# SPACs: International Practices and Governance Aspects

Considerations about SPACs implementation in Brazil

# Presentation

In line with the purpose of connecting, enhancing, and enabling the development of the capital markets in Brazil, and following preliminary studies on Special Purpose Acquisition Companies (SPACs), B3 S.A. – Brasil, Bolsa, Balcão (B3, the Brazilian stock exchange), shares this Report with the market, especially aimed to:

- Provide information regarding international regulations;
- Foster a debate with the local market participants to enable the structuring of SPACs in Brazil in an efficient way;
- Prevent any unjustified increase in compliance costs;
- Ensure investor protection; and
- Ensure the integrity of the Brazilian securities market.

SPACs are innovative investment vehicles that have the potential to capture significant value and become a new avenue of access to capital markets for investee companies. However, international practice and regulation show that some intrinsic risks to its structure demands minimum rights for investors.

This Report is divided into five sections: **1.** Presentation; **2.** Introduction; **3.** Aspects which, based on studies carried out to date, have proven to be key elements for the proper functioning of SPACs; **4.** Additional characteristics to be assessed by the market which may contribute to the proper implementation of the structure; and **5.** Conclusion.

It should be noted that the discussion regarding a potential target investors' limitation in SPACs is not covered in this Report, given that this aspect was part of the Public Hearing Notice SDM nº 02/21 of March 10, 2021[1], which was conducted by the Brazilian Securities and Exchange Commission (CVM).

[1] Within the scope of CVM Instruction nº 551/2014, which included article 32-A in CVM Instruction nº 400/2003, it was understood the importance to restrict the target audience for IPOs conducted by pre-operating companies to qualified investors for a period of 18 months, taking into consideration that it is necessary to wait a certain time until those companies establish a solid track record and projections to enable a well-founded investment decision by retail investors. The CVM Public Hearing Notice SDM nº 02/21 pointed that there might be a potential regulatory asymmetry between SPACs and private equity funds (FIPs), questioning the desirability of limiting the target audience for IPOs conducted by SPACs to qualified investors, only extending to retail investors after 18 months. B3's suggestion on the subject was that securities issued by a SPAC should remain closed to retail trading until it becomes an operating company – i.e., until it acquires the target company.

# Introduction

1. 

Sponsor starts a SPAC IPO

2. 

SPAC raises funds in an IPO and deposits them in an escrow account

3. 

SPAC seeks a target company

4. 

Once a target company is found, a business combination is made

**Sponsor** is an individual or legal entity responsible for undertaking a SPAC and conducting the business combination process.

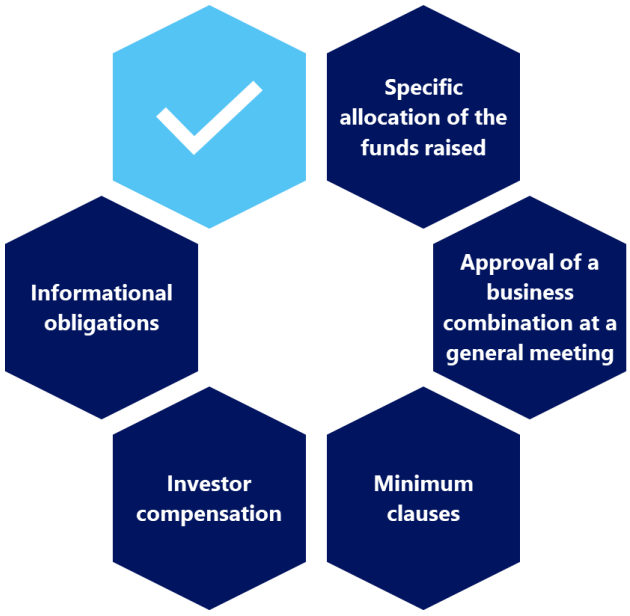
SPACs are publicly held shell companies whose sole purpose is to acquire participation in one or more operating companies. The strategy consists of raising funds in the market through an initial public offering (IPO) and reserving them in a separate bank account (such as escrow or trust), while the **sponsor** seeks out a company with growth potential intending to go public within a pre-established period (generally 18 to 24 months from the IPO closing).

This funding structure first emerged in the United States of America (USA) in the 1990s and more recently has drawn the attention of several market participants worldwide. Data shows that in February 2021, SPAC IPOs in the USA had surpassed the whole year of 2020 – which until then held the record for the highest numbers. Although the market cooled down after the 1Q21, by December 2021 613 SPACs had been launched in the country, reaching a total funding of USD 162.5 billion[2].

