shares and only 0.5% in cash alone.

37 See Klausner M, Ohlrogge M, Ruan, E A Sober Look at SPACs (2020).

or sold at a profit if the Business Combination succeeds[38]. The second group, "longer-term investors", are often committed to retaining their shares if a Target is found which they approve. However, the value of their shares is diluted by the redemptions of the first group.

11.3 Survey findings on Value Dilution

The survey confirms that Value Dilution can be significant but also highly variable, with estimates ranging from less than 25% to more than 75%[39].

> **Box 5 Disclosure of Dilution in Europe:** ESMA issued a Public Statement on 15 July 2021 that highlights the fact that NCAs are expected to scrutinize prospectuses for disclosures in relation to risk factors such as any possible future dilution arising from the payment of the sponsors' fees in shares, the exercise of warrants and/or in relation to the financing of the acquisition. In particular, NCAs are expected to ensure that issuers provide an overview of the amount of possible dilution in different scenarios by means of a table or diagram.

Respondents who provided an estimate indicated that Value Dilution could cover a wide range of values. As regards the average size of the Promote, where respondents were able to provide an estimate, estimates around the figure of 20% seemed to be the most common, although the basis on which respondents made these estimates varied quite considerably, depending on whether the estimate was the size of the promote before or after de-SPAC.

11.4 Disclosure of Dilution

Just over half the respondents required the level of potential dilution to be disclosed at the SPAC-IPO stage. In a number of jurisdictions, disclosure of dilution was also required at the Business Combination stage.

> **Box 6 Proposed Disclosure of Dilution in US**: The SEC has proposed new Regulation S-K Items 1602(a)(4), 1602(c) and 1604(c) to require additional disclosure about the potential for dilution in (1) registration statements filed by SPACs, including those for initial public offerings, and (2) de-SPAC transactions. [Release at page 36]. Proposed Item 1602(c) would require dilution disclosure in registration statements filed by SPACs other than for de-SPAC transactions and would require a description of material potential sources of future dilution following the registered offering by the SPAC, including a SPAC's initial public offering. It would also require tabular disclosure of the amount of potential future dilution from the public offering price that will be absorbed by purchasers of the securities being offered, to the extent known and quantifiable. [Release at page 331.] Proposed Item 1604(c) would require disclosure of each material potential source of additional dilution that non-redeeming shareholders may experience by electing not to tender their shares in connection with the de-SPAC transaction. It would also require a sensitivity analysis in a tabular format that shows the amount of potential dilution under a range of reasonably likely redemption levels and quantifies the dilutive impact on non-redeeming shareholders of each source of dilution. [Release at page 335.]

This disclosure may be provided in a range of ways, from disclosure in a full prospectus to a press release. In other Frameworks, the risk of dilution must be disclosed as part of the general risk factor section of the prospectus.

While some respondents did not have specific requirements on how dilution disclosure should be presented, a significant number indicated

[38] See Harald Halbhuber, Economic Substance in SPAC Regulation (2022).

[39] In the US, with the largest sample size, SPAC Insider data estimates have Value Dilution of 45% just from the Promote and the redemption rate. However, this calculation understates the total Value Dilution, since it ignores Value Dilution due to warrants and rights held by redeeming shareholders (effectively given away for free), any discounts offered to founders or PIPE investors, and underwriting fees (which are based on IPO proceeds rather than post-redemption cash raised)

that they would expect to see dilution scenarios disclosed.

11.5 Restrictions on Warrants to Limit Dilution

Most respondents do not impose direct restrictions on warrants to limit dilution, but a few do, e.g., Hong Kong, Indonesia, Malaysia, Singapore, Kenya, Israel or proposed to do so (Oman). Where warrants are permitted, no Frameworks imposed restrictions on the detachability of warrants, but a majority impose some requirements on the disclosure of warrant terms, in most cases as part of the approved prospectus or other general information requirements.

In some jurisdictions, the **terms of the warrants require approval** as part of the SPAC-IPO process, although approaches vary. In some cases, the preapproval is of the prospectus, and the terms of the warrant may be part of this review or approval. In other cases, the preapproval covers the warrant itself.

Some respondents, such as Hong Kong, specify the information to be provided, e.g., the maximum number of securities which could be issued on exercise of the warrants, the exercise period and amount payable on exercise of the warrants and a summary of any other material terms of the warrants.

Other respondents clarify the basis on which they might intervene, e.g., potential investor detriment and if an arrangement was potentially abusive (UK). A few respondents clarified that preapproval of the warrants is not required, does not occur or may be subject to exemptions (Canada, and Italy).

Many regimes **use the disclosure of warrant terms as a tool to limit dilution**. In Switzerland, the documentation prepared for the SPAC's IPO must include an indication of the maximum dilution effect of any convertible financial instruments, especially warrants.

In the US, the SEC has proposed to require disclosure of each material potential source of additional dilution that non-redeeming shareholders may experience at different phases of the SPAC lifecycle if they elect not to redeem their shares in connection with the de-SPAC.

