BETTER FINANCE
The European Federation of Investors and Financial Services Users
Fédération Européenne des Épargnants et Usagers des Services Financiers

CFA Institute

Special Purpose Acquisition Companies (SPACs):

Impacts on Transparency, Information Disclosure, Investor Protection and Supervision

A joint BETTER FINANCE & CFA Institute Report

March 2022

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The European Federation of Investors and Financial Services Users
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CFA Institute

Foreword

Dear Reader,

CFA Institute has joined forces again with BETTER FINANCE to highlight common issues and values shared by both of our members on fair markets and investor protection. In this effort, we focused on special purpose acquisition companies (SPACs). Although SPACs have been around for a while, they recently have gained popularity in the EU. In this report, we also focus on what a capital markets union (CMU) for the EU would mean in terms of investing opportunities and investor protection. We are seven years from the original CMU action plan produced by the EU. Have we achieved what was set out to accomplish? Do we need to differentiate between institutional markets and retail markets? Current volatile markets and the onset of online platforms and sales of financial products will make the supervision of these products even more challenging and the possibility of mis-selling even greater.

Josina Kamerling

Head, Regulatory Outreach, EMEA, CFA Institute

SPACs bring not only opportunities but also risks for individual investors in terms of transparency and returns on SPACs—post-merger in particular—because of a frequent misalignment of interests between the sponsors and the investors. Obtaining sustainable value for money when participating in EU capital markets is crucial to improve savings returns and pension adequacy. Thus, the question we seek to answer is whether investing in SPACS, in light of the very high costs, is sustainable in the long term.

Guillaume Prache
Managing Director, BETTER FINANCE

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Purpose of the Study

The objective of this project was to understand the perceived experience of market participants with special purpose acquisition companies (SPACs), including investment professionals as well as the recipients of financial services and products (i.e., retail investors). The study presents professional and retail investors views on the main issues that pertain to SPAC vehicles: **transparency and information disclosure, investor protection, and supervision in the context of a capital markets union (CMU**). For this study, BETTER FINANCE and CFA Institute relied on active collaboration and input from their members, which enabled us to present a comprehensive picture of the risks associated with SPACs for individual investors.

BETTER FINANCE and CFA Institute Roundtables

This project focused on the actual experience of market participants with SPACs. To capture the views and the experiences of individual and professional investors, the research team organised **two roundtables**, gathering stakeholders who provided their feedback to a questionnaire disseminated before the meetings (see table 1). In total, we received feedback from 18 experts operating in 12 EU countries: nine BETTER FINANCE members and nine CFA Institute members. The member participation from both organisations was split over two roundtables composed of an equal mix of CFA Institute and BETTER FINANCE members. These discussions also benefitted from the point of view of one academic expert and the participation of two observers, both representatives from the Federation of European Stock Exchanges (FESE).

We also organised a **third roundtable** composed solely of the FESE and its members to gather their points of view and experiences. Their contribution as observers to the research project is provided in the Exhibit 1 at page 20.

CFA Institute Relevant Work on SPACs

Following the recent boom in SPAC transactions, particularly in the United States, CFA Institute set up a SPAC working group, which is composed of leading US market participants and experts, as well as international observers from the Asia Pacific and European regions. The working group has been analysing the sudden increase of SPACs in US public listings as well as the implications for investor protection, corporate governance, and market integrity. The working group will publish a report with policy recommendations for US and global regulators in early 2022.[1].

CFA Institute recently released a detailed crib sheet detailing some of the complications of the SPAC structure and explaining how to assess an investment either as a trading vehicle or a long-term investment strategy.[2] In October 2021, CFA Society France published a report, entitled "Regulatory Arbitrage on

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[1] For more details about the CFA Institute SPAC working group, please see "CFA Institute Announces Launch of SPAC Working Group" (press release, CFA Institute, 5 May 2021), https://www.cfainstitute.org/en/about/press-releases/2021/cfa-institute-announces-launch-of-SPAC-working-group.

[2] See the "SPAC Crib Sheet: What Investors Need to Know Before They Invest" (CFA Institute, 2022), https://www.cfainstitute.org/-/media/documents/comment-letter/2020-2024/20220210.pdf.

Narrative Steroids: The Case of SPACs."[3] The paper looks at the financial performance of these vehicles, the role of the promotional narratives in the explanation of the SPAC growth, and the impact of regulations on SPAC activities. Because this report looks at diverse issues concerning SPACs from a different perspective than the research by BETTER FINANCE and CFA Institute, the conclusions are also slightly different. The main takeaways of the CFA Society France report are as follows:

- SPACs have allowed sophisticated market participants to make large returns. They have severely underperformed, however, for investors with a long-term investment horizon.
- Past successes of SPAC sponsors can be poor predictors of the quality of future business deals, especially if incentives between sponsors and investors are misaligned.
- The information provided by SPACs is highly positive and quite positively biased.
- The rising rate of SPAC redemptions by investors may signal the beginning of a reversal regarding the popularity of SPACs.
- SPAC's performance has been, on average, very disappointing for a number of reasons, including their dilutive nature, the misalignment of the incentives between sponsors and investors, and the possibility for SPACs to disseminate positively biased narratives.

Questionnaire

BETTER FINANCE and CFA Institute designed a concise questionnaire to capture the main aspects of the SPACs framework. The questionnaire included six questions addressing three categories:

1. SPACs in the context of development of capital markets in the EU,
2. disclosure issues for investors, and
3. retail investor protection.

This report also is structured according to these three categories (table 1).

[3] See Philippe Maupas and Luc Paugam, "Regulatory Arbitrage on Narrative Steroids: The Case of SPACs" (CFA Society France, 20 December 2021), http://dx.doi.org/10.2139/ssrn.3985936.

Table 1. Questionnaire and Report Categories

1. **SPACs in the context of development of capital markets in the EU:**
    - *Given that SPACs often invest across borders, do you think that direct supervision over SPACs should be granted to an EU authority, such as ESMA? How would a dynamic supervision change the current situation?*
    - *What issues and concerns would you address to regulators? What should EU regulators undertake to strike the right balance between stimulating SPACs to facilitate access to capital and ensuring investor protection (in view of the CMU)?*

2. **Disclosure issues for investors:**
    - *According to your experience, are SPACs transparent or sufficiently informative about*
        - *a. the track record of their sponsor/initiator?*
        - *b. how they choose the investments?*
        - *c. independent evaluation of the company?*
    - *In your view, what other key information for individual investors should be included? What type of information should SPAC sponsors explicitly disclose when receiving funds from retail investors?*

3. **Retail investor protection:**
    - *Considering the predeal and the postdeal aspects of SPACs, at which point do individual investors encounter most risks? At which stage is it more important to provide stronger individual investor protection?*
    - *Do you see any relevant conflicts of interest between SPAC sponsors and investors?*

Category 1. SPACs in the Context of the Development of Capital Markets in the EU

A Long Way to Go to Complete a CMU

Although the development of a genuine CMU has been one of the main priorities of the European Commission for several years, the true potential of European capital markets remains untapped. Unlike the situation in the United States, where capital markets represent the largest portion of business funding, the EU economy remains overly dependent on bank financing.

EU households as individual, nonprofessional ("retail") investors have been slowly diverted away from direct investments into EU capital markets and the real economy through bank savings and packaged products. Given the prevalent low-interest-rate environment—which has been present for a number of years and is here to stay—the traditional financial savings of EU households barely compensate for inflation and are becoming increasingly complex and risky.

In 2020, the European Commission launched a new Action Plan on CMU,[4] to bolster market-based finance in the EU.[5] The development of European capital markets is also seen as an important tool to support the post-Covid recovery and finance the ongoing sustainable transition of the economy. The intent of the Commission and other EU co-legislators is to increasingly enable retail investor participation in capital

[4] The European Commission published a first *Capital Markets Union Action Plan* on 30 September 2015. A new Action Plan, including 16 legislative and non-legislative actions, was presented on 24 September 2020.

[5] CFA Institute conducted a European survey on Capital Markets Union in 2015. *Capital Markets Union Survey Report* April 2015), https://www.cfainstitute.org/-/media/documents/survey/capital-markets-union-survey-report-april-2015.pdf.

markets, which is significantly lower in Europe compared with other developed financial markets. A greater participation of individual, nonprofessional investors in capital markets would help them achieve better outcomes for their long-term and pension savings, and at the same time, would help businesses access diversified sources of financing.

