

**Sue Lloyd**  
**Chair**  
**IFRS Interpretation Committee**  
**Columbus Building**  
**7 Westferry Circus**  
**Canary Wharf, London E14 4HD**  
**United Kingdom**

**Agenda Item Request: Classification of SPAC shares as equity or liability (IAS 32)**

Dear Ms Lloyd,

The European Securities and Markets Authority (ESMA) is an independent EU Authority that enhances the protection of investors and promotes stable and well-functioning financial markets in the European Union (EU). ESMA achieves this aim by building a single rule book for EU financial markets and ensuring its consistent application across the EU. In the context of ESMA's supervisory convergence work in the area of financial reporting, I would like to raise with you an issue related to the application of IAS 32 *Financial Instruments: Presentation*. ESMA has observed different views on the application of the requirements of IAS 32 in relation to the classification of shares issued by Special Purpose Acquisition Companies (SPAC) as liabilities or as equity instruments when a particular fact pattern is present.

Accordingly, ESMA kindly suggests that the IFRS Interpretations Committee (IFRS IC) considers clarifying the relevant accounting requirements. A detailed description of the case is set out in the appendix to this letter. We would be happy to further discuss this matter with you.

In case you have any questions or comments regarding this letter, please contact Evert van Walsum, Head of the Investors and Issuers Department ([Evert.vanWalsum@esma.europa.eu](mailto:Evert.vanWalsum@esma.europa.eu)).

Yours sincerely,

Anneli Tuominen

## APPENDIX – DETAILED DESCRIPTION OF THE ISSUE

### 1 Description of the issue

1. The issue relates to Special Purpose Acquisition Companies (SPACs), listed entities that are established for the sole business purpose of acquiring a not yet identified target (one or more companies or operating businesses) in the future. SPACs typically have two types of shares after the IPO: founder shares (class A) and public shares (class B). The decision whether to acquire a company identified by the founders is approved either by the shareholders or by the SPAC's management, depending on the provisions in the SPAC's statutes. In the analysis below, we do not take into account how this decision is made, as we believe that this has no influence on the outcome of the analysis.
2. If the acquisition is approved, class B shareholders can (individually) demand a reimbursement of their shares (according to the statutes of some SPACs only the class B shareholders who voted against the acquisition can claim reimbursement).
3. If no company is acquired within a specified period of time (e.g. two years from the date of listing), the SPAC will be liquidated unless the statutes of the company (and also the listing regulations) allow for an extension of the SPAC and the shareholders vote to extend the SPAC's life. After liquidation, the holders of public shares will be "reimbursed" by the distribution of the IPO proceeds received (in some cases plus a minimum guaranteed return on the escrow account where the proceeds are typically held prior to the acquisition), less certain expenses, first to the holders of class B shares and for the remaining part to the holders of class A shares. With regard to the decision to extend the SPAC, we have observed the following cases in practice:
  - a) the decision shall be approved by two-thirds of the shareholders in a shareholders' meeting;
  - b) the decision shall be approved by two-third of the holders of class A shares and two thirds of the holders of class B shares independently in two separate shareholders' meetings.
4. As part of their monitoring and supervisory activities, ESMA and national enforcers have identified different views as to whether class B shares fulfil the conditions set out in paragraph 16 of IAS 32 to be classified as an equity instrument. While the fulfilment of the conditions in (a)(ii) and (b) is fairly obvious, it is questionable whether the condition in (a)(i), which requires that the instrument does not include a contractual obligation to deliver cash or another financial asset, is met.
5. According to paragraph 19 of IAS 32, this condition is generally not met if the entity does not have an unconditional right to avoid delivering cash or another financial asset to settle a contractual obligation. It does not seem clear whether this unconditional right is present, given (a) the class B shareholders' right to ask for a reimbursement of their shares if the acquisition is approved; and (b) the provision that the company must be liquidated if no target company is acquired within a specified period of time and the SPAC's life is not extended. As the class B shares become effectively redeemable upon liquidation of the

SPAC, there are differing views as to whether the company can avoid delivering cash or another financial asset to the holders of class B shares in these circumstances.

6. Moreover, paragraph 16C of IAS 32 implies that a contractual obligation to deliver a pro rata share of the entity's net assets on liquidation meets the definition of a financial liability if the liquidation is either certain to occur and outside the control of the entity or uncertain to occur but is at the option of the instrument holder. As an exception, such an instrument is classified as an equity instrument if it has certain characteristics. In particular, the instrument shall be the most senior instrument of the company, i.e. it cannot have priority over other claims to the assets of the company on liquidation. Since this condition is not met, because holders of the class B shares have priority over the claims of holders of class A shares in the event of liquidation, the classification of class B shares as liabilities as a consequence of the requirement in paragraph 16C is questionable.
7. In addition, as paragraph 20 of IAS 32 explains that a contractual obligation to deliver cash or another financial asset need not be explicit and may be established indirectly through terms and conditions of the financial instrument, an important question is whether the legal setup of the SPAC implies the existence of such an indirect obligation. The SPAC will eventually either acquire a target or be liquidated, and because in both the acquisition and liquidation the reimbursement of class B shares will be outside the control of the entity, considering paragraph BC 9 of Basis for Conclusions on IAS 32, it is not clear whether a contractual obligation to deliver cash or another financial asset is established indirectly (implicitly) through the terms and conditions of the SPAC's statutes.
8. The first section hereafter discusses the different views expressed on the consequences of the right of holders of class B shares to ask for a reimbursement of their shares in the event of an acquisition in terms of the existence of an unconditional right to avoid delivering cash or other financial assets. The second section presents the different views regarding the impact of the SPAC liquidation provisions on the classification of shares.