Some jurisdictions impose specific quantitative caps or rules aimed at restricting Shareholding Dilution and Value Dilution arising from warrants (Singapore, Hong Kong, Malaysia, Israel, and Indonesia).

To limit Value Dilution, restrictions are imposed in some jurisdictions on the exercise price of the warrants, stipulating that the exercise price cannot be less than the price of the SPAC-IPO shares (Singapore) or must at least have a certain premium over the SPAC-IPO share price, such as 15% (Hong Kong).

There may be requirements that warrants must not be exercisable before completion of the de-SPAC (Singapore and Hong Kong) and the warrant holders are not entitled to the escrow funds of the SPAC upon liquidation or redemption (Singapore).

In Hong Kong, there is also a restriction on Sponsor Warrants, which must not contain terms that are more favorable than the terms of other warrants issued or granted by the SPAC.

Box 7 Disclosure of redemption provisions - US SEC: SPACs are currently required to disclose the redemption provisions of their registered capital stock, such as whether redemptions would be required under certain circumstances at the SPAC's option, e.g., whether a SPAC may require the redemption of warrants held by public shareholders for nominal consideration if the underlying shares trade above a certain threshold price. SEC has proposed additional disclosure of each material potential source of additional dilution that non-redeeming shareholders may experience at different phases of the SPAC lifecycle if they elect not to redeem their shares in connection with the de-SPAC. For example, where material, this disclosure would need to explain that if a SPAC's shareholders retain their warrants after redeeming their shares prior to the de-SPAC, the non-redeeming shareholders and the post-business combination company may face potential additional dilution.

11.6 Dilution Caps

A dilution cap is a provision that expressly limits (directly or indirectly) the extent of Value Dilution or Shareholding Dilution that is permitted to occur at a certain point. Dilution caps do not prevent dilution occurring but seek to impose a limit on the maximum amount of dilution that can occur. Typically, caps are imposed on the Promote or warrants (i.e., SPAC Warrants and Sponsor Warrants).

A few jurisdictions (e.g., Hong Kong, Malaysia, Singapore, Israel, Canada, and Indonesia) have provisions that limit the extent of Value Dilution or Shareholding Dilution. Some jurisdictions, such as Hong Kong, Singapore and Canada, impose **a cap on the Promote** of up to 20% of the SPAC's issued share capital as at its IPO (on a fully diluted basis).

Some jurisdictions impose a **cap on the warrants or non-transferable options**. For example, Hong Kong, Singapore and Malaysia impose Shareholding Dilution caps with respect to the conversion of any warrants (e.g., 50% of the number of shares in issue at the time such warrants are issued). In Israel, the Sponsors are entitled to a maximum of 10% on non-transferable options.

Box 8: Dilution Cap - Hong Kong: Listing Rule 18B.23 sets out the dilution cap on warrants. A SPAC must not issue warrants in aggregate that, if exercised, would result in an issue of shares that exceed 50% of the total number of shares in issue at the time such warrants are issued. Listing Rule 18B.29(1) sets out the dilution cap on Promote. A SPAC must not allot, issue or grant any Promote to a Sponsor that represents more than 20% of the total number of shares the SPAC has in issue as at the date of its listing. The Exchange may consider requests from a SPAC to issue additional Promote, as an earn-out portion, if certain conditions are fulfilled. The total number of Promote (including the earn-out portion) should represent an amount not more than 30% of the total number of shares in issue at the time of the SPAC listing.

It is worth noting that two jurisdictions use **disclosure requirements to set a cap on dilution**:

- In Israel, no further dilution is permitted beyond the level disclosed in the initial prospectus.

- In Pakistan, dilution beyond the disclosed level would only be permitted by specific approval by the regulatory agency.

11.7 Earn-out Rights

While dilution mechanically reduces the value of the SPAC investors' stake, this may be offset if the SPAC finds a high-quality Target and/or strikes the deal at a discount. However, the economics of the Promote may mean that a Sponsor is incentivized simply to find a Target rather than find the best Target. Earn-out structures have often been incorporated into SPACs and may involve a "ratchet" arrangement whereby portions of the Promote are exercisable if performance-linked target thresholds are met. These structures may result in a better alignment of interests between Sponsors and SPAC Investors. On the other hand, earn-out rights, on top of the Promote, may result in additional dilution.

In a majority of the jurisdictions, there are no specific rules on earn-out rights issued to Sponsors and earn-out arrangements are permitted in accordance with the general law. However, there is some debate about how effective Sponsor earn-out structures are[40]. A few respondents noted that earn-out rights must be disclosed (UK, Pakistan, Egypt, UAE, US, Hong Kong). One jurisdiction noted that intervention by the regulator may be possible where an earn-out arrangement is potentially abusive (UK). In Belgium, the FSMA recommended linking the founders' remuneration to the value creation, rather than as an upfront payment, in order to reduce Value Dilution.

In Hong Kong, in addition to disclosure requirements, earn-out rights to be issued to Sponsors may be allowed only if certain conditions are met.