Obtaining long-term and sustainable value for money when participating in EU capital markets is now crucial as we are facing a turning point from an economic perspective. A new wave of young, tech-savvy, and previously inactive EU savers started to engage more, invest, and actively trade during the first two years of the global health pandemic.[6] In contrast, the economic downturn triggered by health restrictions has started to take a profound toll on the purchasing power of our earnings and savings, with inflation reaching unprecedented levels in January 2022.[7] In this scenario, we find opportunity, but significant challenges as well: the design of the EU regulatory and supervisory framework to enhance investor protection and to increase financial literacy and awareness will be key to ensuring that investors access a sufficiently diversified, cost-efficient and suitable, range of financial services and products. The upcoming Retail Investment Strategy is a once-in-a-lifetime opportunity to improve the situation of retail investors in the EU. Without ensuring bias-free advice,[8] however, and the enforcement of the existing EU rules on "value for money" (such as ensuring that "no undue" costs" are charged, and cost comparisons with equivalent financial instruments), the strategy will not solve the current detriment suffered by too many EU citizens as retail investors and pension savers.

Because of restrictions to retail access to capital markets and to a lack of trust, retail investors do not fully take advantage of capital market opportunities. The lack of an adequate investor protection framework in the EU represents yet another obstacle to the development of these markets. Last year, this issue was highlighted by the French securities regulator, the Autorité des Marchés Financiers (AMF), calling for a higher level of protection in light of the rise of digital finance and growing cross-border provision of financial markets. The AMF also has stressed that EU rules should be adjusted to facilitate access for retail investors to simple products that are tailored to their needs.[9]

Similarly, the Dutch Ministry of Finance and the Dutch securities regulator, the *Autoriteit Financiële Markten* (AFM), pointed out that consumers' access to capital markets is vital to deepen the CMU. To attract greater retail participation, it is essential to build a legal framework ensuring better and effective investor protection and to create a level playing field for all market participants.[10]

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[6] Based on BETTER FINANCE's research *New Retail Trading Environment: Opportunities and Challenges Ahead* (forthcoming, April 2022).

[7] Based on Eurostat data (prc_hicp_midx), latest monthly index available for EU27 countries.

[8] For details, see "BETTER FINANCE Evidence Paper on the Detrimental Effects of 'Inducements'" (Better Finance, 3 February 2022), https://betterfinance.eu/publication/better-finance-evidence-paper-on-the-detrimental-effects-of-inducements/.

[9] See the AMF position to encourage retail participation in EU capital markets: "Retail Investors: Make Targeted Adjustments to the European Framework to Improve Their Access to Capital Markets" (AMF, October 2021), https://www.amf-france.org/sites/default/files/private/2021-10/position-paper-retail-investor-en.pdf.

[10] See the Dutch Ministry of Finance and AFM non-paper on retail investment strategy: "Commitment to Good Investor Protection in European Retail Investment Strategy (December 2021), https://www.afm.nl/en/nieuws/2021/december/goede-beleggersbescherming-ris.

According to CFA Institute roundtable participants, however, the development of capital markets in Europe remains a challenge because of the European culture of high social protection. This approach does not fit well with the goal of developing a CMU, because small investors often are excluded from accessing risky and complex products. An academic expert, who participated in one of the two roundtables, underlined that, compared with the United States, Europe seems uncomfortable with the idea of having integrated capital markets. To build a true CMU, the EU needs to have an integrated infrastructure, including clear legislation giving legal certainty to investors purchasing financial products in any member state.

Many issues that have impeded the completion of a real CMU have already been identified in the European Parliament's (EP) report "Stocktaking and Challenges of the EU Financial Services Regulation: Impact and the Way Forward Towards a More Efficient and Effective EU Framework for Financial Regulation and a Capital Markets Union,"[11] adopted in 2016. The report underlined that several barriers and obstacles to cross-border access, marketing, and investments need to be addressed and overcome, while also maintaining the highest level of investor protection. Today, cross-border investments across member states remain hindered by the presence of 27 different regimes on insolvency, taxation, and transfer and ownership of securities. Diverse legislative frameworks in reality are preventing retail investors from purchasing products across borders and represent an obstacle to the achievement of a CMU.

The EP report also highlighted that consumer protection does not require large volumes of information. Too much and too complex information will not help retail investors, who need qualitative and comparable data that can help them make a proper investment decision. This need for data remains an issue because of the excess of information that is inconsistent and difficult to understand. The current situation does not ensure a sufficient level of protection for retail investors.

More and better financial education for investors is also needed to foster a return to capital markets and instil investors and SMEs with an equity culture, making them aware of its benefits and risks. The European Commission and the International Network for Financial Education of the Organisation for Economic Co-operation and Development (OECD-INFE) have acknowledged this need. In response, they recently published a joint financial competence framework for adults to improve financial skills and enable sound investment decision-making.[12] Additionally, in line with the recommendations of the High-Level Forum on the CMU,[13] the Commission should promote employee share Ownership (ESO) across the EU as a pillar for independent adult financial education (workplace education), but also for re-equitising the EU economy and rebuilding the EU equity investment culture. If ESO in the EU matched the US level, it would be multiplied by six times, adding €2 trillion in equity market capitalisation of the EU economy.[14]

[11] See the European Parliament's report: "Stocktaking and Challenges of the EU Financial Services Regulation," P8_TA(2016)0006 (European Parliaments, 2014–2019), https://www.europarl.europa.eu/doceo/document/TA-8-2016-0006_EN.pdf.

[12] See the joint EU/OECD-INFE, *Financial Competence Framework for Adults* (European Commission/OECD, 2022), https://ec.europa.eu/info/sites/default/files/business_economy_euro/banking_and_finance/documents/220111-financial-competence-framework-adults_en.pdf.

[13] *Final Report of the High Level Forum on the Capital Markets Union: A New Vision for Europe's Capital Markets* (European Commission, 10 June 2020), https://ec.europa.eu/info/files/200610-cmu-high-level-forum-final-report_en.

[14] See Ştefan Dragoş Voicu, Aleksandra Mączyńska, Guillaume Prache, and Arnaud Houdmont, *CMU ASSESSMENT REPORT: Reconnecting EU Households to the Real Economy and the Capital Markets Union* (BETTER FINANCE, November 2019), p. 17, https://betterfinance.eu/wp-content/uploads/CMU-Assessment-Report-2019.pdf.

The Role of SPACs in the EU Capital Markets

The bulk of SPACs still are found in the United States. In recent years, however, these vehicles have become popular in Europe and around the world because they represent an alternative way for companies to go public other than through the traditional initial public offering (IPO) process. A SPAC is a blank-check company raising funds through an IPO, with the aim of ultimately acquiring an unlisted company.

Retail investors in the EU are often allowed to access SPACs only on secondary markets. Within the context of more developed capital markets in Europe, both CFA Institute and BETTER FINANCE members discussed whether SPACs also should be addressed to nonprofessional investors at the IPO stage. An academic expert highlighted that, if the EU wants to further develop its capital markets, the sale of SPAC instruments should not be prohibited a priori to nonprofessional investors. For instance, the retail segment also includes sophisticated investors, who often enjoy investing in risky products. This group of investors therefore could be given the opportunity to purchase these products if they have sufficient knowledge of capital markets.

Overall, both financial professionals and representatives of retail financial services users agree that retail investors should have the possibility of investing in this instrument only on secondary markets. Opinions were divided, however, as to whether additional investor protection rules with regards to SPACs should be introduced.

Overall, both financial professionals and representatives of retail financial services users agree that retail investors should have the possibility of investing in this instrument only on secondary markets. Opinions were divided, however, as to whether additional investor protection rules with regards to SPACs should be introduced. The approach, instead, needs to be different for institutional investors, who should be allowed to freely invest in SPACs at the moment of the IPO.

Some roundtable participants from both BETTER FINANCE and CFA Institute stressed that greater transparency of information on conflicts of interest, sponsor activities, and the governance of the SPAC structure is needed to incentivise increased retail participation. These products often are unduly risky and are not easily understood by nonprofessional investors.