Given the growing interest in Brazil, preliminary studies on the structuring of SPACs in various jurisdictions were conducted, in order to prepare a Report with guidelines for others aiming to list in B3. Some of the findings are summarised below.

[2]Data available at https://www.spacresearch.com. Accessed on February 23, 2022.

# 5 Elementary aspects




Although the Brazilian legal system does not prohibit the structuring of SPACs or the public offering of securities issued by them, there are some elements that can hamper their implementation or reduce their efficiency[2]. B3 identified five aspects in international standards which could contribute to overcoming existing issues while offering adequate protection to investors and legal certainty to sponsors.

## 1. Specific allocation of the funds raised

The funds raised in the SPAC IPO are essential for acquiring the target company and, consequently, the enterprise's success. Therefore, the proper management of these funds deserves special attention.

In international practice[3], at least 90% of the funds raised in the SPACs' IPO must remain deposited in an escrow account allocated to: **(i)** enable investment in the target company (given that it can be carried out in several ways, including mergers and acquisitions, it will be referred to herein as a "business combination"), duly approved at a general shareholders' meeting, or, in some cases, by the board of directors; **(ii)** pay the shareholders' proportional interest in a SPAC, in case they decide to leave before the business combination; and **(iii)** refund investors in the event of a SPAC liquidation. Therefore, it is important that the escrow account and IPO documents ring-fence the use of the deposited funds.

Additionally, it is also recommended that the funds deposited in the escrow account are not used for the SPAC's maintenance costs, such as administrators' remuneration, target company's due diligence, legal fees, feasibility of business combination, or any benefits granted to the sponsor, controlling shareholder, managers and persons related to them[4].

[2] For further information on the regulatory hurdles encountered to date and for suggestions about the pre-operability of SPACs, see B3's statement to the Public Hearing Notice SDM nº 02/2021.
[3] Nasdaq Rule IM-5101-2 and NYSE Listed Company Manual Section 102.06.
[4] FCA Listing Rule 5.6.18A, "G", (2).

## 2. Approval of a business combination at a general meeting

Following the IPO, the target company search process is conducted and once chosen, the business combination must be formally approved. Some jurisdictions – notably the USA[5] – allow deliberation on this subject to be made by the board of directors, without approval in a shareholders' general meeting.

As the business combination is a transaction that effectively defines in which company the shareholders will invest, disclosure is particularly important. In the USA, disclosure at this time should be more in line with an IPO of the target company[6].

Under the terms of a bulletin released by the United States' Securities and Exchange Commission (SEC) on the subject, key information about the target company's business must be prepared, such as financial statements, main transaction conditions (including the entity's capital structure resulting from the business combination), as well as information about the interests of the parties involved in the transaction, particularly the sponsor[7].

According to Brazilian Corporate Law, the target company acquisition may be submitted to the shareholders, depending on the chosen format[8]. In any case, it is recommended to always be deliberated by the shareholders regardless of the chosen format and observing the due disclosure about, for instance, the operation's conditions, evaluation criteria and capital structure following the transaction, enabling the exercise of political rights by all shareholders (holders of common or preferred shares).

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[5] See nº 3.

[6] *"The overall thrust of any changes would be to bring de-SPAC mergers more in line with traditional IPOs"* (https://www.whitecase.com/publications/insight/record-breaker-us-ma-2021/whats-next-spacs). *"The* [SEC] *guidance statements include the following:* (...) *Questioning the use of revenue projections by stat-ups merging with SPACs and whether de-SPAC transactions should be treated more akin to traditional IPOs"* (https://www.cliffordchance.com/content/dam/cliffordchance/briefings/2021/09/guide-to-special-purpose-acquisitioncompanies.pdf).

[7] "*Proxy, information or tender offer statement. If the SPAC seeks shareholder approval of the initial business combination, it will provide shareholders with a proxy statement in advance of the shareholder vote. In cases where the SPAC does not solicit the approval of public shareholders, because certain shareholders, such as the sponsor and its affiliates, hold enough votes to approve the transaction, it will provide shareholders with an information statement in advance of the completion of the initial business combination."*

"*The proxy or information statement will contain important information about the business of the company that the SPAC wants to acquire, the financial statements of the company, interests of the parties to the transaction, including the sponsor of the SPAC, and the terms of the initial business combination transaction, including the capital structure of the combined entity." (SEC investor bulletin: "What you need to know about SPACs*").

