
RE: CONSULTATION PAPER ON SPECIAL PURPOSE ACQUISITION COMPANIES

On 17 September 2021, The Stock Exchange of Hong Kong Limited (the “Exchange”) published its Consultation Paper on Special Purpose Acquisition Companies (the “**SPAC Consultation Paper**”) and seeks market feedback on their proposals to amend the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (the “**Listing Rules**”) to create a listing regime for special purpose acquisition companies (“**SPAC(s)**”) in Hong Kong. The Exchange is open to public comments regarding their proposals until 31 October 2021.

What is a SPAC?

A SPAC is a shelf company designed to raise capital through an initial public offering (“**IPO**”) for the purpose of conducting a business combination¹ with an existing operating company within a pre-defined time period after its listing. Subsequently, an operating company can merge with (or be acquired by) the publicly traded SPAC and become a listed company in lieu of conducting its own IPO.

A SPAC does not have business operations and does not have assets other than (i) the proceeds from its IPO; and (ii) the funds raised from professional managers who have private equity, corporate finance and/or relevant industry experience (hereinafter referred to as “**SPAC Promoters**”) to pay for the SPAC’s expenses. In SPAC listings, SPAC Promoters are incentivised by promoter shares² and promoter warrants³ (hereinafter referred to as “**Promoter Shares**” and “**Promoter Warrants**”, respectively) that are issued exclusively to them by SPACs.

SPAC Formation and Listing⁴

Generally, SPACs are formed by SPAC Promoters and investors of SPACs rely on SPAC Promoters to identify a suitable operating company (a “**De-SPAC Target**”) and negotiate terms of De-SPAC Transactions, which in turn provide them with a return on investment. After the listing of a SPAC, SPAC Promoters will aim to identify a De-SPAC Target and enter into negotiations with its management on the terms of a De-SPAC Transaction. Upon successful negotiations and seeking approval from SPAC shareholders, the company resulting from the De-SPAC Transaction (the “**Successor Company**”) becomes the listed issuer in place of the SPAC, whereas the owners of the De-SPAC Target will usually become the controlling shareholders of the Successor Company. In the event that a SPAC fails to complete a De-SPAC Transaction within the deadline prescribed in the prospectus that is issued at IPO, it must

¹ A “*business combination*” refers to a merger, share exchange, asset acquisition, share purchase, reorganisation or other form of transaction. Such transaction(s) will be referred to as “**De-SPAC Transaction(s)**” in this client alert.

² Promoter Shares refer to shares of a separate class to regular shares of a SPAC (excluding the Promoter Shares, the “**SPAC Shares**”) which are issued by a SPAC exclusively to a SPAC Promoter at nominal consideration as a financial incentive to establish and manage the SPAC.

³ Promoter Warrants refer to warrants of a separate class to regular warrants of a SPAC (excluding the Promoter Warrants, the “**SPAC Warrants**”) which are issued by a SPAC exclusively to a SPAC Promoter.

⁴ For further details of the formation and listing processes of SPACs and the typical stages of De-SPAC Transactions, see Paragraphs 28 to 37 of the SPAC Consultation Paper.

either seek approval from SPAC shareholders for an extension of its lifespan, or proceed to liquidation.⁵

An overview of the key proposal advanced by the Exchange in the SPAC Consultation Paper is set out below.⁶

A. KEY PROPOSAL RELATING TO SPACs

1. *Investor Suitability*

Only “*professional investors*”⁷ (“**Professional Investors**”) are allowed to participate in subscription and trading of the SPACs. Companies resulting from De-SPAC Transactions are exempted from this restriction. Both SPAC Shares and SPAC Warrants each must have at least 75 Professional Investors, of which 30 investors must be institutional Professional Investors.

2. *Trading Arrangements*

SPAC Shares and SPAC Warrants are to be separately traded from the initial offering date. There are additional measures in place to mitigate volatility risk associated with the trading of SPAC Warrants.

3. *Dilution Cap*

Promotor Shares can only account for at most 20% of the total number of shares of the SPAC at the initial offering date. An additional 10% of Promotor Shares may be issued upon the Successor Company satisfies the performance targets. It is suggested that a similar cap of 30% should also be imposed on the dilution resulting from the exercise of SPAC Warrants.

4. *Suitability of SPAC Promoters*

A SPAC Promoter should show that it either has (i) experience in managing assets with an average collective value of at least HK\$8 billion over a continuous period of at least three financial years; or (ii) held a senior executive position at an issuer that is or has been a constituent of the Hang Seng Index or an equivalent flagship index.

Each SPAC must have at least one SPAC Promoter which (i) holds a Type 6 (Advising on Corporate Finance) licence and/or Type 9 (Asset Management) licence issued by the Securities and Futures Commission (“**SFC**”); and (ii) holds at least 10% of the Promoter Shares.

⁵ For further details of the implications of failing to complete a De-SPAC Transaction within the prescribed deadline, see Paragraph 38 of the SPAC Consultation Paper.

⁶ The Exchange’s key proposals are summarised in Table 1 (Pages 3 to 5) of the SPAC Consultation Paper and set out in full in Chapter 5 of the SPAC Consultation Paper.

⁷ Professional Investors include (i) individual professional investors (as defined under section 1 of Part 1 of Schedule 1 to the Securities and Futures Ordinance (Cap 571) (the “**SFO**”), as prescribed by the Securities and Futures (Professional Investor) Rules (Cap 571D)); and (ii) institutional professional investors (as defined under paragraphs (a) to (i) in section 1 of Part 1 of the SFO, hereinafter referred to as “**Institutional Professional Investors**”).