Although SPACs have been around since 1990s, the renewed fashion in the use of such vehicles began recently, with a boom in 2020.[15] Most SPAC transactions in Europe have almost exclusively taken place in a handful of countries. From January 2019 to December 2021, 40 out of 48 SPAC listings occurred in the United Kingdom, the Netherlands, France, Italy, Luxembourg, and Sweden (table 2). Some of these operations were incorporated in tax-friendly jurisdictions, such as Luxembourg. In terms of capital raised, these transactions represent a small fraction of the capital raised in the US market. The lack of a single European legislation also does not attract foreign investments to Europe. Non-EU investors are discouraged

[15] *The SPACs Boom: Europe Picks Up the Pace*, Deloitte Insights (Deloitte, 2021), https://www2.deloitte.com/content/dam/insights/articles/154482-spacs-in-europe/DI_The-SPACs-boom.pdf.

from the fragmented approach taken to regulate SPACs across EU member states. This current fragmentation, which also includes differences in tax rules, does not help cross-border investors, who need to understand different regulatory regimes.

Table 2. Number of SPAC listings in Europe by nation from 1 January 2019 to 31 December 2021

Issuing Country	Number of Issues	Percentage of Market Share
United Kingdom	12	25
Netherlands	9	19
France	6	13
Luxembourg	5	11
Italy	4	8
Sweden	4	8
Cayman Islands	3	6
Finland	2	4
Guernsey	1	2
Germany	1	2
Switzerland	1	2
Total	48	100

Source: Refinitiv, 2021.

The European IPO Report 2020[16] explained that the declining number of IPOs is due to particular structural reasons. First, alternative ways of financing, such as resorting to private equity, have lower costs attached. Evidence indicates that an increasing amount of assets have been allocated to private equity funds, and a growing number of companies seem to be taken over before the listing process. Second, the decreasing buy-side interest in European small and medium enterprises (SMEs) has led to a change in firm's business models, which are no longer adapted to SMEs. Different business models have contributed to making SMEs less attractive for investors. Additionally, active fund managers need to comply with documentation rules on equity investments and face restrictions on the minimum trading volumes of investments in public funds. Finally, IPOs do not provide much flexibility because the funding investors/sponsors are not allowed to sell company shares during the IPO lockup period, which usually lasts 90 to 180 days, and are subject to market price fluctuations.

SPACs provide the opportunity to bypass some of these burdensome steps that are required when applying for a traditional IPO process. The risk of setting up specific investor protection rules in relation to the SPACs listing process is that it would make life harder for businesses looking to go public through a SPAC.

[16] For more details, see the *European IPO Report 2020* (Accountancy Europe, CFA Institute, EBRD, FESE, 2020), https://www.fese.eu/app/uploads/2020/03/European-IPO-Report-2020.pdf. The report was prepared by the European IPO Task Force, which is composed of corporate representatives and independent experts involved in the admission of companies to listing in Europe. Accountancy Europe, CFA Institute, the European Bank for Reconstruction and Development (EBRD), and the Federation of European Securities Exchanges (FESE) relaunched the European IPO Task Force, which was established in 2015, to assess recent developments in IPO markets and take stock of the outcomes of the recommendations made in 2015.

Another reason for keeping the current status quo is that the information that is disclosed in SPAC prospectuses is as detailed as the disclosures for a regular IPO. The main issue, which concerns investments through both SPACs and IPOs, is that most retail investors do not read through the entire prospectus document, which is often several hundreds of pages long.

A practitioner from CFA Institute also pointed to the fact that retail investors make up only a small part of investments in SPACs and do not play an important role for the success of a SPAC. Given the low participation from retail investors in this type of investments, additional rules on retail investor protection for SPACs may not be warranted. Some roundtable participants from BETTER FINANCE, however, stressed that, as long as nonprofessional investors can have access to this type of products, an adequate level of protection should be guaranteed. (For details, see the Policy Recommendations, in particular on Investor Protection, on page 19.

During the roundtables, an overall consensus was reached on the importance of having a single regulation and supervision in the EU with regard to SPAC transactions. Both CFA Institute and BETTER FINANCE members agreed that central supervision of SPACs should be entrusted to a European authority, such as the European Securities and Markets Authority (ESMA). A uniform regulation and supervision for SPACs at the EU level would facilitate the development of these vehicles and the achievement of a CMU. A few participants from CFA Institute remarked that even when a European regulation is in place, such as the Markets in Financial Instruments II (MiFID II), uneven implementation and interpretation of such legislation can occur in member states. Also, national competent authorities may interpret the very same European rules differently (although this happens more with EU Directives than with EU Regulations) and may apply their enforcement powers differently.[17] Having a central supervision and regulation for SPACs certainly would reduce differences in regulatory approaches across member states and would ensure an increased harmonization of enforcement practices from national competent authorities (NCAs).

Category 2. Disclosure Issues for Investors

During the first part of the roundtables, BETTER FINANCE and CFA Institute members were asked to provide their expertise regarding the issues related to information disclosure of SPAC vehicles. We asked stakeholders whether the information provided by SPACs is sufficient and transparent for individual investors, in particular with respect to certain aspects of the investment, such as the track record of the sponsors, the procedure to select the company for the merger, and the independent evaluation of the company. Stakeholders also were asked to determine what the most important information is for retail investors and what type of information SPACs need to disclose to retail investors.

[17] CFA Society Poland published "Report on Gold-Plating in Polish Capital Markets Law" (CFA Society Poland, 2022). The report underlines many examples of Gold-Plating in Capital Markets Law in Poland.

Transparency and Information Disclosure
Are SPACs transparent or sufficiently informative?

According to CFA Institute roundtable participants, transparency is a key issue that needs to be addressed by regulators. SPACs can have a positive economic impact on society, but only if they are fully transparent, or at the very least as transparent as typical IPOs.

According to the experience of BETTER FINANCE members participating in the roundtable, in Germany for example, the issuance of SPACs is limited. Most SPACs are legally established in Luxembourg but are listed in Amsterdam. Retail investors generally are excluded from the IPO, but they show significant interest in participating in the second phase of the SPACs, after the IPO has taken place. Special attention should be given to the information provided in the prospectus, because SPACs can be considered complex investments that do not present any business plan or operating business at the IPO stage. The German financial authority (BaFin) considers SPAC shares to be risky investments, which should be approached with caution by retail investors.[18]

According to CFA Institute roundtable respondents, transparency is a key issue that needs to be addressed by regulators.

In Europe, information disclosure in the prospectus falls under Regulation (EU) 2017/1129, also called the Prospectus Regulation. The regulation provides a set of requirements for the drafting, approval, and distribution of prospectuses accompanying the securities on offer to the general public or at the moment of the admission to trading markets in EU member states.[19] SPACs also fall under Directive 2014/65/EU (MiFID II) on product governance requirements for the scrutiny of products in terms of target market.[20]

In addition, even if SPACs are similar to private equity funds, Directive 2011/61/EU[21] on Alternative Investment Funds does not cover special purpose acquisition instruments aimed at acquiring an operating company.[22]

[18] "What Is a SPAC?" Federal Financial Supervisory Authority, 11 August 2021, https://www.bafin.de/EN/Verbraucher/GeldanlageWertpapiere/SPACs_artikel_en.html?nn=7858592#doc16377434bodyText3.

[19] "Prospectus," European Securities and Markets Authority, https://www.esma.europa.eu/regulation/corporate-disclosure/prospectus.

[20] "SPACS: Prospectus Disclosure and Investor Protection Considerations," ESMA32-384-5209 (European Securities and Markets Authority, 15 July 2021), https://www.esma.europa.eu/sites/default/files/library/esma32-384-5209_esma_public_statement_spacs.pdf.

[21] "Directive 2011/61/EU of the European Parliament and of the Council," *Official Journal of the European Union* (8 June 2011), https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32011L0061&from=EN.

[22] "Publication of Listing Guidelines by the Luxembourg Stock Exchange with Respect to SPACs," Global Markets Update, 26 August 2021, https://www.ashurst.com/en/news-and-insights/legal-updates/publication-of-listing-guidelines-by-the-luxembourg-stock-exchange-with-respect-to-spacs.