[8] The business combination may take the form of various corporate transactions, some of which necessarily are an exclusive competence of the general meeting, such as the acquisition of companies, purchase of shares, merger or transaction with a related party that corresponds to more than 50% of the total assets value of the SPAC, contained in the last approved balance sheet (art. 122, items VIII and X, of the Corporate Law). It is possible that operations that do not fall within these institutes are not submitted to the general meeting.

Also on this matter, it should be noted that the New York Stock Exchange (NYSE) has the right to carry out a second scrutiny by assessing whether the listing continuity of the SPAC – combined with the target company – is in the best interest of the market and investors and has the discretion to start the delisting procedure[9].

For now, B3 will assess business combinations on a case-by-case basis as they occur and reserves the right to take the appropriate measures within its activity scope depending on the transaction characteristics.

## 3. Minimum clauses

One of the SPAC's main qualities is the reimbursement option during the business combination process. Therefore, it is recommended that the SPAC's bylaws establish the scenarios in which the shareholders receive the proportional amount of their contribution back. Ideally, such right would be given at least in: **(i)** a business combination approval; **(ii)** a bylaws' amendment that result in a restriction of rights or the imposition of burdens on its shareholders; and **(iii)** a sponsor change.

## 4. Investor compensation

If a SPAC does not find a target company, and the term expires without the business combination being carried out, its managers must: **(i)** return the funds from the escrow account to the shareholders proportionally to their respective ownership; and **(ii)** delist the SPAC[10].

## 5. Informational obligations

Seeking an adequate disclosure[11], it is recommended to be informed in the SPAC's and IPO's documents, besides others:

[9] NYSE Listed Company Manual Section 802.01.
[10] See nº 3.
[11] It should be noted the SEC's efforts to require a more detailed disclosure within the IPO and business combination context: https://www.sec.gov/news/public-statement/munter-spac-20200331, https://www.sec.gov/news/public-statement/spacs-ipos-liability-risk-under-securities-laws, https://www.sec.gov/news/public-statement/accounting-reporting-warrants-issued-spacs and https://www.sec.gov/news/speech/peirce-remarks-fordham-journal-102221. Furthermore, see the SGX Mainboard Listing Rule 625.

- Risk factors specifically arising from the SPAC structure:
    - The funds raised through the IPO are intended for investment in a company other than the SPAC itself;
    - Absence of an obligation (unless otherwise provided by regulatory acts) to obtain an opinion from an independent financial advisor on the transactions' pricing with potential target companies;
    - Lack of track record of a newly established SPAC;
    - Absence of a legal framework in Brazil specifically designed for SPACs;
    - Possibility that a business combination with target companies is not successfully executed;
    - The shareholders' right to investment recover may hinder the execution of a business combination; and
    - The existence of a timeframe may limit the negotiation power for a possible business combination.
- Remuneration due and any benefits granted to sponsors and their stakeholders;
- Funds' source that will support the SPAC maintenance between the IPO and the business combination;
- Main characteristics of the escrow account, including the financial institution in charge; and
- Data and conditions for exercising the warrants issued by the SPAC.

# 10 Additional **characteristics**

Besides the elementary aspects listed above, other were identified in the study, on which B3 would like to promote further discussion among market participants and other stakeholders.

1. **Term**: Nasdaq Stock Market (Nasdaq) and Financial Conduct Authority (FCA) have rules that establish a timeframe for SPACs to acquire a target company – respectively, 36 and 24 months after the IPO. In others, like Singapore Exchange (SGX), there is also the possibility of extending the initial term[12].

2. **Sponsor**: a key stakeholder of a SPAC, entrusted by the investors to find a suitable target company and strike a good deal – this is where the expression "blank-check companies" comes from. Therefore, it is recommended that they have a professional background and/or adequate business experience, although there are some examples of SPACs sponsored by celebrities. In addition, they could be required to hold participation in a SPAC, subject to a lock-up on trading, to align their interests with other shareholders[13].

3. **IPO**: while deposited in the escrow account, the funds' application may be previously defined or exclusively chosen by the sponsor – for example, SGX allows the investment only on liquid short-term securities with a minimum rating grade[14]. Moreover, the underwriters' fees can be divided into two tranches – the first to be paid immediately after the IPO, and the second after the business combination, in accordance with a practice recognised by NYSE.

