

Hong Kong Capital Markets Update

ISSUE 2021-06 | Sep 2021



HKEX's consultation on SPAC

On 17 September 2021, the Stock Exchange of Hong Kong Limited (the "Exchange") published a [consultation paper](#) ("Consultation") seeking market feedback on proposals to create a listing regime for special purpose acquisition companies ("SPACs") in Hong Kong. The deadline for submissions is 31 October 2021.

Key Proposals

Pre De-SPAC Transaction (including SPAC formation)

- **Investor suitability**

The subscription for and trading of a SPAC's securities would be **restricted to Professional Investors only**, with **a minimum of 75 Professional Investors**, of which **30 must be Institutional Professional Investors**.

- **Fund raising size**

The funds expected to be raised by a SPAC from its initial offering must be **at least HK\$1 billion**.

- **Trading arrangements**

Separate trading of SPAC Shares and SPAC Warrants with extra measures for trading of SPAC Warrants.

- **SPAC Promoters**

Must meet suitability and eligibility requirements, and **each SPAC** must have **at least one Promoter** which **(i) is a SFC licensed firm** and **(ii) holds at least 10% of the Promoter Shares**.

- **Dilution cap on Promoter Shares and all warrants**

A **cap on Promoter Shares** at a **maximum of 30%** of the **total number of all shares in issue** at the initial offering date, and a **similar 30% cap** on dilution from the **exercise of all warrants in aggregate**.

De-SPAC Transaction

- **Full application of New Listing Requirements**

The Successor Company must meet all new listing requirements **as for traditional IPO/RTO** save for a smaller **minimum number of shareholders of 100** instead of 300.

- **Mandatory outside independent PIPE investment**

Must constitute **(i) at least 15% - 25%** of the **expected market capitalisation** (depending on the size of the Successor Company) and **(ii) at least 5%** of the **issued shares** of the Successor Company as at listing date; and **at least one of which is asset management firm or fund**.

- **Shareholder vote**

Must be approved by SPAC shareholders at a general meeting with **SPAC Promoters** and **shareholders with a material interest** in the transaction **abstaining from voting**.

- **Redemption option**

Must be given to SPAC shareholders to redeem shares prior to a De-SPAC Transaction; a change in SPAC Promoters; and any extension of completion deadline, **excluding those who vote in favour of the above resolution(s)**.

- **Completion deadline**

Must be announced within 24 months and **completed within 36 months** from the SPAC listing date.

Background

A SPAC is a shell company that raises funds through its listing for the purpose of acquiring a business (the “De-SPAC Target”) at a later stage (the “De-SPAC Transaction”) within a pre-defined time period after listing.

While the listing regime for SPACs is new to Hong Kong, it has a long history in the U.S. and its popularity has increased significantly in recent years. The introduction of a SPAC listing regime would allow Hong Kong to remain competitive globally by providing another route to attract Greater China and South East Asia companies to list in Hong Kong that may otherwise choose to list elsewhere via De-SPAC Transactions.

However, the “shell” characteristic of SPACs will give rise to concerns about market quality and shareholder protection. Since the reputation of Hong Kong’s capital market is also an important cornerstone of its competitive position as an international financial centre, it is crucial for a successful Hong Kong SPAC listing regime to impose safeguards that not only maintain but enhance this reputation for quality.

To strike a balance between market development and quality, the SPAC listing regime proposed in the Consultation, which is acknowledged to be more stringent than that of the U.S. market, is aimed at listing SPACs that have experienced and reputable SPAC Promoters that seek good quality De-SPAC Targets. It is designed to provide a high entry point for SPAC listing applicants and De-SPAC Targets.

The key proposals of the Consultation are summarised below.

Pre De-SPAC Transaction

(A) Investor suitability

Due to the risks associated with the SPACs, such as price volatility and insider trading before the De-SPAC Transaction, the Exchange is proposing the subscription and trading of a SPAC’s securities to be restricted to Professional Investors¹ only prior to the De-SPAC Transaction, with additional approval, monitoring and enforcement measures to ensure compliance with such requirements.

Because of the above restrictions, the number of investors who are eligible and willing to subscribe for the shares of a SPAC in its initial offering will be much smaller than the number of investors in a typical IPO. Therefore, instead of requiring a minimum of 300 shareholders, the Exchange is proposing that a SPAC must distribute (i) each of the SPAC Shares and SPAC Warrants to a minimum of 75 Professional Investors, of which 30 must be Institutional Professional Investors, and (ii) at least 75% of each of SPAC Shares and SPAC Warrants to Institutional Professional Investors.