Box 9: Earn-out Provision - Hong Kong: Under Note 1 to Listing Rule 18B.29(1), the Exchange may consider requests to issue earn-out rights to a Sponsor subject to a number of conditions, including, amongst others:

(a) the total number of ordinary shares of the Combined Entity to be issued under (i) such earn-out rights ("earn-out shares") and (ii) all Promote must, together, represent an amount not more than 30% of the total number of shares that the SPAC had in issue as at the date of its listing;

(b) the earn-out rights must only be convertible into earn-out shares subject to the satisfaction of objective performance targets. The rule also sets out certain requirements if those performance targets are determined by changes in the price of the Combined Entity's shares;

(c) the listing document produced for the SPAC's initial listing must disclose any proposed earn-out rights to be issued to a Sponsor upon the completion of the de-SPAC, including details of such earn-out rights, e.g., the performance targets;

(d) any instruments or other securities representing the earn-out rights must only carry the earn-out rights, and must not entitle their holder to any other rights such as voting and dividend rights;

(e) the material terms of the earn-out rights negotiated and agreed between the parties to the de-SPAC must be disclosed in the relevant announcement and the listing document;

(f) SPAC shareholders granting approval for the earn-out rights at the general meeting called to approve the de-SPAC, with such earn-out rights included in the resolution approving the de-SPAC (at which the Sponsor and its close associates must abstain from voting); and

(g) if the de-SPAC does not complete, the earn-out rights are cancelled and become void.

[40] Klausner M., Ohlrogge M., Is SPAC Sponsor Compensation Evolving? A Sober Look at Earnouts (2022).

11.8 Conclusions

- The often-significant levels of dilution that are commonly embedded in SPACs raise concerns about investor protection. Dilution can arise at a number of points in the life of a SPAC and from various sources, including the Promote, costs, warrants and the Redemption Right.

- Regulators take a range of approaches to address dilution risks.

- The most common approach is to require clear disclosure of the potential dilutive elements in the SPAC process. In some cases, there is a degree of prescription about the form this disclosure should take, typically requiring some kind of scenario analysis and guidance on how dilution should be calculated.

- Another approach is to implement requirements that limit or reduce the amount of dilution that may occur. Some jurisdictions impose a dilution cap to limit the extent of dilution. In some jurisdictions, the terms of the warrants must also be pre-approved separately or as part of the SPAC prospectus, or they may be subject to other restrictions.

- Much of Sponsor remuneration is paid upfront but linking their remuneration to the ultimate value created – acquiring a high quality Target for a price and on terms favorable to Investors – may reduce Value Dilution. Earn-out provisions are a way that may better align the interests of Sponsors and Investors, but they may result in additional dilution, depending on the structure.

12. Focus on Retail Participation and Investor Redemption

12.1 Introduction

The SPAC process is complex and uncertain, and the expected returns may not be commensurate with the risks this creates for investors. Consequently, some regulators ban or limit retail participation while others permit it but may also implement general or specific measures to protect investors.

The attraction of SPACs is often attributed to the fact that they allow retail investors to invest in private equity assets that would otherwise only be available to institutional investors – hence the label "*poor man's private equity"*[41]. Another attraction is that the money invested is held in a Protected Account and investors can get this money back by exercising their Redemption Rights at the de-SPAC stage. This significantly reduces the downside risk for investors[42], while redeeming investors may still be able to get the upside returns if they retain their warrants.

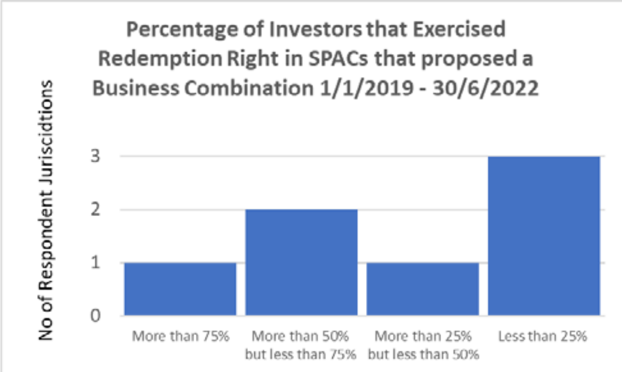

Figure 12 Exercise of Redemption Right (IOSCO Survey)

However, while there is evidence that the returns to redeeming investors during the period between the SPAC-IPO and the de-SPAC are generally either slightly positive or around zero, the returns to non-redeeming investors after the de-SPAC are often negative[43]. Retail investors seem to be less likely to recognize this and are generally less likely than other investors to redeem their shares[44]. These poor expected returns are one of the motivations for regulators to implement investor protection measures. The other investor protection concern is that SPACs are complex processes, and it is difficult for most investors to make a good assessment of a SPAC as a potential investment.