SPACs, however, do not provide the same level of information as traditional IPOs, because no operating business is featured in the prospectus between the listing and the merger. Nonetheless, the prospectus provides information on the target market for a potential business acquisition, such as innovation, technology, or ESG. Therefore, from the point of view of finance professionals, because of the nature of SPACs, the disclosure of information regarding the expertise of the sponsors and the operating team is more important than the information on the target market. In addition, investors have the possibility to redeem their shares in case they do not agree with the target merger (also called *business combination*) which takes place after the IPO (retail investors who bought after the IPO receive the IPO price minus costs). This feature can lead to risk-free arbitrage opportunities, and it represents another main difference compared with the typical IPO.

According to the experience of a CFA Institute roundtable participants, the presentation of the sponsors generally is perceived as a marketing gimmick, resulting in superficial disclosure of information. Therefore, the technical due diligence of the sponsor becomes key to providing a comprehensive picture of the SPAC. Another important aspect is the information about the management team and the disclosure of any scandals related to their past performance. Additional information should be provided about the relationship between the management team and the sponsors to clarify how the SPAC's initiative came up as well as who defined the SPAC's strategy.

The same considerations were expressed by BETTER FINANCE roundtable participants with regard to the importance of disclosing the responsibilities of the sponsors, on the one hand, and the management team, on the other, including all the interests that the sponsors might have in the future acquisition of the company or their role in the company.

Nonetheless, it is notable that roundtable stakeholders held a common perception regarding the difficulty of understanding **how to clearly define or measure the track record of the sponsor.** On the one hand, this information is crucial for retail investors, but on the other, there are no specific criteria or a standardised approach to define the track record in the prospectus.

Another element of concern for CFA Institute roundtable participants is the information disclosed by the target company in terms of growth prospects and revenues, which is important in determining the worthiness of the upcoming merger. Research found that figures on growth prospects generally were inflated to make the target company appear more attractive. For example, in the United States, electric car companies planning to be listed on SPACs have announced skyrocketing future forecasts with revenues higher than US$10 billion just after three years of production and sales. For comparison, the tech giant Google achieved a revenue of US$10 billion in eight years (considered to be the fastest start-up in US history) and Tesla reached the US$10 billion threshold after 11 years following its first car production.[23] The Securities and Exchange Commission (SEC) is investigating the difference in liability for projections in pre-IPO versus SPACs merger, which has been defined as "regulatory arbitrage or loophole."[24]

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[23] Eliot Brown, "Electric-Vehicle Startups Promise Record-Setting Revenue Growth," *Wall Street* Journal, 15 March 2021, https://www.wsj.com/articles/electric-vehicle-startups-promise-record-setting-revenue-growth-11615800602.

[24] See the reference from Robert Jackson, a former commissioner with the SEC and a professor at New York University's law school in Brown, "Electric-Vehicle Startups Promise Record-Setting Revenue Growth."

In addition to a lack of transparency, SPACs have been heavily criticised in research[25,26] and press articles[27] with regards to costs. At the time of the IPO, the underwriting fee appears to be lower than the traditional IPO fee charged by the bank. Contrary to a traditional IPO, SPACs give shareholders the possibility to redeem their shares in case they do not agree with the business combination.[28] According to research conducted in the United States,[29] the number of shareholders that redeems their shares just before the merger represents more than 50%.[30] Therefore, what is paid as an underwriting fee for the IPO is much greater in terms of the SPAC's funding at the time of the business combination. In the end, those who bear the losses are the investors who keep their shares at the time of the de-SPAC, unlike those investors who buy the shares at the time of the IPO and redeem their shares before the merger takes place.[31]

AMF, the French Market Authority, in its report on *SPACs Opportunities and Risks for a New Way of Going Public*, shows that the weak performance of SPACs in the United States is correlated to the dilution of their investments.[32]

The dilution problem also has been underlined by the Belgian Financial Services and Markets Authority (FSMA):

> *[…] those shareholders (in particular, retail investors who buy shares on the secondary market before the business combination) who decide not to redeem their shares at the time of the business combination may undergo significant dilution (depending on several factors such as the percentage of negative votes and the conditions under which sponsors can be reimbursed), with the risk that the acquisition may not allow for the creation of sufficient value (within reasonable time) to offset the dilution.*[33]

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[25] Michael Klausner and Michael Ohlrogge, "A Sober Look at SPACs," Law and Economic Research Paper Series (working paper no. 20-48, New York University School of Law, October 2020), https://www-cdn.law.stanford.edu/wp-content/uploads/2021/01/SSRN-id3720919.pdf.

[26] Michael Klausner, Michael Ohlrogge, and Emily Ruan, "A Sober Look at SPACs," Harvard Law School Forum on Corporate Governance, 19 November 2020, https://corpgov.law.harvard.edu/2020/11/19/a-sober-look-at-spacs.

[27] Robert Armstrong, "Spac's Fee Problem," Opinion, *Financial Times,* 29 September 2021, https://www.ft.com/content/6b1d70db-edae-474c-bd6f-bb60dfa99c51.

[28] Armstrong, "Spac's Fee Problem."

[29] Armstrong, "Spac's Fee Problem."

[30] Armstrong, "Spac's Fee Problem."

[31] Klausner and Ohlrogge, "A Sober Look at SPACs."

[32] Laurent Grillet-Aubert, *SPACS: Opportunities and Risks of a New Way of Going Public* (AMF, July 2021), p. 8, https://www.amf-france.org/sites/default/files/private/2021-07/spacs_opportunities-and-risks-of-a-new-way-of-going-public.pdf.

[33] "Public Consultation by the FSMA about a Proposal for Minimum Standards for the Structuring, Information Disclosure, and Trading in SPACs on Euronext Brussels" (Financial Services and Markets Authority, 5 May 2021), https://www.fsma.be/sites/default/files/media/files/2021-05/20210505_consultation_spac_en.pdf.

BETTER FINANCE
The European Federation of Investors and Financial Services Users
Fédération Européenne des Épargnants et Usagers des Services Financiers

CFA Institute

Key Information for Individual Investors

What type of information should SPAC sponsors explicitly disclose when receiving funds from retail investors?

From an individual investor perspective, the information disclosed in the prospectus is crucial to guarantee an appropriate level of protection. In particular, for individual investors, it is important to know the following:

- how SPACs select the investment (information on the selection procedure);
- the evaluation procedure, in particular, information regarding the independent evaluation;
- the track record of the sponsor, and information regarding the incentives and the conflict of interest of the sponsors; and
- costs and fees arising from the successful business transaction.

From a professional investor perspective, there is a consensus on the importance of the type of information that is disclosed to individual investors (e.g., track record, evaluation, and selection procedure). Even more important for professional investors, however, is SPAC's governance along with the qualifications of the SPAC's initiators. According to some market participants, the main problem with the information disclosure—already present in the prospectus—is that individual investors do not pay much attention to the prospectus document because of its length and complexity.

Looking at the information on the target company, it would also be important to provide details about how the deal might originate and what the strategy is to reach the business combination (e.g., the deal could be reached with the help of advisers). The sponsors and the management team should give information about the indicative number of potential targets that will be approached, including quantitative parameters, such as maximum leverages, key performance indicators (KPIs), profitability, and EBIDTA margins.

Therefore, in light of the previous considerations, from an individual investor perspective, it is necessary to have more than a "regular prospectus" to provide transparent information to retail investors. SPACs, because of their complexity, require a higher level of disclosure and transparency.

According to individual investors organisations participating in the roundtable, the creation of a "**summary prospectus**" to help retail investors navigate the relevant information on SPACs governance, costs, and the selection procedure of the target company would reduce the complexity associated with a traditional prospectus.

CFA Institute roundtable participants agreed with the need for better uniformity, comparability, and comprehensibility of the information disclosed. One CFA Institute member, who took part in the roundtable contends that the market uptake of SPACs in Europe will remain rather limited and that during financial

CFA Institute roundtable participants agreed with the need for better uniformity, comparability, and comprehensibility of the information disclosed.

downturns or recessions, this phenomenon will tend to disappear not only in Europe but also in the United States.