Also, the current open market requirements should be applied and therefore (i) not more than 50% of each class of SPAC Shares and SPAC Warrants must be beneficially owned by the three largest public shareholders; and (ii) at least 25% (15% - 25% when market capitalisation is larger than HK\$10 billion) of each class of SPAC Shares and SPAC Warrants must be held by the public.

(B) Fund raising size

Since the Exchange is targeting to list SPACs that have experienced and reputable SPAC Promoters that seek good quality De-SPAC Targets, it is proposing setting a minimum fund raising threshold of HK\$1 billion from the SPAC initial offering, with the minimum issue price of HK\$10 for each SPAC Share and the minimum board lot size and subscription size of HK\$ 1 million.

The Exchange believes the setting of the HK\$1 billion minimum fund raising threshold can help validate the reputation of the SPAC Promoter and ensure that De-SPAC Transactions will be of a sufficiently large size to result in Successor Companies² that meet the minimum market capitalisation requirements for listing.

¹ In this Consultation, “Professional Investors” refers to both Institutional Professional Investors and Individual Professional Investors under the definition of “professional investor” in section 1 of Part 1 of Schedule 1 to the SFO. “Individual Professional Investors” means non-Institutional Professional Investors that are any individual and corporate entity falling under the Securities and Futures (Professional Investor) Rules (Cap. 571D), in which they can be (i) an individual having a portfolio of not less than HK\$8 million, (ii) a trust corporation with total assets of not less than HK\$40 million; and (iii) corporation or partnership which have a portfolio of not less than HK\$8 million or total assets of not less than HK\$40 million.

² Successor Company refers to the listed issuer resulting from the completion of a De-SPAC Transaction.

(C) Trading arrangement

While the Exchange is concerned about the volatility risk associated with the trading of SPAC securities and especially for the separate trading of SPAC Warrants in which the lack of liquidity may further exaggerate its volatility and lead to a disorderly market, the stakeholders suggested that disallowing separate trading of SPAC Shares and SPAC Warrants may discourage certain types of investor (e.g. hedge funds who prefer holding warrants than shares due to lower investment capital usage) from fully participating in the trading of SPAC securities, to the detriment of liquidity and the attractiveness of the SPAC regime as a whole.

Therefore, the Exchange is seeking feedback on whether the separate trading of SPAC Shares and SPAC Warrants should be allowed from the date of initial listing onwards until the completion of the De-SPAC Transaction; and either Option 1 (allow only manual trades on SPAC Warrants) or Option 2 (allow both auto-matching of orders with Volatility Control Mechanism, and manual trades, on SPAC securities) to be the additional measures to mitigate the risks of extreme volatility and a disorderly market when separate trading is allowed.

Also, due to the heightened risk of insider trading, the Exchange is proposing prohibiting the SPAC Promoter (including its directors and employees), the directors and employees of SPACs, and their respective close associates, from dealing in any of the SPAC's securities prior to the completion of a De-SPAC Transaction.

(D) SPAC Promoters

SPAC Promoters (a.k.a. "SPAC sponsors" in the U.S.) refer to the professional managers, usually with private equity, corporate finance and/or industry experience, who establish and manage a SPAC.

Since SPACs are newly-formed cash companies without a track record of operations, the investors of SPAC primarily rely on the quality of the SPAC Promoters to act in their best interests. Therefore, the Exchange is proposing the SPAC Promoters must meet suitability and eligibility requirements, in which the character, experience and integrity as well as the capability in meeting a standard of competence commensurate with the position of each SPAC Promoter must be satisfied by the Exchange³.

Also, in order to help ensure high quality SPAC Promoters and better alignment of interests with other SPAC investors, the Exchange is proposing that each SPAC must have at least one SPAC Promoter that is a firm holding (i) a Type 6 (advising on corporate finance) and/or a Type 9 (asset management) license issued by SFC; and (ii) at least 10% of the Promoter Shares at listing and on an ongoing basis for the lifetime of the SPAC.

Moreover, in light of the critical role that SPAC Promoters play in identifying suitable acquisition targets and the reliance placed upon the SPAC Promoters by investors, the Exchange is proposing that any material change in SPAC Promoters would require approval by a special resolution of shareholders (excluding the SPAC Promoters and their close associates).

In addition, the Exchange is proposing Promoter Shares and Promoter Warrants⁴ should be issued to SPAC Promoters only and should not be eligible for listing and trading as the Exchange considers them to be incentives to SPAC Promoters and, hence, should not pass into the hands of persons who are not the SPAC Promoter.

Last but not least, a SPAC Promoters lock-up would be imposed during which their holdings (including Promoter Shares and Promoter Warrants) cannot be disposed of and the Promoter Warrants are not exercisable within 12 months from the completion date of the De-SPAC Transaction. The Exchange considers the proposed lock-up periods should help validate the information presented to investors in the listing document regarding the valuation of the De-SPAC Target and the Successor Company.