41 Davidoff, S.M., 2008, "Black Market Capital. Columbia Business

Law Review,1:172-268 Dimitrova, L.: “Perverse Incentives of Special Purpose Acquisition Companies, the “Poor Man’s Private Equity Funds”,” Journal of Accounting and Economics, 63, 99–120 (2017); Rodrigues U & Mike Stegemoller, Exit, Voice, and Reputation: The Evolution of SPACs, 37 DEL. J. CORP. L. 849 (2013);

42 Boyer and Baigent (2008)

43 Lewellyn, S. “SPACs as an Asset Class,” SSRN Working Paper (2009): finds that while investors experience a positive 2% return following an acquisition announcement, their returns are -2% return at the date of acquisition. Jenkinson and Sousa (2011) find that more than half of SPAC acquisitions are value destroying and, six months after the merger, SPAC investors’ average cumulative return is - 24%, which falls to -55% one year out. Similarly, Zhang, Gahng, Ritter (2021) find that IPO investors have earned annualized returns of 23.9%, while investors in the merged companies have earned 11.3% in the first year on common shares.

44 Passador (2021) finds that individual/family investors constitute about 23% of shareholders, but that institutional investors (45%) are more likely to redeem after the de-SPAC than other investors, including those individuals/family investors (35%).

12.2 Scale of Retail Investment

The survey found that **retail participation in SPACs is relatively low**: all respondents that provided an estimate and permitted retail participation thought that between 1 January 2019 to 30 June 2022, retail investor participation in SPACs at the point of SPAC-IPO was less than 25%[45] of the total money invested to SPACs. The position was similar at the point of the de-SPAC.

12.3 Redemption Right

The Redemption Right is an important investor protection feature that serves to limit the downside risks for investors, although the evidence is that retail investors are less likely to use this protection[46]. The Redemption Right also affects a shareholder's incentive to approve any proposal for a Business Combination with a Target.

> **Box 8 Redemption Rights in the UK**: Those SPACs that wish to take advantage of the UK's alternative approach to suspension need, among other things to provide a 'redemption' option allowing investors to exit their shareholding before any acquisition is completed. The holders of the listed shares have the right to require the SPAC to redeem or otherwise purchase their shares for a predetermined amount, which is exercisable: a) at the discretion of the holder prior to completion of a reverse takeover; and b) whether or not the holder voted in favor of the reverse takeover on any shareholder resolution to approve the transaction (Listing Rule 5.6.18AG(7))

About **half of Frameworks did not impose any requirements** on whether shareholders are permitted or prohibited to redeem their shares. The other half was split between those that require a SPAC to **permit all holders to redeem** (in some cases barring Sponsors), and those that require a SPAC to **permit redemption by dissenting shareholders only**. A couple of jurisdictions (e.g., Malaysia) require **redemption by at least the dissenting shareholders,** although SPACs have extended this Redemption Right to cover other shareholders (e.g., those who vote for, abstain or are absent from voting).

Some alternative approaches to redemption that were also identified include:

- In Singapore new SPACs could impose a limit on the maximum number of shares that could be redeemed by a single holder. This limit may not be set at lower than 10% of the shares issued at IPO which must apply equally to all independent shareholders entitled to a redemption right and is required to be disclosed in the initial prospectus.
- While most Redemption Rights were triggered by the Business Combination decision, in Italy, according to the general company law provisions, Redemption Rights would typically be granted upon a material change to the company's corporate purpose, delisting or moving the registered office to a different country.
- In the UAE, redemption opportunities are required to be offered upon an extension of the SPAC's life.
- In Hong Kong, redemption opportunities must be offered prior to a general meeting to approve, among other things: (a) an extension of the deadline to complete a de-SPAC and (b) the continuation of the SPAC following a material change in Sponsor or SPAC directors.

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45 The US analysis of Form 13F data shows total ownership by reporting firms (institutional investors) of 64% (both median and mean) at the end of the first quarter after the IPO. However, the analysis omits all institutional investors that do not report on Form 13F and also treats outliers in the data very conservatively, so total institutional ownership after the IPO is likely even higher than 64%.

46 See footnote 42.

- While most regimes require redemption at a pre-determined price or calculation mechanisms, in the South Korean Framework, dissenting shareholders can elect to have their shares repurchased at fair value.

12.4 Prohibiting Retail Participation

Some jurisdictions (Brazil and Hong Kong) prohibit retail participation and only allow professional/qualified/institutional investors to participate in SPACs at both the SPAC-IPO stage and in the secondary market during the period between the SPAC-IPO and the de-SPAC. In Brazil, trading by retail investors is only allowed 6 months after the SPAC's Business Combination, and then only with restrictions. The prohibition on retail investor participation is usually justified on the basis that SPACs are not appropriate investments for retail investors due to their complexity and inherent risks (Hong Kong and Brazil).

12.5 Permitting Retail Investor Participation

Many jurisdictions permit retail investors to participate at the SPAC-IPO stage as well as in the secondary market during the period between the SPAC-IPO and the de-SPAC.

Some justify this on the basis that these transactions can be classified as permissible regulated products. Others (Malaysia, Singapore and the UAE) consider that retail participation should be allowed because it provides opportunities for retail investors to invest in private equity-type investments that are otherwise not available to them. One jurisdiction (Kenya) justified retail participation because it has only a limited number of professional investors, and so retail investors are necessary for a viable SPAC market, subject to sufficient investor protection measures.

