

How Global Markets Are Preparing For Potential SPAC Growth

By **Mark Geday, Edwin Luk and Jeffrey Letalien** (June 17, 2021, 4:52 PM EDT)

With a rising number of special purpose acquisition companies currently in the process of looking for acquisition targets, SPACs remain an area of acute interest to investors, M&A targets and regulators.

Throughout 2020, SPACs emerged as the preferred route for taking a company public in the U.S.

As the number of suitable domestic targets for U.S. SPACs diminishes, the turn to overseas markets for potential targets may continue.

In addition, as governments from the U.K. to Singapore and Hong Kong have taken heed, they are positioning themselves to ensure that homegrown talents in particular are not tempted by favorable regulatory regimes in the U.S.

We take a look at current trends and considerations in the U.S. in addition to what governments in Asia and Europe are doing to try to rebalance the international SPAC market.

The U.S. Market

Going public through a SPAC, as opposed to a traditional initial public offering, has offered hundreds of private companies a key benefit of relative speed in going public.

An average business combination is completed from three to four months after execution of a definitive agreement, compared with a typical six-month traditional IPO process.

As the size of SPAC IPOs and valuation of SPAC business combinations have increased, SPACs have become increasingly popular, with record numbers of transactions in 2020. The volume continued unabated during most of the first quarter of 2021.

The pace of business combinations has also accelerated, with many SPACs entering into agreements



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with target businesses within a few months after the IPO.

SPACs traditionally have had a duration of 18 to 24 months — with a provision for an automatic extension if the SPAC entered into a letter of intent or an agreement with a potential target business by the initial expiration date and a provision that warrants become exercisable upon the later of the first anniversary of the IPO or 30 days after the business combination.

But both the extension provision and the one-year minimum period before the warrants may be exercisable have become less common in recent IPOs, reflecting the faster pace.

Meanwhile, the high number of SPACs that had completed their IPOs and were seeking targets for a business combination created a seller's market.

Beginning in March, the market for new SPAC IPOs and the private investment in public equity market for financing business combinations cooled slightly, likely a result of saturation.

In addition, the time period for marketing PIPE transactions became longer, including, in many cases, because of the difficulty of scheduling investor meetings resulting from the large number of SPACs seeking to raise capital at the same time.

Nevertheless, for target businesses considering a business combination with a SPAC, the delays resulting from competition in the PIPE market may be worth the wait as the terms that sellers can command are quite favorable.

In a seller's market, a target business can consider offers from multiple SPAC bidders. Many SPAC sponsors are forfeiting a portion of their founder shares and/or warrants as part of the negotiated terms of the business combination.

A SPAC that has filed its first annual report on Form 10-K is required to include three years of audited financial statements of the target in its proxy statement filed with the U.S. Securities and Exchange Commission for the business combination, while a target that qualifies as an emerging growth company is only required to provide two years of audited financial statements if the SPAC has not yet filed its 10-K.

As a result, a business combination with a more newly formed SPAC may be more attractive to the target. A non-U.S. target business may also seek a business combination structure that retains its status as a foreign private issuer subject to reduced disclosure and reporting requirements or a structure that is favourable to its shareholders from a tax perspective.

The change in U.S. presidential administration and in SEC leadership has cast some doubt on the continued popularity of SPACs in the U.S., particularly following a series of SEC staff statements in early April.

Most notably, the SEC staff issued an interpretation that would result in the accounting for most SPAC warrants as liabilities and indicated that the safe harbor for forward-looking statements applicable in non-IPO transactions may not be available for statements in the business combination proxy materials, which may add risk to the widespread use of financial projections.

Although the time, effort and expense required by existing SPACs to evaluate the accounting treatment

of their warrants, in most cases resulting in restatements of financial statements, has led to delays in SPAC IPOs and business combinations, it appears likely that such developments are speed bumps rather than roadblocks, and that the SPAC market will remain active, even if the SEC review process is slowed by the backlog of filings and the continued high volume of transactions.

U.K. and Europe

Historically, there have been relatively few SPACs or other forms of cash shell listed on the U.K. markets, with most of those raising relatively small amounts — less than £10 million (approximately \$13.9 million).

The presumption that trading in a SPAC's shares would be suspended upon announcement of a potential de-SPAC transaction has been seen as one of the key obstacles to listing SPACs in the U.K., as it removes the ability for SPAC investors to exit their investment if they are unenthusiastic about the proposed target.

The extremely active SPAC market in the U.S. has led to a reevaluation of listing regimes in relation to SPACs, not just in the U.K., but in a number of other key financial centers around the world.

In April, the U.K. Financial Conduct Authority opened its consultation on proposed changes to the U.K. listing rules for certain SPACs.

The consultation launch followed the publication during the previous month of the results of the U.K. government's U.K. Listing Review, which recommended changes to the listing regime to increase the attractiveness of U.K. listings for SPACs, while developing market and investor safeguards.