The European Securities and Market Authority (ESMA), in its public statement on prospectus disclosure and investor protection issues raised by SPACs,[34] stresses the need to have a uniformed SPACs disclosure regime:

> *ESMA notes that the structure of SPAC transactions is complex and there may be variations between transactions. Furthermore, differences in company law and market practices in jurisdictions mean that investors need to study the structure of SPAC transactions carefully to ensure that they understand the transaction. ESMA places significant importance on the comprehensibility and comparability of SPAC prospectuses and therefore has decided to publish this statement to promote uniform disclosure.*[35]

Category 3. Retail Investor Protection

Retail Investor Protection across the Various SPACs Stages (Predeal and Postdeal)
At what stage is it important to reinforce retail investor protection?

Generally, SPACs are not marked for retail investors in the primary market, but rather the vehicle becomes accessible to retail investors just after the listing. Some differences, however, across jurisdictions emerge. At Euronext in France (Paris), SPACs are listed in the professional segment with a minimum threshold of €1 million as entry costs. Nonetheless, as explained by the French financial market authority (AMF), retail investors can still have access to SPACs shares in the secondary market.[36]

Euronext Amsterdam has lower entry costs (€100,000), and SPACs are sold in the nonprofessional segment (but retail investors do not participate in the primary market). In Belgium, SPACs are reserved for professional investors, but individual investors are not impeded from buying shares on the secondary market.[37]

Roundtable stakeholders from both BETTER FINANCE AND CFA Institute agree on the need to provide retail investor protection across the various phases of SPACs. The retail investor protection should be complementary to the transparency regime.

[34] "SPACS: Prospectus Disclosure and Investor Protection Considerations, ESMA32-384-5209."
[35] "SPACS: Prospectus Disclosure and Investor Protection Considerations," ESMA32-384-5209.
[36] https://www.amf-france.org/sites/default/files/private/2021-07/spacs_opportunities-and-risks-of-a-new-way-of-going-public.pdf
[37] https://www.fsma.be/sites/default/files/media/files/2021-05/20210505_consultation_spac_en.pdf

Roundtable stakeholders from both BETTER FINANCE and CFA Institute agree on the need to provide retail investor protection across the various phases of SPACs. The retail investor protection should be complementary to the transparency regime according to the disclosure of the information discussed in the previous section. Even though retail investor protection should be applied across the various SPACs stages, CFA Institute and BETTER FINANCE roundtable participants emphasised that the premerger stage requires particular attention. Indeed, the possibility of redeeming the shares ahead of the merger, puts retail investors in front of a more complex financial instrument. From a behavioural finance perspective, to take this decision, retail investors need to critically assess the proposal of the business combination, which requires a significant amount of information. For this reason, the level of information disclosure needs to be at the core of any measure aimed at improving retail investor protection.

To tackle the lack of information disclosure for retail investors, however, roundtable participants noted that legislative changes could affect present market practices. From a market participant perspective, the enforcement of additional obligations would generate additional issues driven by overregulation. The process of being listed in regular IPOs has become longer and more complex. Therefore, it is difficult for companies to get listed through regular channels (IPOs) and, as a consequence, they have pursued alternative options, such as SPACs. A possible solution would be to create a simpler IPO framework that allows legitimate companies to enter capital markets and prevent less transparent vehicles, such as SPACs, from becoming alternatives to circumventing the present regulations.

From an individual investor perspective, the regulatory environment should be improved to lift the barriers to entry, in particular for SMEs. Conversely, it is essential to stress that the simplification of the IPO framework should not come at the expense of retail investor protection.

With a view on good governance, a BETTER FINANCE member raised the importance of preventing conflicts of interests by taking the example of the UK Financial Conduct Authority's (FCA) proposal for new measures for SPACs.[38]

As part of its SPACs proposal, the FCA proposed to exclude from the discussion and the vote any board member that[39]

1. has links with the target company or the subsidiaries (director or associate),[40] or
2. has conflict of interest with the company intended for the merger or the subsidiaries.[41]

As an example of good governance, the FCA proposes to exclude sponsors, founders, and directors from the shareholder approval of a transaction. Shareholders have voting rights and the majority of the shareholders'

[38] "Investor Protection Measures for Special Purpose Acquisition Companies: Changes to the Listing Rules," Policy Statement PS21/10 (Financial Conduct Authority, July 2021), p. 15 https://www.fca.org.uk/publication/policy/ps21-10.pdf
[39] "Investor Protection Measures for Special Purpose Acquisition Companies," p. 15.
[40] "Investor Protection Measures for Special Purpose Acquisition Companies," p. 15.
[41] "Investor Protection Measures for Special Purpose Acquisition Companies," p. 15.

votes is necessary to proceed with the merger. In addition, it is necessary to ensure that sufficient information is disclosed on the terms and conditions of the transaction to proceed with the voting.[42]

Finally, different opinions emerged on the classification of SPACs as an ill-suited financial product for retail investors. Some stakeholders at the roundtable, both from BETTER FINANCE and CFA Institute, raised the question whether retail investors should be excluded from the SPACs target market, because of its complexity and the risks involved. These considerations also have been invoked by the regulators, in particular ESMA, which in its public statement notes the following:

> *SPAC shares and warrants are, amongst other things, subject to the MiFID II requirements on product governance. ESMA notes that, in light of the risk and complexity of SPAC shares and warrants, it expects manufacturers and distributors of SPAC shares and warrants to carefully scrutinise such products in their respective product approval process in order to assess whether retail clients should be excluded from the positive target market or even included in the negative target market.*[43]

Conflicts of Interest between SPAC Sponsors and Investors

It has become quite clear that sponsors have huge advantages and economies of scale within the SPACs system. Generally, sponsors get 20% of the SPAC equity (also called "promote"), which is then transferred into company shares after the de-SPAC, generating high payoffs.[44]

According to several stakeholders, the 20% share reserved for sponsors raises strong concerns about the misalignment of incentives between the sponsors and retail investors. The main issue revolves around the incentives of the sponsors to quickly find a business combination even though the quality of the deal is suboptimal. In addition, as previously mentioned, the misleading disclosure of skyrocketing revenue forecasts attracts an increasing number of individual investors, who are left with undervalued shares after the deal. The US Senate already raised concerns about the risk that SPAC initiators might use this vehicle to circumvent the law at the detriment of individual investors.[45]

From a market perspective, another concern has been highlighted—that is, the information asymmetry between the sponsors and the retail investors, thus reinforcing the disequilibrium of incentives between these two parties.

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[42] "Investor Protection Measures for Special Purpose Acquisition Companies," p. 17.
[43] "SPACS: Prospectus Disclosure and Investor Protection Considerations, ESMA32-384-5209."
[44] *Financial Times, Ortenca Aliaj, Sujeet Indap, and Miles Kruppa, The SPAC sponsor bonanza,* November 13 2020, https://www.ft.com/content/9b481c63-f9b4-4226-a639-238f9fae4dfc
[45] "Senate Democrats Step Up Scrutiny of Blank-Check Firms," Reuters, 22 September 2021, https://www.reuters.com/business/senate-democrats-step-up-scrutiny-blank-check-firms-2021-09-22.

Policy Recommendations

One of the objectives of this report is to extrapolate the key messages discussed during the roundtables to provide policy recommendations for EU policy makers and financial supervisory authorities.

SPACs in the context of development of capital markets in the EU: Ensuring a higher level of investor protection is a prerequisite for the development of capital markets in the EU. Currently, retail investors have low trust in financial markets, and their protection should be improved, at the least, by the following: (1) harmonising the regulatory frameworks across all EU categories of retail investment products in line with MiFID II; (2) providing full transparency and complete explanation of commission structures (legislators are assessing the current legislative framework covering trailer fees for execution-only services[46]); and (3) clarifying and specifying that “acting in the best interest of clients” (MiFID and IDD) should imply that obligations “do not charge undue costs” (this requirement not to charge undue costs currently applies only to investment funds and is not really enforced).

1. **Safeguards:** It would be much easier for supervisory authorities and consumers to enforce the safeguards awarded by EU legislation if these requirements were clarified, more specifically defined, and applied to all retail investment products. Small investors are often discouraged from the excessive and confusing amount of information that they receive before purchasing an investment product. Information should be clear, comparable, and qualitative to allow end investors to make a sound investment decision.