12.6 Permitting Retail Participation subject to conditions

Many of the jurisdictions that permit retail participation impose additional general or specific investor protection measures. EU[47] law does not prohibit retail participation in SPACs and, subject to suitability tests conducted by regulated financial institutions, retail clients can invest in SPAC deals (see Box 9).

[47] The EU does not have a single harmonised framework for SPACs. Overall, these fall under the Prospectus and Listing Regulations and directives, as well as under product governance requirements set out in MiFID II. ESMA's approach to SPACs consists in ensuring the harmonisation of such requirements by clarifying regulatory expectations regarding SPACs, so that potential investors are provided with clear, comprehensible and comparable information when making their investment decisions.

However, some EU member jurisdictions (Belgium and the Netherlands) **discourage retail participation,** and many EU member jurisdictions (France, the Netherlands and Italy) **de facto exclude retail participation at the IPO stage**. This may be because SPACs are listed on the professional segment of a market, and consequently retail investors do not then have access to SPAC shares in the secondary markets (France, Italy). SPAC shares listed on Euronext Brussels have to carry a notice that they are reserved for professional investors[48].

Box 9 ESMA Statement on Investor Protection
The European Securities and Markets Authority (ESMA) issued a Public Statement on the prospectus disclosure and investor protection issues raised by special purpose acquisition companies (SPACs). The statement highlights ESMA's view that SPAC transactions may not be appropriate investments for all investors due to risks relating to dilution, conflicts of interest in relation to sponsors' incentives and the uncertainty as to the identification and evaluation of the target company. In addition, ESMA emphasizes the importance of the proper application of the MiFID II product governance rules and their role in ensuring investor protection.

In other cases, retail participation is de facto excluded at the IPO stage because the IPO is only offered to non-retail investors, but in these cases, retail investors may have access to SPAC shares in the secondary markets (Netherlands).

12.7 General or Specific Rules and Provisions for Retail Investor Protection

General rules: In most jurisdictions, general investor protection rules, such as suitability tests disclosure requirements and Key Information Documents, apply to SPAC transactions. In the EU, trading by retail investors is subject to general MiFID II[49] requirements on product governance, requirements that a financial institution must administer an appropriateness test before execution of a retail trade, or the product governance and appropriateness/suitability policies of the investment firm/bank/retail broker.

SPAC-Specific Rules: The survey found that many jurisdictions impose specific rules to ensure investor protection, some of which have been described above, such as the requirement that the funds raised from a SPAC-IPO should be held in a Protected Account, requirements on disclosure of conflict of interest, etc.

For all IPOs, including SPAC-IPOs, the UK's approach to identifying the potential for investor detriment includes consideration of whether: (i) there is an imminent risk of catastrophic loss of value for investors, such as a significant risk of all or substantially all of the applicant's assets being confiscated shortly after listing; or (ii) the business is linked to individuals so questionable that no investor should be exposed to them, among other indicators. If this is the case, the regulatory reviewing team of a SPAC can advise against approving the application.

48 See FSMA Opinion https://www.fsma.be/sites/default/files/media/files/2021-06/fsma_opinion_2021_04_en.pdf

49 https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32014L0065

Box 10 Specific suite of rules to support Investor Protection in Singapore

(i) SGX will consider various factors in assessing the listing suitability of a SPAC, including those set out under Paragraph 2.1 of Practice Note 6.4 of the SGX Mainboard Rules, such as the profile of the sponsor;

(ii) de-SPAC must be completed within 24 months of listing with an extension of up to 12 months subject to fulfilment of prescribed conditions set out under Listing Rules 210(11)(m)(i) & (ii);

(iii) the de-SPAC transaction must be approved by a majority of independent directors and shareholders;

(iv) at least 75% vote by independent shareholders is required for the continued listing of the SPAC if a material change occurs in relation to the profile of the sponsor prior to de-SPAC;

(v) proceeds from the SPAC IPO must be placed in an escrow account and the escrow funds may only be drawn down prior to de-SPAC under limited circumstances as specified under Paragraph 6.1 of Practice Note 6.4 of the SGX Mainboard Rules;

(vi) requirement that a competent and independent valuer be appointed to value the target where a PIPE is not conducted in conjunction with the business combination or where the target is a mineral, oil and gas or property investment/development company;

(vii) requirement that the combined entity following the de-SPAC must meet initial listing admission criteria that are the same as for non-SPAC issuers; and

(viii) requiring the financial advisers of the de-SPAC to be issue managers and for due diligence conducted by the financial advisers for the de-SPAC to have regard to the Listings Due Diligence Guidelines issued by the Association of Banks in Singapore (ABS) that are applicable to all IPO.

The US takes an approach that is disclosure-based, focusing on full and fair disclosure that allows investors to make informed investment decisions.