[12] Nasdaq Rule IM-5101-2, FCA Listing Rule 5.6.18AG(3) and SGX Mainboard Listings Rule 210(11)(m).
[13] SGX Mainboard Listings Rule 210(11)(e).
[14] SGX Mainboard Listings Rule 210(11)(i)(iv).

**4.**

**Corporate governance**: the rules issued by NYSE and Nasdaq establish that the SPAC's board of directors must have independent members, and the business combination must be previously approved by most of them[15]. Furthermore, SGX sets a minimum number of independent members on mandatory advisory committees, such as remuneration and audit[16]. Such practices can serve as inspiration for Brazilian SPACs.

**5.**

**Target company**: both NYSE and Nasdaq establish that a business combination transaction needs to use at least 80% of the amount reserved in the escrow account[17]. It is advisable for SPACs to inform at the IPO's documents if there is any minimum amount to be used for the business combination transaction.

**6.**

**Business combination**: SGX, for instance, establish specific requirements, such as the need to hire an independent financial advisor to **(i)** assist the sponsor in finding a target company and conduct the business combination, or **(ii)** draft an appraisal report for the target company[18].

**7.**

**Conflict of interests**: if a business combination involves a target company that is a sponsor's related party[19], additional safeguards may be observed, such as obtaining a fairness opinion issued by an independent financial institution. Additionally, if the sponsor could act through vehicles other than the SPAC (as a fund or company manager), it is recommended to disclose the measures to be taken to manage potential conflicts of interest and avoid damage to the shareholders.

[15] See nº 3.
[16] SGX Mainboard Listings Rule 210(11)(g).
[17] See nº 3.
[18] SGX Mainboard Listings Rule 210(11)(m)(v) and (vi).
[19] Concept according to Brazilian Technical Pronouncement CPC nº 05.

**8.**

**Refund**: NYSE and Nasdaq rules allow all shareholders to have the right to recover the proceeds proportional to the shares owned by them regardless of whether they voted for or against the business combination[20].

**9.**

**Political rights**: NYSE and SGX rules require that the business combination to be carried out, while being deliberated by the board of directors – previously to the general meeting – to be approved by most of its independent members[21]. Furthermore, regardless to the applicable laws and regulations, the SPAC should consider limiting the sponsor and its affiliates' stakeholders votes regarding the business combination.

**10.**

**Post-business combination**: in the IPO documents, there could be a specific section exploring the possible scenarios for the shareholding base dilution resulting from the sponsor's participation or the exercise of available warrants and indicating what would be the necessary return on each share to offset them, as recommended by the Financial Services and Markets Authority (FSMA)[22]. Also, a limit could be set for the SPAC's shareholding dilution from the exercise of warrants, as discussed in a public consultation held by the Hong Kong Exchange (HKEx)[23]. Finally, as established by SGX, the sponsor's remuneration could be restricted to a specific amount – e.g., up to 20% of the funds raised in the IPO[24].

[20] See nº 3. The rules require that the reimbursement must be made if the shareholder has voted against the business combination. However, it does not prohibit the SPAC from establishing in its own documents the possibility to compensate all shareholders regardless of their votes.
[21] NYSE Listed Company Manual Section 102.06 and SGX Mainboard Listings Rule 210(11)(m)(viii).
[22] See "Public consultation by the FSMA about a proposal for minimum standards for the structuring, information disclosure and trading in SPACs on Euronext Brussels" and SGX Mainboard Listings Rule 625(7).
[23] HKEx Consultation Paper on SPACs, paragraphs 299 to 314.
[24] SGX Mainboard Listings Rule 210(11)(f).

# Conclusion

Considering the abovementioned, the adoption of certain practices can contribute to increasing the efficiency of SPACs, while mitigating the risks intrinsic to their structure and maintaining the integrity of the Brazilian securities market.

In this respect, this Report aims to inform the market about the regulation and practices around the world, and present reflections and recommendations on the implementation of SPACs in Brazil. Subsequently, when the vehicle reaches a certain level of maturity in the country, B3 will evaluate, alongside with the market, the convenience of issuing a specific rule.

Furthermore, in line with its commitment to fostering the development of the Brazilian capital markets, B3 is available to address any aspects related to the SPAC structure. Please contact us at sre@b3.com.br.

Finally, B3 clarifies that: **(i)** CVM may require additional information during the filing of a publicly held company registration and any public offering submitted by SPACs that is not necessarily linked to the aspects discussed herein; and **(ii)** this document does not in any way represent a suggestion or recommendation for investment in SPACs, nor does it provide legal advice regarding their constitution or current national or foreign law.