³ In the Consultation, it is explained that a SPAC Promoter with experience of (i) 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) holding a senior executive position (e.g. Chief Executive or Chief Operating Officer) at an issuer that is or has been a constituent of the Hang Seng Index or an equivalent flagship index will be viewed favourably towards the satisfaction of the Exchange.

⁴ "Promoter Shares" are typically issued at a nominal price exclusively to SPAC Promoters as a financial incentive to establish and manage the SPAC. "Promoter Warrants" are normally purchased by SPAC Promoters to a value that is enough to cover the fees and expenses incurred for the SPAC.

(E) Dilution cap on Promoter Shares and all warrants

In order to reduce the risk of dilution to the SPAC Shares held by the investors, the Exchange is seeking feedback on whether a dilution cap on the maximum dilution possible from the conversion of Promoter Shares or exercise of warrants issued by a SPAC should be imposed. If such a dilution cap is preferred, the Exchange is proposing prohibiting a SPAC from issuing:

- Promoter Shares to SPAC Promoters that represent more than 20% of the total number of the shares the SPAC has in issue as at the date of its listing, and additional Promoter Shares after completion of the De-SPAC Transaction that represent more than 10% of the total number of shares the SPAC has in issue as at the date of its listing subject to the Successor Company meeting set performance targets (i.e. a cap on Promoter Shares at a maximum of 30% of the total number of all shares in issue as at the initial offering date);
- SPAC Warrants or Promoter Warrants that entitle the holder to more than a third of a share upon their exercise;
- warrants, in aggregate (i.e. SPAC Warrants plus Promoter Warrants) that, if exercised, would result in more than 30% of the number of shares in issue at the time such warrants are issued; and
- Promoter Warrants that, if exercised, would result in more than 10% of the number of shares in issue at the time such warrants are issued.

Also, under the proposal, SPACs must not grant any anti-dilution rights to SPAC Promoters when the execution would result in the number of Promoter Shares they hold more than those at the time of the SPAC initial offering.

Furthermore, the Exchange will require full disclosures in the De-SPAC Transaction circular about the dilution in number and value to non-redeeming SPAC shareholders that may occur if the transaction is completed.

De-SPAC Transaction

(A) Full application of New Listing Requirements

- *Deemed new listing*

Since the De-SPAC Transaction will result in the new listing of a business, the Exchange proposing that the De-SPAC Transaction should be considered in the same way as a reverse takeover (“RTO”) (i.e. a “deemed new listing”) to address the risk that SPACs could be used to circumvent the quantitative and qualitative criteria for a new listing.

That means the Successor Company would need to meet all new listing requirements⁵, such as the minimum market capitalisation requirements and financial eligibility tests under Chapter 8 of the Listing Rules, as well as the existing requirements on any forward looking statements in the listing document (e.g. the requirement for reports from reporting accountants and IPO sponsors on profit forecasts).

Also, if the De-SPAC Transaction is considered to be a connected transaction, the Exchange is proposing that the existing connected transaction rules should apply.

- *Open market requirement*

The Successor Company must also meet the existing open market requirement (see the last paragraph of “(A) Investor Suitability” in the “Pre De-SPAC Transaction” section), but the Exchange is proposing that the Successor Company can have at least 100 shareholders rather than the 300 shareholders normally required as it is likely to have a much smaller shareholder base at the time of De-SPAC Transaction given the proposal that SPACs are restricted to Professional Investors only.

- *Size of De-SPAC Target*

To help ensure that De-SPAC Targets are businesses with sufficient substance to justify a listing, the Exchange is proposing the De-SPAC Target must have a fair market value of at least 80% of funds raised by the SPAC from its initial listing (prior to any redemptions). Also, the Exchange is further proposing that the SPAC must use a certain proportion of the net funds it raises (i.e. funds raised from its initial offering plus PIPE investments, less

⁵ WVR structures companies (Chapter 8A), mineral companies (Chapter 18) and pre-revenue biotech companies (Chapter 18A) would be eligible De-SPAC Targets if they meet the relevant new listing requirements. However, investment companies (Chapter 21) would not be an eligible De-SPAC Target under the current proposal.

(A) Full application of New Listing Requirements (Continued)

redemptions) as consideration for a De-SPAC Transaction to avoid a substantial portion of its assets consisting wholly or substantially of cash following the transaction, rendering it a “cash company” unsuitable for listing.