As illustrated in Box 10, other Frameworks have adopted a suite of measures to ensure investor protection.

12.8 Conclusions

- Investor harm from SPACs is one of the main regulatory concerns, but retail investor participation appears to be relatively low. Retail participation can take place at the SPAC-IPO stage, the de -SPAC or secondary trading in the intervening period, but only a few regimes apply different rules on retail participation to these different stages.

- Some regulators restrict retail investor participation on the basis that the mechanism is too complex and uncertain for retail investors and restrict SPACs to professional investors. In other cases, SPACs may simply choose not to offer their shares to retail investors or list on a retail market.

- However, most jurisdictions permit retail participation in SPACs but also apply a) existing general investor protection measures e.g., a suitability test and/or b) a suite of SPAC-specific measures to protect Investors.

13 Focus on Liquidation

13.1 Introduction

A SPAC will normally be required to be liquidated if it does not find a Target within a specified time, if the Business Combination is not approved, or if funding is insufficient to complete the deal. In the event of liquidation, most SPAC Frameworks determine how the funds in the Protected Account are to be distributed pro rata to the shareholders. However, the Sponsors have a strong incentive to complete a transaction and avoid liquidation, as Sponsor shares do not generally participate in any liquidation. This means the Sponsor may lose its investment and its potential Promote if the SPAC is liquidated. A Sponsor will only benefit from the Promote shares (and other remuneration) if a transaction is completed.

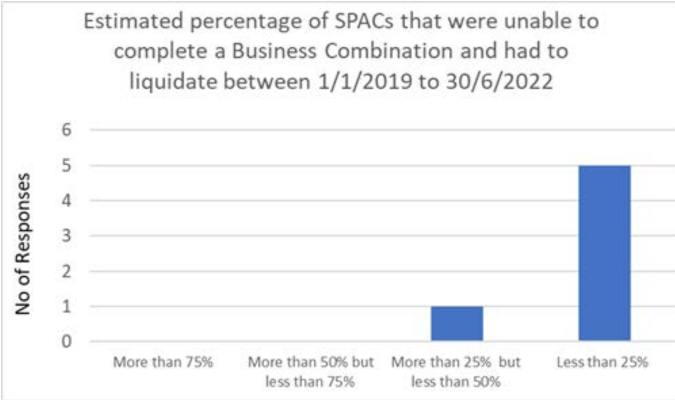

Figure 9 SPACs Unable to Complete a Business Combination (IOSCO Survey)

13.2 The Backlog of SPACs

While the boom in SPAC-IPOs has ended, there is now a significant backlog of SPACs seeking Targets. In the US, 990 SPACs had an IPO during January 2019 – June 2022; by the end of June 2022, 12 of them had been liquidated, 289 had realized a Business Combination, 117 had announced a Business Combination but had not yet closed, and 572 were still searching for a Target. Many of these may not be able to complete a deal before their deadline expires in 2023 or 2024 (see Figure 10).

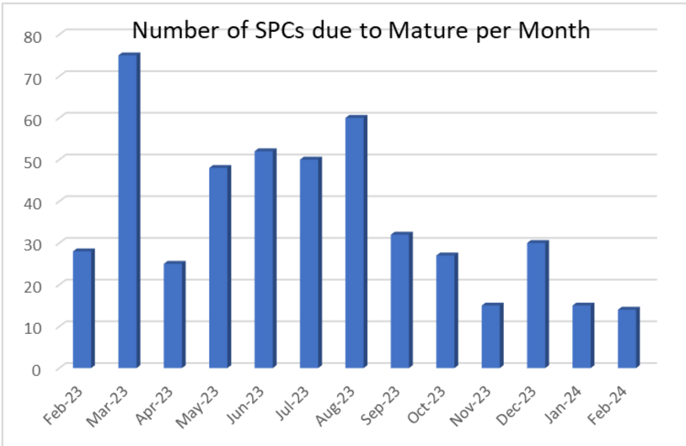

Figure 10 US SPACs Maturing in 2023-2024 (Boardroomalpha)

15 years ago, liquidation was a relatively common outcome for SPACs, but this fell significantly over the subsequent decade[50]. This is confirmed in the survey findings, which show that most respondents' SPACs have liquidation rates below 25%. The liquidation of this new generation of SPACs therefore remains relatively untested. In some cases, SPACs are seeking to avoid liquidations by re-negotiating their terms with investors. For example, Greencity Acquisition Corp has now sought to extend its deadline to close a deal twice, according to a filing with the Securities and Exchange Commission.[51]

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50 Passador (2021) found the liquidation rate was about 60% in 2010, before falling to less than 5% in 2018/19.

51 https://www.sec.gov/Archives/edgar/data/1768910/000110465922107113/tm2225151d4_def14a.htm

13.3 Issues that liquidation has raised or could raise

While most jurisdictions have not had any experience with SPAC liquidations, **most either believed that SPAC liquidations have not raised additional issues or that they did not foresee that the liquidation of a SPAC would raise any concerns** beyond those that arose in a normal liquidation. One respondent noted that their SPACs were exempted from normal commercial liquidation laws (UAE).