Approval from the shareholders of a SPAC (excluding SPAC Promoter(s) and its/their close associates) by way of special resolution is required for any material change in SPAC Promoters. Shareholders must be granted a redemption right in the event that they intend to vote against such material change.

5. Fund Raising Size

Fund raising size for any initial offering of SPAC must be at least HK\$1 billion (equivalent to approximately US\$128 million).

B. REGARDING DE-SPAC TRANSACTIONS

1. Listing Requirements

The Successor Company must meet the existing listing requirements for post De-SPAC Transaction (including engagement of Sponsor for due diligence, minimum market capitalisation requirements and financial eligibility tests).

2. Independent Third Party Investment

Upon completion of the De-SPAC Transaction, (i) public float must be at least 25% of the expected market capitalisation of SPAC (or a minimum of 15% if the expected market capitalisation at listing is more than HK\$1.5 billion); and (ii) at least 5% of the issued shares of the Successor Company as at the date of the listing must be beneficially owned by one asset management firm or fund (with assets under management or fund size of not less than HK\$1 billion).

3. Approval by shareholders of a SPAC

Shareholders of a SPAC (other than those with a material interest) should have the right to vote at a general meeting⁸ regarding the De-SPAC Transaction. Redemption rights should also be granted to Shareholders, so that they are able to redeem the SPAC Shares in case they vote against the De-SPAC Transaction.

4. Forward Looking Information

Any forward looking statements in the listing document for a De-SPAC Transaction must meet the same standard as that required for IPOs (including the requirement for reports from the reporting accountant and IPO sponsor on such statements).

5. Open Market in Shares of the Successor Company

Shares of the Successor Company must be held by at least 100 shareholders to ensure there are sufficient spread and liquidity for trading.

⁸ In respect of such conditional approval at a general meeting, a shareholder with a material interest (including SPAC Promoter(s) and its/their close associates) must abstain from voting. Further, if the De-SPAC Transaction results in a change of control, any outgoing controlling shareholders of the SPAC and their close associates must not vote in favour of the De-SPAC Transaction.

6. Consequences of Failing to Meet De-SPAC Deadlines

If a SPAC (i) fails to publish a De-SPAC Announcement within 24 months of the date of its listing; or (ii) fails to complete a De-SPAC Transaction within 36 months of the date of its listing, trading of such SPAC's shares must be immediately suspended. The SPAC must then be liquidated and de-listed after it makes full refund (plus accrued interest) to its shareholders.

OUR VIEW

The Exchange acknowledges the importance of maintaining Hong Kong's competitive position and reputation for high-quality listings and stable secondary trading, which relies on the protections provided by Hong Kong's regulatory framework, including the Listing Rules. Further, the Exchange is mindful of the likelihood of there being an over-supply of SPACs seeking sub-standard De-SPAC Transactions if a SPAC listing regime is introduced in Hong Kong. On such basis, the Exchange proposes an approach that would result in a SPAC listing regime which is more stringent than that of the United States and of Singapore, but would ensure that only those SPACs with prudent SPAC Promoters who seek for quality De-SPAC Targets are listed.⁹

The following table shows the brief comparison of the requirements for SPAC in the U.S., Hong Kong and Singapore.

	U.S.	Hong Kong (proposed)	Singapore
Minimum Share Price	US\$4, usually US\$10	HK\$10	SG\$5
Fund Raising Amount	Market Cap: at least US\$50 million	HK\$1 billion	Market Cap: at least SG\$150 million
SPAC Promoters	Experience and track record are factors for consideration	At least one SPAC Promoter holds Type 6 or Type 9 SFC licence	Track record, reputation and professional team are the considerations
Investors	No restrictions	Limited to Professional Investors. Initial offering must have at least 75 Professional Investors, of which 30 investors are institutional Professional Investors.	No restrictions
Voting and Redemption Rights	Shareholders who vote against the de-SPAC transaction	A redemption right must be made available to shareholders who intends	All independent shareholders who vote against the de-

⁹ For further details, see Paragraphs 9 to 13 of the SPAC Consultation Paper.

	must have the share redemption rights	to vote against (i) any material change in SPAC Promotors or (ii) the De-SPAC Transaction	SPAC transaction must have the share redemption rights
Lock-up Period	Not specified, can be 12 months after de-SPAC transaction	12 months after De-SPAC Transaction	6 to 12 months after de-SPAC transaction
De-SPAC Target	Not specified, successor company only needs to comply with listing rules	Not include any investment company, but can acquire bio-tech or mining companies	Limited to bio-tech, mining, petroleum or natural gas companies
Transaction Period	36 months, but usually 24 months	24 months for announcement, 36 months to complete the De-SPAC Transaction. If not, principal and interest shall be returned to shareholders.	24 months, shareholders and the exchange can approve for extension of another 12 months

Please get in touch with our members at hyu@lylawoffice.com or at (+852) 2115-9525 if you would like to further discuss any of the issues raised in this client alert or the SPAC Consultation Paper more generally.

HENRY YU & ASSOCIATES

21 SEPTEMBER 2021



Disclaimer: The information provided in this article is not intended to be, nor does it constitute, legal advice and is not a substitute for obtaining proper legal advice in respect of any specific issue.