#### **1.1 Effect of the class B shareholders' right to demand a reimbursement of their shares, in the event of the acquisition of a company, on the existence of an unconditional right to avoid delivering cash or another financial asset**

##### ***View 1: The SPAC has an unconditional right to avoid delivering cash or another financial asset***

9. Proponents of View 1 argue that even though class B shareholders can demand reimbursement of their shares if the acquisition is approved, the entity has an unconditional right to avoid delivering cash or another financial asset. They point out that the SPAC's management can decide to never present any potential acquisition to the shareholders' meeting, so that class B shareholders will never be entitled to ask for a reimbursement of their shares. Proponents of View 1 note that, according to the definition in paragraph 11 of IAS 32, a financial liability is subject to the existence of a contractual obligation. Therefore, a possible constructive (non-contractual) obligation of the SPAC to reimburse the class B shareholders due to the absence of a practical ability to act in a manner inconsistent with

the SPAC's main business purpose should not be taken into account when determining the classification of class B shares.

10. Proponents of this view also point out that the IASB discussed whether economic compulsion should affect the classification of a financial instrument under IAS 32. The June 2006 IASB Update highlighted in this context that a contractual obligation must be established through the terms and conditions of the instrument and that economic compulsion by itself would not result in a financial instrument being classified as a liability under IAS 32. The IASB also emphasised that IAS 32 requires an assessment of the substance of the contractual arrangement but does not require or permit to consider factors not within the contractual arrangement when classifying a financial instrument as an equity or a debt instrument.
11. Proponents of view 1 therefore conclude that any economic compulsion that might arise from the SPAC objective to acquire a target company should not be taken into account in the classification of class B shares under IAS 32. As management can avoid acquiring a company based on the contractual arrangement, the SPAC has an unconditional right to avoid delivering cash or another financial asset.

***View 2: The SPAC does not have an unconditional right to avoid delivering cash or another financial asset***

12. Proponents of View 2 believe that avoiding redemption of B shares by not presenting any acquisition targets to the shareholders would contradict the SPAC's main objective to acquire a target company. The acquisition of a target is the sole business purpose of the SPAC and the reason why class B shareholders choose to invest in the SPAC. The management of the SPAC is expected to diligently pursue the purpose to identify suitable potential targets and to enter into negotiations to acquire (at least one of) such targets within the time limits defined in the prospectus and in some cases, also in the SPAC's statutes. The proponents of this view believe that the fulfilment of the sole business purpose described in the prospectus may constitute, from a legal perspective, a contractual commitment of the SPAC towards the class B shareholders.
13. Therefore, proponents of this view conclude that the SPAC's management cannot exercise its discretion never to present any potential acquisition to the shareholders' meeting (or never to approve an acquisition, should that be a decision that the management has discretion to make). Thus, a contractual obligation (which goes beyond mere economic compulsion) is established indirectly (implicitly) through the terms and conditions of the SPAC's statutes, so that the SPAC does not have an unconditional right to avoid repaying the class B shareholders.
14. Furthermore, some proponents of this view point out that preparation of the SPAC's financial statements on a going concern basis requires that the SPAC seeks to fulfil its sole business purpose. Based on paragraph 4.33 of the CF they consider that the conclusion that it is appropriate to prepare the SPAC's financial statements on a going concern basis implies that the SPAC has no practical ability to avoid the reimbursement of class B shares.

## 1.2 Effect of the provisions regarding the SPAC's liquidation on the classification of shares

15. This section presents alternative views on the classification of class B shares under the assumption that the right of holders of class B shares to demand the reimbursement of their shares in the event of an acquisition does not constitute an obligation to deliver cash or another financial asset (View 1 in section 1.1).