Potential conflicts of interest were the main concern of those who believed that SPAC liquidations could pose problems, in particular because Sponsors are incentivized to enter into unfavorable de-SPAC transactions if the alternative is to liquidate the SPAC. The backlog of SPACs may accentuate this risk, as they all compete for a limited pool of quality Targets.

Some noted that, in the event of liquidation, shareholders may not be able to recover their initial investment due to certain costs or matters of priority and process, i.e., whether there are sufficient operational measures to ensure parity of shareholders with other creditors of the SPAC, so that external shareholders would receive a refund amount as close as possible to the initial issue price of the SPAC-IPO. The risks relating to the safe custody of the funds in the Protected Account were also noted, as was the need for adequate disclosure on what happened in liquidation.

13.4 Conclusions

- As set out earlier, the main safeguard for Investors is that invested funds are held in a Protected Account which should be available to be disbursed on liquidation. Most SPAC Frameworks make provisions for the liquidation of a SPAC, with the funds, net of certain specified costs and expenses, to be distributed pro-rata to the shareholders; many Frameworks expressly exclude the Sponsor and/or management shareholders from the liquidation distribution.

- An additional issue is that SPACs may seek to extend the time period to find a Target to avoid liquidation. One safeguard against this may be to set an overall maximum time period in which to find a Target, but some jurisdictions also require that Redemption Rights must be offered before or upon an extension of the deadline to complete a de-SPAC (UAE, Hong Kong, Italy).

14 Conclusions and Lessons Learnt

This Report has noted that a significant number of jurisdictions have recently updated their Frameworks. Currently, about half of the respondent jurisdictions permit SPACs, even if many have not yet had any or many listings. The Report has also found that many active SPAC markets support a significant proportion of cross-border transactions and that some regulatory responses to SPACs have been driven by cross-border considerations. Accordingly, issues around the regulation of SPACs are of interest to IOSCO and its members.

This Report has looked at the various Frameworks that apply to SPAC around the world and identified many commonalties both in the requirements that apply to SPACs and in the outcomes that regulators are seeking. Where different approaches are taken, these are generally aimed at achieving similar outcomes with respect to investor protection and market integrity.

One conclusion is that there is no "one-size-fits-all" model for the regulation of SPACs; markets and regulations are still evolving and developing, and it is too early to judge what the most effective approaches are. Nonetheless, this Report and the SPAC Network has identified a number of common approaches to the regulation of SPACs. Based on these, a set of approaches has been developed that authorities may consider in reviewing or developing their SPAC Framework (see Section 15 SPAC Framework - Considerations Based on Jurisdictional Practices below).

This Report has also compared SPACs with traditional IPOs in terms of how they function, the outcomes pursued and achieved, and how traditional IPO rules and regulations are applied to SPACs. The Report concludes that broadly speaking, SPACs have a similar role as IPOs - there are often critical differences, but these may be due to the need to tailor the rules that apply within the IPO framework to suit the different structure of the two-step SPAC process. Consistencies identified between the SPAC rules and IPO rules should help to reduce arbitrage between traditional IPO and SPAC markets, uphold market integrity and maintain investor protection.

15 SPAC Framework
Considerations Based on Jurisdictional Practices

This set of considerations is based on the conclusions and lessons learned in this report about the different jurisdictions' SPAC Frameworks. They are intended to support or guide regulators as they review, develop, align or improve their SPAC Framework, as well as identify potential risks.

1. Disclosure at the SPAC-IPO: ***For SPAC Frameworks which require that at least the standard IPO prospectus/listing documents and information requirements apply to SPAC-IPOs, guidance on how these requirements apply to SPAC-IPOs could be a useful addition.***

Additional information requirements could be imposed to account for differences in structure and risks in the SPAC process. These additional information requirements may cover risk factors, conflicts of interest, dilution scenarios and the information to be disclosed about the Business Combination.

2. Review of Disclosure at the SPAC-IPO stage: SPAC Frameworks may consider requiring a SPAC to be reviewed by the relevant regulator and/or the exchange prior to listing.

3. Disclosure at the Business Combination: ***SPAC Frameworks generally have some requirement, under general law or otherwise, to disclose sufficient information about matters relating to the Business Combination at the shareholders' meeting to allow the shareholders to make an informed decision.***

SPAC Frameworks may consider requiring the issuance of an approved prospectus, a non-offering prospectus or disclosure in a listing document of the same information that would be required of an issuer seeking to complete a traditional IPO.

4. Due Diligence: ***SPAC Frameworks may consider if and what kind of due diligence should be performed on the Target and who is responsible for this.***

Consideration may be given to a requirement that an auditor or an independent expert issue a fairness opinion on the Business Combination and/or the valuation of the Business Combination transaction.

A requirement that a specified entity be appointed to perform the necessary due diligence and certify the fairness and valuation of the Business Combination transaction may also be considered.