In particular, the FCA's consultation considers the proposed removal — for SPACs meeting certain criteria including criteria linked to the size and duration of the SPAC — of the existing presumption of suspension for a SPAC's listed shares when it announces a potential acquisition.

The goal is to increase investment opportunities by removing disproportionate barriers to listing for larger SPACs that have high levels of structural investor protections.

The FCA believes that this will provide a more flexible regime and align more closely with other international markets. While the proposed changes would mean that investors in qualifying SPACs should be able to continue trading their shares after announcement of a proposed acquisition, the presumption of suspension would continue to apply to any SPACs not meeting the qualifying criteria.

Whether the proposed changes to the U.K. regime will lead to a surge in the listing of SPACs in the United Kingdom, or whether, as the FCA itself states, SPACs are "likely to remain a modest feature of U.K. markets," remains to be seen.

On continental Europe, Frankfurt has specific rules for SPACs that closely follow the U.S. rules. While Amsterdam does not have specific SPAC rules, listings are possible and, in part due to the flexibility of local laws, there have been a number of recent SPAC listings on the Amsterdam exchange. It is likely that the London, Frankfurt and Amsterdam exchanges will continue to compete for SPAC listings.

Asia

Given the strong demand across Asia for the Asian-sponsored SPACs that have listed in other exchanges so far, as well as the growing familiarity that the local and regional investor base have with some recent SPACs, there is now an increasing willingness to improve the attractiveness for SPAC listings within Asia.

Securities regulators and exchanges in Hong Kong and Singapore are both in the process of considering the introduction of a SPAC regime, which are currently not allowed in these markets.

In Hong Kong, the Securities and Futures Commission and the Hong Kong Exchanges and Clearing had been directed by the city's financial secretary in March to explore a suitable listing regime for SPACs.

It is an established rule for traditional IPOs in Hong Kong that an issuer must carry out a business with sufficient level of operations and have assets of sufficient value to support its operations.

In recent years, the Hong Kong regulators also tightened rules to prevent backdoor listings and the use of shell companies to improve corporate governance.

At this stage, it remains to be seen how the Hong Kong regulators will strike the balance on safeguarding the interest of investors and capture the opportunities available in the heated SPAC market.

However, it is expected that a public consultation exercise will take place prior to any new listing regime for SPACs is introduced and the regulators will not deviate from such practice to rush through any changes, particularly given that today Hong Kong continues to remain strongly as one of the largest destinations for IPOs in the world.

In Singapore, the Singapore Exchange Ltd. closed its public consultation exercise for SPACs in April.

Driven by the concerns and risks associated with SPAC listings, the consultation focused on reducing some of the risks of excessive dilution for long-term investors, as well as the rush for sponsors to de-SPAC.

One of the most important proposals in this regard is the future exercisability of warrants after the de-SPAC transaction. The Singapore Exchange proposed that either any warrant issued with ordinary shares of the SPAC at IPO must be nondetachable from the underlying ordinary shares for trading; or there must be a cap on the resultant dilutive impact to shareholders post-business combination arising specifically from the conversion of issued warrants.

The exchange acknowledged that nondetachable warrant is not in line with market norms and may diminish the traditional upside advantage to SPAC investors. This proposal, if adopted, is likely to have a significant impact on the attractiveness as a destination for SPAC listings.

In addition, the Singapore Exchange proposed to mandate that only independent shareholders who vote against the business combination will be afforded with redemption right. This is aimed to address concerns on high redemption rates observed in the U.S.

Other safeguards proposed by the Singapore Exchange that are not required with U.S. SPACs include requiring the founding shareholders, the management team and their associates to meet a minimum equity participation at IPO and observe an extended moratorium period for at least six months from the

completion date of a de-SPAC transaction.

At this stage, the market still awaits the conclusion of the Singapore Exchange consultation exercise. It cannot be ruled out that further safeguards may be introduced by the exchange as it aims to put in place a SPAC framework that would be suitable for the local market.

Conclusion

It is clear that the global movement for SPACs has been dominated by the U.S. and appears far from slowing down. As discussed, the change in U.S. presidential administration and in SEC leadership has cast some doubt on the continued popularity of SPACs in the U.S.

However, this and other developments seem unlikely to derail the SPAC market, which we expect to remain active.

As the appetite for international listings grow and we look to Europe and Asia, we wait to see how these regulatory shifts sway potential listings in the coming months. The U.K.'s FCA believes SPACs are "likely to remain a modest feature of U.K. markets," so whether the proposed changes to listing rules open the floodgates is yet uncertain.

In Asia there has been a strong demand for the Asian-sponsored SPACs that have listed in other exchanges so far.

However, there has been a strong emphasis from regulators in Hong Kong and Singapore to safeguarding the interests of investors while also capturing the opportunities available in the heated SPAC market.

Which way the scales will tip in this regard remains a matter of interest.

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