### ***View 1: Class B shares are equity instruments***

16. Proponents of View 1 point out that although the SPAC class B shares become effectively mandatory redeemable upon liquidation of the company, the company has an unconditional ability to avoid the outflow of cash because liquidation can be prevented if a shareholders' meeting resolves to extend the life of the company. They argue that the voting of shareholders against liquidation should be seen as an action of the company and not as a private action of shareholders in their capacity as holders of the particular instrument "class B share".
17. In support of their view, proponents of View 1 refer to paragraph 17 of IAS 32, which states that although the holder of an equity instrument may be entitled to receive a pro rata share of any dividends or other distributions of equity, the issuer does not have a contractual obligation to make such distributions because it cannot be required to deliver cash or another financial asset to another party. This implies that the decision of shareholders about the payment of dividends taken in the shareholders' meeting is the decision of the entity. By analogy, the decision of the shareholders' meeting to extend the life of the SPAC should also be considered decision of the entity.
18. Moreover, the proponents of View 1 refer to paragraph AG26, which states, with regard to distributions to holders of the preference shares, that the preference shares are equity instruments when distributions are at the discretion of the issuer. Noting that the standard does not provide an explanation of when distributions are at the issuer's discretion, proponents of View 1 argue that actions reserved for the shareholders in general meetings are effectively actions of the entity itself (and therefore at its discretion) as those actions are part of the entity's decision making and corporate governance process. In their opinion, this reasoning should apply not only to distributions to holders of the preference shares, but also to all assessments of whether an entity has an unconditional right to avoid delivering cash or another financial asset to settle a contractual obligation.
19. Some proponents of this view believe that it makes no difference whether the class A and class B shareholders approve the SPAC's extension in one joint meeting or in two separate meetings, since both procedures comply with the legal or statutory requirements of the respective entities and as such also reflect the corporate governance process of these entities (View 1a).
20. Other proponents of this view, however, consider that the arguments presented above are only valid if the decision to extend the SPAC's life is approved jointly by all the SPAC's shareholders (View 1b). In contrast to this, a separate vote indicates that the particular interests of each group of shareholders prevail, and the voting process would reflect the

private actions of the shareholders. Therefore, the outcome of the vote would not be within the control of the SPAC.

21. Regarding the requirements in paragraph 16C, the proponents of View 1 believe that this paragraph is not applicable in the case at hand. They argue that liquidation is not certain to occur and is under the control of the entity, which can extend its own life as explained above (the entity is not in substance a limited life entity).
22. As a result, proponents of View 1a believe that B shares meet the definition of an equity instrument. Proponents of View 1b are of the opinion that this definition is only met if the decision to extend the SPAC is approved jointly by all the SPAC's shareholders. Therefore, if the decision is approved in two separate meetings, the class B shares should be accounted for as liabilities, according to View 1b.

***View 2: Class B shares are debt instruments***

23. Proponents of View 2 note at first that IAS 32 defines an equity instrument as a residual interest in the assets of an entity after deducting all of its liabilities. According to the standard, only instruments that do not meet the definition of a liability are classified as equity. Hence, the instrument is classified as equity only if it can be clearly demonstrated that it does not include a contractual obligation to deliver cash or other financial assets, and the exceptions narrowly defined in paragraphs 16A – 16D of IAS 32 do not apply.
24. Based on these initial considerations, proponents of View 2 believe that not all actions of shareholders can be interpreted as actions of the entity itself. In particular, the actions of shareholders resulting in decisions which are not regular decisions of the shareholders' meetings cannot be considered as actions of the entity.
25. Moreover, taking into consideration the reasoning set out in section 1.1 under View 2, it can be argued that there is an indirect (implicit) contractual obligation to deliver cash or another financial asset. As the SPAC will eventually either be liquidated or acquire a target company, the SPAC does not have an unconditional right to avoid delivering cash to class B shareholders.
26. With this in mind and taking into account that the exception in paragraph 16C does not apply because class B shares are not the most senior instruments of the company, the proponents of View 2 conclude that class B shares should be accounted for as liabilities.

## **2 Request**

27. ESMA seeks clarification on whether and under what circumstances class B shares should be classified as liabilities or as equity instruments. More specifically, ESMA suggests that the IFRS IC considers clarifying what impact the following features have on the classification of class B shares:
  - a) the existence of the class B shareholders' right to demand reimbursement of their shares in the event of an acquisition, depending on how the acquisition decision is made (e.g. by the shareholders or by the management of the SPAC);

- b) provisions regarding the SPAC's liquidation, in particular the possibility to extend the life of the SPAC, taking into consideration the different modalities of how the decision to extend the SPAC's life is approved (e.g. in one shareholders' meeting or in two separate shareholders' meetings).
28. ESMA observed the relevance of the fact patterns described above for several issuers in different European jurisdictions. ESMA believes that given the existence of differing views and the increasing popularity of SPAC companies in several jurisdictions it is important to provide clarity on this issue in the short term.
29. ESMA notes that the IFRS IC has already discussed in 2010 how to assess whether an entity has an unconditional right to avoid delivering cash if the contractual obligation is at the ultimate discretion of the issuer's shareholders and that the IASB expects to address this issue as part of its current project on Financial Instruments with Characteristics of Equity (FICE project). ESMA considers, however, that the issue described in this Agenda Item Request is sufficiently narrow and should therefore be addressed outside of the FICE project.