   SPACs could represent an important tool for the growth of EU capital markets. Companies could use these vehicles to go public in an alternative and quicker way than through an IPO. Some safeguards should be guaranteed, however, to ensure a high level of investor protection. We encourage regulators to consider the following actions:

   a. Allow direct investments in SPACs only for professional investors. Retail investors should have access to SPAC products only through secondary markets.
   b. Require clear and sufficient disclosure of information regarding the sponsor activities, conflicts of interest, and governance of the SPAC structure. High transparency on these aspects is essential to attract retail investments.
   c. SPAC transactions should be regulated and supervised at the European level by ESMA. A single regulation and supervision would facilitate greater harmonisation in the application and enforcement of rules.

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[46] For additional information on HLF CMU recommendations on "inducements,” please see the report on “A New Vision for Europe ‘s Capital Markets, Final Report of the High-Level Forum on the Capital Markets Union,” (European Commission, June 2020), p. 98, https://ec.europa.eu/info/sites/default/files/business_economy_euro/growth_and_investment/documents/200610-cmu-high-level-forum-final-report_en.pdf.

2. **Information disclosure:** The information provided in the prospectus should comply with the criteria of *uniformity, comparability, and comprehensibility*. In addition, if SPAC shares are also addressed to retail investors, the information disclosed needs to be presented in a standardised and simplified manner to retail investors. Therefore, in light of current enforcement problems in terms of the current legal requirements for the summary prospectus's maximum length, readability (minimum font size in particular), and intelligibility, ESMA should issue technical standards and guidelines to ensure the enforcement of such requirements. This is particularly important for SPACs because these securities are high risk, high cost in the premerger phase, and exposed to conflicts of interests. ESMA also should consider other supervision actions targeted at SPACs. The summary prospectus for SPACs should include the following information:

    a. **SPACs governance**
        i. track record and qualifications of the sponsor and the management team of the SPAC,
        ii. any incentives and potential conflicts of interest of the sponsors and the management team, and
        iii. the relationship between the management team and the sponsors to clarify how the SPACs initiative came up and who defined the SPACs strategy.
    b. Clear and prominent information about **costs and fees** arising from both the SPAC IPO and the subsequent initial business combination.
    c. **Target company**—including more specific information on the strategy to select the company, such as the following:
        i. selection procedure of the company,
        ii. number of potential targets, and
        iii. quantitative parameters (e.g., leverages, KPI profitability, EBITDA margins).
    d. **Independent evaluation procedure**—expected procedure to evaluate the target company.

3. **Retail investor protection:** The framework on retail investor protection should be complemented by a transparency regime guiding the information disclosure. Therefore, we propose the following actions to improve the SPACs framework:

    a. **Better governance**—Additional requirements should be added, such as exclusion from the vote of board members who have links with the target company or conflicts of interest with the target company or its subsidiaries.
    b. **Better alignment of the interests of the sponsors with those of the investors, such as**
        i. making the granting of the "promote"[47] conditional to the performance of the sponsor, and

[47] The promote is the 20% of SPAC shares that sponsor receive as a compensation to look for target company (business combination).

   ii. reducing the "promote" of the sponsor from 20% to a fairer share (i.e., 5%) complemented by a traditional remuneration, such as executive compensation and target bonus.

c. **Effective collective redress at EU level—**The collective redress directive must reflect the EU innovative approach and create a mechanism that ensures a high level of consumer protection (Articles 38 and 47 of Charter of Fundamental Rights), equal conditions for access to justice (Article 67 of Treaty on the Functioning of the European Union) for the entire spectrum of consumers in the EU, including investors and financial services users.

In addition, ESMA and national competent authorities should investigate **the performance and revenue forecasts** claimed by the target companies of SPACs to intervene in the case of egregiously misleading claims and false projections.

Exhibit 1. Contribution from the Federation of European Stock Exchanges and Its Members

To complement the feedback from CFA Institute and BETTER FINANCE members, a third roundtable saw the participation, as observers, of the Federation of European Stock Exchanges (FESE) and its members to offer additional input on the SPACs market from the perspective of EU stock exchanges. The views expressed by participants, at meetings and in their support of this report, are views of the individuals and should not be seen as representing the official views of FESE or of the organisations for which they work.

SPACs in the Context of the Development of Capital Markets in the EU

FESE members and representatives emphasised that the development of SPACs in Europe is beneficial for some industries (e.g., high-tech and other fast-growing sectors) because going through an IPO is a time-consuming process, which might not always be convenient for certain types of firms. SPACs in the EU are considered private placement products, mainly purchased by institutional investors. A very small proportion of investors in SPACs come from the retail segment. For this reason, European exchanges do not see the necessity of explicitly restricting these vehicles to professional investors only.

A participant highlighted that as long as sufficient information is provided through the SPAC prospectus (and the information is fully understood), retail investors looking to invest in SPACs on secondary markets would be able to make a well-informed decision. Moreover, having a diverse and fragmented investor base may hamper the final outcome of SPACs. Sponsors usually have a close relationship with investors. An extremely diversified investor clientele (including retail investors) would complicate this engagement process and could lead to uncertainty in the private placement of the equity transaction, which is raised to fund the subsequent acquisition.

The discussion also focused on the purpose of SPACs, and whether their ultimate intent overlaps with the possible creation of an EU IPO fund. Roundtable participants argued that SPACs are an important source of funding for smaller companies that cannot afford to launch an IPO. In particular, these vehicles are attractive for private equity and venture capital funds. In addition, SPACs are also seen as a way to promote cross-border investments across member states. An increasing number of cross-border businesses, which are expected to go public, have chosen the SPAC route rather than the traditional IPO process. The EU IPO fund, which is a solution that the European Commission has recently been exploring[48], would help bridge the equity gap between SMEs and large companies. Specifically, this tool could be used to attract greater participation from institutional investors in small and medium IPOs. This solution would address the issue of SME financing in cases in which government support is lacking or insufficient and could support market segments with low liquidity.

In May 2021, FESE published a briefing note on SPACs, explaining that the recent success of these vehicles could lead to an increase in company listings in the EU. Regulators should support the SPAC listing process in EU capital markets to reduce the risk that non-EU SPACs listed in other markets potentially could purchase growing non-listed EU target companies. This situation would result in growing EU companies being listed on the market (outside the EU) where the SPAC is listed.[49]

Information Disclosure

As a general remark, the stock exchanges noted the clear difference that exists between the US and EU SPAC markets. SPACs in the United States are more readily available for retail investors, unlike Europe where SPACs are mostly institutional products. After the IPO, however, SPAC shares are traded on secondary markets and therefore also are accessible to retail clients. The liquidity is limited**,** however, and the retail investor participation is quite small.

Even if on primary markets SPACs are addressed largely to institutional investors, regulated markets do not only make use of the professional segment. For example, Euronext Amsterdam has listed SPACs in the nonprofessional segment but has limited the sales of SPACs to professional investors. Even if there is no urge to promote SPACs to retail investors, discussion is ongoing with the Dutch regulator to open the sale of SPACs to retail investors on the primary market. Notably, as long as the information is sufficient and the safeguards are in place, there should not be particular issues linked to the involvement of retail investors. In contrast, Euronext Paris addresses SPACs only in the professional segment, whereas the Luxembourg Stock Exchange, for the moment, has not listed SPACs at all. SPACs that are legally established in Luxembourg, however, have been routed to professional segments on other stock exchanges, such as Amsterdam or Frankfurt.

Participants noted that professional investors receive sufficient information. Generally, the information regarding certain aspects of the SPACs, such as information on the sponsor group, governance, SPACs structure, acquisition strategy, and the disclosure of incentives, is deemed adequate.

Although EU legislation has set the standards for product governance and investor information, it also has been observed that more and more information is provided following the requests of institutional investors. Sponsors provide granular information, which to a certain degree, is comparable to the level of information provided in traditional IPOs. Note that sponsors have a reputation to manage; therefore, it is in their interest to provide comprehensive and complete information to investors.

Looking at the composition of investors, participants noted that the "usual suspects" among the professional investors are generally US centric or investment firms related to the sponsors.