- *IPO sponsor appointment*

Same as an IPO, the Exchange is proposing that a SPAC must appoint at least one IPO sponsor to assist with the application for listing of the Successor Company. The IPO sponsor(s) will be required to perform due diligence with regards to a De-SPAC Transaction which is commensurate with that required for a traditional IPO.

The IPO sponsor(s) must be formally appointed at least two months prior to the date of the listing application. However, for the application for SPAC listing, the Exchange is proposing reducing this requirement to one month as the due diligence required of an IPO sponsor prior to the submission of a listing application will be minimal for an applicant without business operations.

Also, if the De-SPAC Target is taking a "dual-track" approach to listing (i.e. applying for listing via a traditional IPO and considering listing via a SPAC at the same time), the Exchange would take into account the due diligence performed by the IPO sponsor(s) during the whole dual-track process for the purpose of considering whether the minimum engagement period of two months has been satisfied.

(B) Mandatory outside independent PIPE investment

Since the risk of artificial valuations of De-SPAC Targets could be mitigated by the validation of independent third parties, the Exchange is proposing to mandate SPACs to obtain funds from outside independent PIPE investors to complete De-SPAC Transactions.

To provide sufficient comfort that the valuation negotiated between the SPAC Promoter and the owners of the De-SPAC Target is not artificial, the Exchange is proposing that the outside independent PIPE investment should constitute at least 25% of the expected market capitalisation of the Successor Company. A lower percentage of between 15% and 25% would be acceptable in the case of Successor Companies with an expected market capitalisation, at the time of listing, of over HK\$1.5 billion.

Also, the Exchange is proposing that at least one independent PIPE investor in a De-SPAC Transaction be an asset management firm with assets under management of at least HK\$1 billion or a fund with fund size of at least HK\$1 billion. The investment made by this firm or fund must result in it beneficially owning at least 5% of the issued shares of the Successor Company at the date of the Successor Company's listing.

(C) Shareholder vote

From a shareholder protection perspective, the Exchange is proposing that the De-SPAC Transaction, including the terms of any outside investment (e.g. PIPE investment) to complete the De-SPAC Transaction, must be conditional on approval by the SPAC's shareholders at a general meeting.

Also, consistent with the existing requirements for large notifiable transactions, the Exchange would like to impose restrictions on voting by shareholders with a material interest in the De-SPAC Transaction. Hence, the SPAC Promoter(s) and their close associates should abstain from voting at the relevant general meeting on the relevant resolution(s) and the outgoing controlling shareholder(s) of the SPAC and their close associates must not vote in favour of the relevant resolution(s) if the De-SPAC Transaction results in a change of control.

(D) Redemption option

As a safeguard to the interests of SPAC investors, the Exchange is proposing a SPAC must provide its shareholders with the opportunity to elect to redeem all or part of their shareholdings at the price at which they were issued in the SPAC's initial offering, plus accrued interest, under the following circumstances of a shareholder vote on:

- a material change in the SPAC Promoter managing a SPAC or its eligibility and/or suitability;
- a De-SPAC Transaction; and
- a proposal to extend the De-SPAC Announcement Deadline or the De-SPAC Transaction Deadline (see “(E) Completion Deadline” below).

(D) Redemption option (Continued)

In order to help ensure the shareholder vote on the transaction functions as a meaningful check on the reasonableness of its terms of and curb abusive practices (such as over-valuation), as well as to help ensure the interests of non-redeeming shareholders are not prejudiced by votes cast by persons whose interests are not aligned with them, the Exchanges is proposing SPACs should be prohibited from accepting elections for redemption from shareholders that vote in favour of above resolution(s).

(E) Completion deadline

Considering that a deadline that causes a SPAC Promoter to rush to engage in a sub-optimal De-SPAC Transaction would not be in the best interests of SPAC investors while the lifetime of a SPAC should be as short as possible to limit the period within which any issues associated with cash companies (e.g. speculative trading in their shares) can occur, the Exchanges is proposing the following deadlines from the SPAC listing date:

De-SPAC Announcement Deadline – to announce the De-SPAC Transaction within 24 months

De-SPAC Transaction Deadline – to complete the De-SPAC Transaction within 36 months

Also, the Exchange is proposing permitting a SPAC to apply for an extension of either a De-SPAC Announcement Deadline or a De-SPAC Completion Deadline for a maximum period of six months. The extension request should be first approved by its shareholders and the Exchange will retain the discretion to reject it.

If a SPAC is unable to announce a De-SPAC Transaction within 24 months, or complete one within 36 months, the SPAC must liquidate and return all the funds it raised, plus accrued interest, to its shareholders. The Exchange will automatically cancel the listing of a SPAC upon the completion of its liquidation.

If you have any questions about the matters discussed in this publication, please feel free to contact the following capital markets partners and directors.

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