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What to Expect as the HKEx Rolls Out Its New SPAC Listing Regime

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This month the Hong Kong Stock Exchange (HKEx) brought into effect its eagerly awaited listing rules for special purpose acquisition companies (SPACs)[1]. They adopt a well-thought-out approach, which balances making available this innovative new route to listing in Hong Kong along with key investor protections. The rules are specifically designed to promote the development of a high-quality SPAC market to meet the needs of corporates and investors.

In this alert, we examine the new SPAC listing rules and the key principles that shape them.

How the HKEx Thinks About Cash Shells and SPACs

Over many years, speculative trading in the securities of cash shell companies, and the often low-quality acquisitions they made, led the HKEx to tighten its rules and practices to prevent the creation and continued listing of cash shell companies. This involved clamping down on listed companies with insufficient business operations, halting backdoor listings and ensuring that listing suitability reviews stopped the creation of cash shells via initial public offerings (IPOs).

However, with SPAC activity booming in the U.S. markets, particularly in the last couple of years, the HKEx expedited its consultation on and implementation of the new SPAC listing rules to meet the widely expected market demand for listed SPACs in Hong Kong.

The HKEx's long-held concerns over listed cash shell companies drove its adoption of this particular SPAC listing regime, which is more stringent when compared to other key markets such as the New York Stock Exchange (NYSE), the National Association of Securities Dealers Automated Quotations (NASDAQ), the London Stock Exchange (LSE) and the Singapore Exchange (SGX).

The New SPAC Listing Rules – These Key Principles Drive How They Will Work in Practice

Hong Kong-listed SPACs are best understood by recognizing the key principles that shape the new SPAC listing regime.

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Avoiding Market Speculation, Undue Volatility and Market Abuse

Only professional investors[2] (whether individual or institutional) are permitted to subscribe for or trade in SPAC securities (with a minimum of 75 investors, of which at least 20 must be institutional investors holding 75 percent or more of the issued securities upon issue), and the SPAC needs to satisfy the HKEx rule that offering arrangements maintain that restriction and preclude public participation. The professional nature of SPAC investors, alongside the usual HKEx open-market requirements, are seen as bulwarks against speculation, high volatility and market abuse issues such as ramping the market and insider dealing.

Speculation in SPAC warrants has been seen as a cause of SPAC share price volatility when those two securities are stapled together—hence, the HKEx requires the shares and warrants of a SPAC to be separately traded from the date of initial listing. This is a structural safeguard designed to reduce pure equity volatility, alongside auto-matching of trade orders with VCM[3], to promote more efficient price discovery and therefore further mitigate market fluctuations.

Quality of Promoters and Management – Governance and Oversight

Each SPAC must raise at least HK$1 billion (about US$128 million) in its initial offering and is required to have at least one promoter[4] holding a Type 6 (Corporate Finance) or Type 9 (Asset Management) Securities and Futures Commission (SFC) license (or the overseas equivalent, as determined by the HKEx). The SPAC board must include at least two Type 6 or Type 9 licensed individuals, at least one of whom represents the licensed SPAC promoter.

Any material changes to the promoter or the directors require approval by the HKEx and also by a special resolution of the SPAC shareholders (with the promoter abstaining)—absent which resolution within one month of the material change concerned, the SPAC is obliged to return the capital raised and delist.

All SPACs are subject to a 24-month post-listing deadline for announcing a compliant De-SPAC transaction[5] and a 36-month post-listing deadline for completing such a deal—subject in each case to any six-month extension that may be approved by an ordinary resolution of the SPAC shareholders.

All of these measures seek to ensure a properly funded, high standard of SPAC governance and management oversight, with the additional safeguard of the investors being able to reclaim their investment if the promoter or the board that they originally bought into changes materially or the SPAC does not fulfill its role in timely seeking a suitable De-SPAC target.

Maintaining the Quality of Listed Businesses on the HKEx

To be an eligible De-SPAC target, the business in question must be large enough (fair market value (FMV) of >80 percent of SPAC initial funds raised), be able to meet all the usual HKEx listing eligibility requirements (including minimum market capitalization, financial metrics and management continuity and ownership) and appoint an IPO sponsor in the usual way.

As part of the De-SPAC transaction, the SPAC must raise new equity funds (by way of a private investment in public equity (PIPE)) from professional investors (with at least 50 percent coming from three or more "sophisticated" investors[6]) of a minimum percentage amount referenced on a sliding-scale basis to the value of the De-SPAC target agreed by the SPAC's board—from 25 percent for smaller target deal sizes, down to 7.5 percent for the largest value De-SPAC deals.

These requirements will deliver both HKEx and independent equity market quality assurance for businesses coming to market by way of a De-SPAC transaction.

Ensuring Alignment of Interests as Between SPAC Investors and Their Promoters

The promoter holds a position of unique influence in the context of a SPAC, with the potential ability to heavily influence management in matters such as dilutive equity and equity-linked issuances and the selection and valuation of any De-SPAC target. These concerns are addressed by several SPAC listing rules.

As to dilution, promoter shares are capped at 20 percent of the upon-listing share count of the SPAC (with the potential for additional promoter earn-out equity if the HKEx specifically approves the same), and all types of warrants are capped at 50 percent of the share count at the time of issue of the warrants. There are certain prescribed parameters for the terms of SPAC warrants and, in addition, promoter warrants cannot include terms that are more favorable than other warrants issued by the SPAC. Importantly, promoter shares and promoter warrants must remain unlisted and in the ownership of the promoter for the lifetime of those securities so that the promoter remains invested in the SPAC and its objective of concluding a successful De-SPAC transaction.

Any proposed De-SPAC transaction and the related PIPE investment must be approved by the SPAC shareholders by way of an ordinary resolution (with the promoter abstaining)—and additional safeguards apply to proposed De-SPAC transactions that are connected (per the connected transaction listing rules) to the promoter or a director. Regardless of how a SPAC shareholder voted on the De-SPAC transaction, each such holder has a right to redeem its equity at the original subscription cost. In contrast, the promoter's interest in the successor company is locked up for 12 months following completion of the De-SPAC transaction.

The Outlook for the Hong Kong SPAC Market

Given the historical concerns over cash shells, and taking into account the size and quality thresholds for HKEx-listed issuers, these new SPAC listing rules strike a sensible balance between establishing an active SPAC market in Hong Kong and maintaining the HKEx's hard-earned reputation for maintaining regulatory standards and market quality.

Corporates and investors will welcome the broad scope of opportunity that the new regime represents. In particular, De-SPAC transactions will provide an alternative route to market for eligible companies from the region and beyond, and an alternative exit option for investors' portfolio companies, in addition to a merger and acquisition (M&A) deal or a traditional IPO.

[1] See Chapter 18B of the HKEx Listing Rules. A SPAC is a listed company that has no operating business and is established for the sole purpose of conducting a De-SPAC Transaction with a target company within a predefined time period, so as to achieve the listing of the target company.

[2] A professional investor is an institutional or an individual professional investor as defined under the Securities and Futures Ordinance, including (i) a corporation or partnership with a portfolio of >HK$8 million or total assets of >HK$40 million and (ii) an individual with a portfolio of >HK$8 million.

[3] Volatility Control Mechanism, an exchange mechanism designed to mitigate extreme price volatility.

[4] Defined as a person who establishes a SPAC and/or beneficially owns promoter shares issued by a SPAC.

[5] Defined as an acquisition of, or a business combination with, a target company by a SPAC that results in a listing of the successor company.

[6] Defined as a fund or its investment manager with assets under management (AUM) of at least HK$8 billion.

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