Regarding the involvement of retail investors in SPACs, participants emphasised that it is also in the interest of the sponsors to avoid an excessively fragmented investor base to facilitate engagement with each investor. The inclusion of retail investors at the early stages of the SPACs will increase the complexity and will generate more uncertainty with regard to the outcome of the second phase, which is

[48] For more information, please read the recent Centre for Strategy and Evaluation Services, "A Public-Private Fund to Support the EU IPO Market for SMEs: Final Report" (prepared for the European Commission, 2020), https://ec.europa.eu/info/sites/default/files/economy-finance/a_public-private_fund_to_support_the_eu_ipo_market_for_smes_final_report_updated.pdf.
[49] For more details, please see "Briefing Note on SPACs," (FESE, 10 May 2021), https://www.fese.eu/app/uploads/2021/05/FESE-Briefing-note-on-SPACs-Final.pdf.

the private investment in public equity transaction (PIPE) to fund the subsequent acquisition. Hence, it is more interesting for the sponsors and the market to limit the product to institutional investors. Several participants highlighted, however, that SPACs do not need to be limited to certain investor groups (only professional investors) because minimum transparency requirements are already in place with the prospectus regulation.

Investor Protection

In terms of good practice, Italy was mentioned as a leading example of ensuring investor protection regarding SPACs. In Italy, SPAC sales are made in the professional segment at first (at least until the business combination) and access is granted to retail investors only after the de-SPAC process. This separation is made because retail investors might not fully understand the cost structure, the effects of dilution, and lockups of the promotion. Therefore, it is deemed to be better to have retail investors join only when the business combination has been concluded.

According to some participants, national regulators and EU regulators take different approaches to handling SPACs. Because the Prospectus Regulation tackles aspects of standard financial products, it would be potentially useful to create a different set of rules specific to SPAC Prospectuses.

According to another participant, SPACs are already de facto institutional products, and therefore, the market does not need to expand to the retail segment. If, however, market developments cause retail investors to actively participate in SPACs, then higher investor protection might become necessary. As noted, however, the creation of additional EU legislative layers could reduce the attractiveness of SPACs.

Therefore, at this stage, the common view among market participants is that investor protection for SPACs does not need to increase because EU markets have not yet reached the same level of maturity as the US markets.

A Mapping of Regulatory Measures on SPACs

Given the popularity that SPACs have experienced in recent times, several regulators have started looking into the governance of the vehicles and the issues concerning investor protection. As a result, regulators have proposed new rules amending existing national listing legislation or have issued recommendations and guidance statements. In this report, we examine the measures introduced in the EU, the United States, the United Kingdom, and Hong Kong SAR.

European Union

In the EU, SPACs are required to comply with the disclosure rules under the Prospectus Regulation,[50] and the product governance requirements under the Markets in Financial Instruments (MiFID II) Directive.[51] On 15 July 2021, ESMA released a public statement[52] calling NCAs to work in a coordinated fashion to ensure clarity and comparability of the information disclosed in the SPAC prospectuses.

The EU Authority noted that a prospectus must be published in the IPO stage of the SPAC as shares and warrants are admitted to trading on a regulated market or another trading venue. An approved prospectus may not always be published, however, when the business combination with the target company takes place. In this case, ESMA showed concern about the fact that not all information regarding the merger would be disclosed to investors. This information is extremely important for shareholders that are called to approve the business combination. In addition, the prospectus may not fully comply with all standards that are applied and verified when an organization is admitted to trading or issues new securities.

According to ESMA, the SPAC prospectuses should include the following information:

- risk factors;
- the issuer's strategy and objectives;
- escrow accounts and the reinvestment of the proceeds;
- relevant experience and principal activities of the administrative, management, and supervisory bodies;
- conflicts of interest;
- shares, warrants and shareholder rights;
- major shareholders;
- related-party transactions;
- material interests;
- the proceeds of the offer;
- the intention of certain persons to subscribe in the offer; and
- the offer price.

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[50] See the "Regulation (EU) 2017/1129 of the European Parliament and of the Council of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Directive 2003/71/EC," https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:02017R1129-20211110&from=EN.

[51] See the "Directive 2014/65/EU of the European Parliament and of the Council of 14 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU," https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:02014L0065-20160701.

[52] "SPACS: Prospectus Disclosure and Investor Protection Considerations, ESMA32-384-5209."

In addition, ESMA recommended that NCAs also should include the following information in SPAC prospectuses:

- 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,
- information about possible changes to the governance after the acquisition of the target company, and
- detailed information about the possible scenarios that may arise if the sponsors fail to find a suitable target to acquire.

This information is essential to enabling investors to make an informed investment decision. Therefore, NCAs are encouraged to verify that SPAC prospectuses provide such disclosures.

ESMA also noted that investments in these vehicles may not be appropriate for retail investors because of the complexity of the SPAC structure, transactions, and incentives, as well as the uncertainty about identifying the target companies.

In its public statement, ESMA finally remarked that manufacturers and distributors of SPAC shares and warrants should carry out a thorough product assessment to define the target market and understand whether such securities also could be offered to retail clients.

United Kingdom

In July 2021, the FCA proposed some amendments[53] to the UK Listing Rules to address investor protection issues concerning SPACs. Listing Rule 5.1.1R[54] states that the FCA may suspend the listing of securities if the smooth operation of the market is or could be jeopardized, or if this is necessary to protect investors. The FCA noted that, for a SPAC, the presumption is that listing would be suspended when a potential acquisition target is announced.

The FCA proposed removing this presumption for those SPACs that fulfil specific criteria regarding investor protection and the smooth operation of the market. Under the current rules, the acquisition of the target company is considered to be a reverse takeover. When such a takeover occurs, the listing of the SPAC shares is cancelled, and the combined entity will be required to apply again for listing.

The purpose of removing this procedure is to eliminate a barrier to listing for these vehicles and, at the same time, to encourage the disclosure of detailed information concerning the potential target company.

The new rules set out that the presumption of the listing suspension for SPACs does not apply in the following situations:

- the SPAC raises at least £100 million when the SPAC shares are initially listed;
- the amount raised is ring-fenced to either fund acquisition or is returned to shareholders when they redeem their shares or the SPAC winds up, less the funds needed to cover the SPAC running costs;
- the SPAC sets a time limit to find and acquire a target company within two years of admission to listing (This period could further be extended by 12 months by shareholder approval. Alternatively,

[53] See the "Investor Protection Measures for Special Purpose Acquisition Companies."
[54] See the UK Listing Rules 5.1.1R, https://www.handbook.fca.org.uk/handbook/LR/5/1.html.

the FCA allows for this time limit to be extended by 6 months without any shareholder vote, in limited circumstances.[55]);
- the board approved any proposed acquisition, excluding from the discussion and vote any board member that has a connection, or a conflict of interest, related to the target company or its subsidiaries;
- the board publishes a fair and reasonable statement if any of the SPAC directors have a conflict of interest, which reflects advice from a qualified and independent adviser;
- the SPAC requires shareholder approval for any proposed target acquisition (SPAC founders, sponsors, and directors are excluded from voting);
- the SPAC allows for a redemption option, which allows investors to exit their investment before any acquisition is completed; and
- investors receive sufficient information on key terms and risks from the SPAC IPO through to the announcement and conclusion of any acquisition.

The FCA has stated that, with these measures, it does not intend to engage in a regulatory race to the bottom or to set standards, but rather to encourage SPACs to get listed in the United Kingdom while ensuring sufficient investor protection.

United States

In the United States, the Securities and Exchange Commission (SEC) Rule 419[56] establishes that all securities (also called "penny stocks"[57]) issued in connection with a blank check offering and the gross proceeds must be deposited into an escrow or trust account, until the acquisition of the target company is completed. These escrowed funds should be returned to the investors if the acquisition has not taken place within 18 months from the effective date of the SPAC registration statement. This rule, however, limits blank check entities to penny-stock companies and does not cover SPACs. Penny stocks are defined as any equity security meeting or exceeding certain criteria, among which the issuer shall have the following:

- US$5 million in shareholder equity;
- a market value of listed securities of US$50 million for 90 consecutive days before applying for the listing; and/or
- a net income of $750,000 in the most recently completed fiscal year or in two of the last three most recently completed fiscal years.