5. Listing Requirements: SPAC Frameworks may consider whether the same listing requirements should apply to Combined Entities as to companies going public through a traditional IPO and, if so, how these should be modified. Consideration may be given as to whether the Combined Entity should be subject to review by the relevant regulator or by the exchange before listing.

6. Share Trading: ***SPAC Frameworks may consider whether certain share trading (e.g., trading by certain conflicted persons such as Promotors) should be restricted during the period between the announcement of the Business Combination and de-SPAC.***

7. Gatekeepers: ***SPAC Frameworks may consider whether to identify Gatekeepers in the SPAC process that are responsible for and liable for misrepresentation (in the prospectus or other relevant information documents) or for providing advice and conducting due diligence.***

Consideration can be given to whether specific Gatekeeper obligations need to be imposed in light of the particularities of the SPAC process, in particular at the Business Combination and de-SPAC stage.

8. Disclosure of Dilution: ***SPAC Frameworks may consider requirements on the clear disclosure of the potential dilution of any investments. These requirements may include how dilution should be calculated and the form the disclosure should take, such as a thorough dilution scenario analysis.***

9. Restrictions on Warrants: ***Since Warrants are a significant source of dilution, SPAC Frameworks may consider restrictions on the terms of Warrant in order to limit dilution. The terms of the Warrants may also be required to be disclosed at the SPAC-IPO stage.***

10. Dilution Caps: ***SPAC Frameworks may consider imposing a cap to limit the extent of dilution. Provisions on earn-outs may also be considered.***

11. Permitting Retail Participation: ***SPAC Frameworks may consider whether retail investors should be permitted or restricted from participation in the SPAC process.***

Where retail participation is permitted, general investor protection measures (e.g., suitability tests) may apply and SPAC-specific measures may be developed to protect investors.

12. Time Limit to Complete: ***SPAC Frameworks may impose a time limit (typically 24 - 36 months) to complete the Business Combination or de-SPAC.***

The possibility to extend this time limit may be granted, but consideration may be given to protecting investors in the event of an extension, for example, by granting them the right of redemption.

13. Redemption Rights: ***SPAC Frameworks may consider granting the right of redemption to at least the shareholders dissenting in the vote on the Business Combination.***

Annex 1

Scenario showing the magnitude of dilution from a financial perspective at different stages of a SPAC

This scenario has been worked out on the basis of an example taken from the Belgian FMSA[52]. For the purposes of this simulation, it is assumed that a company was established by the Sponsors, who have created 2,500,000 founder shares and 2,500,000 founder Warrants. All Warrants confer the right to buy one share at a price of EUR 11.50. The price paid for one founder share and one founder warrant is EUR 0.01. A private placement has been reserved, for institutional investors, of 10,000,000 units at EUR 10 per unit, where a unit consists of one share and one warrant. At the SPAC-IPO, or the start of trading on the secondary market, units were sold at a price of EUR 10. The upfront IPO fee is set at EUR 3,000,000 and the deferred fee payable at the time of the Business Combination at EUR 4,000,000. Finally, the shares in a SPAC are not divided into classes, they have a Redemption Right exercisable at the time of the vote on the Business Combination, and they are considered as equity instruments in the tables below for illustrative purpose[53]. There is no second round of financing, and all (other) parameters are kept constant[54].

In all these steps, each shareholder sees its shares being diluted (by way of Value Dilution and Shareholding Dilution).

1 Equity/Share value at the establishment of the SPAC (Step 1)

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 €	

The founder shares are issued on the establishment of the SPAC and at this point no dilution has occurred.

2 Equity/Share value due to the private placement with institutional investors (Step2)

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

52 Michael Klausner, Michael Ohlrogge, Emily Ruan, A Sober Look at SPACs provides a more detailed example.

53 Note that there are many suggestions that SPAC Shares are normally classified as financial liabilities. See, for example, section 4.1.2 of Ernst &Young's publication, "Accounting for SPACs". See link: https://assets.ey.com/content/dam/ey-sites/ey-com/en_gl/topics/ifrs/ey-apply-ifrs-accounting-for-spacs-july-2021.pdf?download

54 For a fuller analysis, please consult https://www.fsma.be/sites/default/files/media/files/2021-05/20210505_consultation_spac_en.pdf

Because the Promote was issued at a nominal price of EUR 0.01 per share, a Value Dilution occurs immediately in respect of the institutional investors’ SPAC Shares. Each share in the SPAC now represents EUR 8 of the estimated equity value of the SPAC.

3 Equity/Share value at the launch of the SPAC-IPO (Step 3)

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

At the launch of the IPO, further dilution occurs due to the costs, and each share in the SPAC now represents EUR 7.76 of the estimated equity value of the SPAC.

4 Equity/Share value when 25% of the public shares are redeemed and the cost of Business Combination is incurred (Step 4)

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

At the Businesses Combination, the redemption of 25% of the shares removes 25m in cash and results in further Value Dilution for the remaining investors. This value dilution is further increased through the costs of the combination, meaning that each share in the SPAC now represents EUR 6.80 of the estimated equity value of the SPAC.