[55] The six-month extension applies if (1) the shareholder approval for a reverse takeover has been obtained but this takeover has not yet been completed; (2) a general meeting to obtain the approval of the reverse takeover has been convened; (3) the SPAC has either announced that a general meeting to obtain the approval of the reverse takeover will be convened on a specified date, or a notice to convene this general meeting will be sent to shareholders within a specified time following the announcement; and (4) an agreement for the reverse takeover has been entered but such takeover has not yet been completed, and the SPAC has not made an announcement in accordance with (3).
[56] See the SEC Rule 419 of 1933, which was amended in 1993, 17 CFR § 230.419—Offerings by Blank Check Companies, https://www.law.cornell.edu/cfr/text/17/230.419.
[57] Rule 3a51-1 of the Exchange Act defined a penny stock as any equity security other those that fulfil certain conditions concerning the issuer and the stock issued. See 17 CFR § 230.3a51-1—Definition of a "Penny Stock," https://www.law.cornell.edu/cfr/text/17/240.3a51-1.

Because SPACs today are much bigger than penny stocks, they do not fit this definition and are not subject to Rule 419.

Despite not being covered by Rule 419, the 2020 Financial Industry Regulatory Authority (FINRA) Guidance 08-54 emphasised that SPACs normally place almost all of their proceeds in an escrow account, which will be used at the time of the target company acquisition. The SPAC assets are released from this account when the acquisition is approved or when the SPAC is dissolved.[58]

With regard to the IPO phase, the FINRA Guidance highlighted that firms recommending SPAC securities to investors must perform a suitability analysis to ensure sure that the features of these products are well understood. In particular, retail investors should fully comprehend the risks associated with an investment in these vehicles.

In December 2020, SEC staff also issued a guidance document on SPAC disclosure.[59] This document highlights that SPAC sponsors, directors, and officers should clearly disclose potential conflicts of interests as well as whether conflicts related to other business activities include fiduciary or contractual obligations to other entities. In addition, they should provide information about how conflicts of interest will be addressed.

According to this staff guidance, SPACs also should provide clear disclosure on the following:

- the sponsors', directors', and officers' financial incentives to complete a business combination transaction, and whether their incentives differ from public shareholder interests;
- potential losses that sponsors, directors, and officers could incur if the business combination transaction is not completed;
- the amount of control that sponsors, directors, and officers would have if the business combination were approved;
- whether, and how, the SPAC may amend provisions to its governing instruments to facilitate the completion of a business combination transaction;
- whether, and how, the SPAC could extend the time by when it has to complete a business combination transaction, and whether shareholders could redeem their shares in the case of such an extension;
- sponsors', directors', and officers' previous SPAC experience, including disclosure of the outcome of presented and completed business combination transactions and liquidations; and
- the terms of securities held by sponsors, directors, officers, and their affiliates; a comparison between the rights of these classes of securities and those offered in the IPO; and the resulting risks to public shareholders.

Finally, the FINRA Guidance provides views on the information to be provided to investors when the SPAC negotiates a business combination transaction. In particular, the SPAC should disclose any additional financing necessary to complete the transaction and demonstrate how such financing could affect shareholders. The vehicle also should provide information on the evaluation of the potential acquisition candidates and should explain how, and why, the target company has been selected. Moreover, investors

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[58] FINRA Regulatory Notice 08-54, Guidance on Special Purpose Acquisition Companies, https://www.finra.org/rules-guidance/notices/08-54.

[59] US SEC, Special Purpose Acquisition Companies, CF Disclosure Guidance, Topic No. 11, 22 December 2020, https://www.sec.gov/corpfin/disclosure-special-purpose-acquisition-companies.

should receive clear information on the fees that the underwriter of the IPO would receive following the target acquisition.

The SEC Investor Advisory Committee (IAC) published SPAC recommendations,[60] which, in particular, call for the SEC to enhance its focus on SPAC disclosures and exercise stricter enforcement on the following:

- the role of the SPAC sponsor, including conflicts and financial interests relative to retail investors;
- the economic effect of SPAC securities and impact to dilution (explained in a plain English);
- the mechanics and timeline of the de-SPAC process[61];
- the opportunity set and target company areas of focus;
- the competitive pressure and risks concerning the search for appropriate targets and reaching market acceptable prices for those companies (this disclosure also should make clear that the SPAC sponsor has an interest in the completion of the transaction, even though this may not benefit the remaining investors after the de-SPAC process);
- the acceptable range of terms under which any additional funding may be requested;
- how the SPAC sponsor assesses the readiness of the potential target companies; and
- the sponsor's commitment to the minimum pre-de-SPAC diligence concerning the target company's accounting practices.

Hong Kong SAR

In September 2021, The Stock Exchange of Hong Kong Limited (the Exchange) launched a public consultation on SPACs.[62]. The consultation sought feedback on a series of proposed changes to the listing rules in Hong Kong for the creation of a listing regime for SPACs.

The Exchange's approach to SPACs is to ensure that only those vehicles with reputable and experienced promoters seeking quality de-SPAC targets are listed. The Exchange shares the SEC's concerns on investor protection and disclosure standards for SPACs. The consultation paper highlights that, because Hong Kong SAR markets have a higher retail participation in proportion to the United States, the SPAC listing process in Hong Kong SAR needs to have more stringent requirements, with several additional safeguards and restrictions.

With regard to the phase preceding the de-SPAC transaction, the Exchange proposed the following:

- The subscription and trading of SPAC securities will be reserved for professional investors.
- A SPAC must distribute each of SPAC shares and warrants to a minimum of 75 professional investors, of which 30 must be institutional professional investors.

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[60] See US SEC, "Recommendations of the Investor as Purchaser and Investor as Owner Subcommittees of the SEC Investor Advisory Committee Regarding Special Purpose Acquisition Companies," 26 August 2021, https://www.sec.gov/spotlight/investor-advisory-committee-2012/draft-recommendation-of-the-iap-and-iao-subcommittees-on-spacs-082621.pdf.

[61] The de-SPAC process refers to the merger between the SPAC and the target acquisition company.

[62] See the Stock Exchange of Hong Kong Limited, "Special Purpose Acquisition Companies" (consultation paper, HKEX, September 2021), https://www.hkex.com.hk/-/media/HKEX-Market/News/Market-Consultations/2016-Present/September-2021-Special-Purpose-Acquisition-Co/Consultation-Paper/cp202109.pdf.

- Separate trading of SPAC shares and warrants from the initial offering date will include additional measures to mitigate the volatility risk associated with the trading of warrants.
- A total cap shall be set on the issue of promoter shares, in aggregate, of 30% of the shares the SPAC has in issue as at the initial offering date.
- The issuance of warrants that entitle the holder to purchase more than a third of a share upon their exercise is prohibited.
- The issuance of warrants that, in aggregate, would result in more than 30% of the shares the SPAC has in issue at the time such warrants are exercised is prohibited.
- The issuance of promoter warrants that would result in more than 10% of the shares in issue when such warrants are exercised is banned.
- SPAC promoters must fulfil specific eligibility and suitability requirements. In particular, each SPAC must have at least one SPAC promoter to be a firm that holds an advising on corporate finance and/or an asset management license, and hold at least 10% of the promoter shares.
- A shareholder approval through a special resolution is required for any material change in SPAC promoters. A redemption right must be made available to shareholders in the event of a vote against such material change.
- The SPAC must expect to raise at least HK$1 million funds from the initial offering.

The Exchange also proposed the following changes to the rules concerning the de-SPAC transaction:

- A successor company must meet all new listing requirements in full, including IPO sponsor engagement to conduct due diligence, minimum market capitalization requirements, and financial eligibility tests.
- A mandatory third-party independent investment must constitute at least 25% of the expected market capitalization of the successor company, and result in at least one asset management firm or fund owning at least 5% of the issued shares of the successor company as of the date of the successor company's listing.
- The de-SPAC transaction must be contingent on shareholder approval in a general meeting. Shareholders with a material interest in the transaction are excluded from voting, and if the transaction results in a change of control, any outgoing controlling shareholders and their close associates must abstain from voting.
- SPAC shareholders would be able to redeem only those shares voted against a de-SPAC transaction.
- Application of the existing requirements on forward-looking statements in the listing document for a de-SPAC transaction should meet the same standard as required for an IPO.
- A successor company must ensure that at least 100 shareholders hold its shares.[63]

[63] This differs from the requirement for a new listing, for which at least 300 investors must hold the company shares.

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