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Insights

FCA'S NEW RULES FOR SPACS

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SUMMARY

In response to Lord Hill's review of the UK Listing Regime, the FCA consulted earlier this year on changes to the Listing Rules for special purpose acquisition companies (SPACs). The proposed changes remove the presumption of suspension of trading in a SPAC's shares upon the announcement of a potential business combination (a so-called "de-SPAC transaction") until publication of a prospectus by the enlarged group. This was a unique feature of the UK Listing Rules and one of the main reasons SPACs have chosen to list on other European exchanges to date rather than in London.

Following its consultation, the FCA has now published new rules and guidance which will come into force on 10 August 2021. The FCA believes these new rules provide greater flexibility to larger SPACs, provided they embed certain features that promote investor protection and the smooth operation of our markets. In providing this alternative approach for SPACs, it is clear that the FCA is seeking to attract more SPAC listings to London.

Changes to the Listing Rules – background

Under the current UK Listing Rules, there is a general presumption that an acquisition by a shell company, including a SPAC, will be considered a reverse takeover under the Listing Rules. This classification triggers the suspension of trading in the SPAC's shares upon announcement of such acquisition until a prospectus is published by the enlarged group following which the SPAC's shares are cancelled and a new listing application is made by the combined entity.

This presumption of suspension, often seen as a key deterrent for potential investors in UK SPACs, exists in order to protect investors from a disorderly market existing in the shares of the listed company as a result of insufficient publicly available information at the time of the announcement of a proposed acquisition, which could impair the process for proper price formation. The FCA has sought to address this by requiring certain detailed information to be provided by a SPAC to the market about a proposed business combination in order to avoid suspension.

New Rules for SPACs

Subject to a few instances which are highlighted below, the FCA is implementing its original proposals largely unchanged. The FCA will therefore dis-apply the presumption of suspension if a SPAC is structured with the following features:

- **Minimise raise** - A minimum size threshold of £100m raised from third party investors when a SPAC's shares are initially listed. This excludes any funds the sponsors have provided, whether by way of a warrant or sponsor share subscription or through a cornerstone investment in the deal. This is lower than the £200m initially proposed by the FCA and is in response to feedback that £100m better reflects the size of SPACs we are likely to see in UK/European markets and the likely size of prospective target companies. As £100m would still require a SPAC to attract institutional investors to raise this level of funds, it was thought that this will still achieve the FCA's intention of ensuring scrutiny by institutional investors of the terms of a SPAC, the credibility of its management and other governance aspects.
- **Ring-fenced IPO proceeds** - Monies raised are ring-fenced via an independent third party to either fund a business combination, or be returned to shareholders (in the event of investors redeeming shares or if a SPAC is wound-up), less any amounts specifically agreed to be used for a SPAC's running costs. This is already a fairly standard feature in most SPACs and is intended to protect investors from misappropriation or excessive running costs being incurred by the SPAC's management – trust and escrow account arrangements being the most commonly used methods to date. The FCA deliberately avoided specifying how ring-fenced funds must be held in order to provide a degree of flexibility for issuers in light of trust law varying from jurisdiction to jurisdiction.
- **Time limit for completing business combination** - Setting a time limit, in the SPAC's constitution, to find a target and complete the business combination within two years of listing, with the option to extend this to three years with shareholder approval. There is also the option to extend the initial two year period or the extended three year period for up to six months, without shareholder approval, in limited circumstances including where the SPAC is in the process of seeking shareholder approval for a business combination (e.g. a general meeting has been convened) or has already obtained shareholder approval but further time for closing to take place. In any event, any 6 month extension must be notified to the market before the end of the initial two year period or three year period if extended with shareholder approval.
- **Board approval** - Board approval of any proposed business combination, excluding from the Board discussion and vote any Board member that is, or has an associate that is, a director of the target or its subsidiaries, or has a conflict of interest (e.g. directors that may have loaned the target money, hold an equity stake in the target or have other direct links with the target).

This exclusion would not apply to a director who has a general financial interest in the SPAC, including where they hold ‘sponsor’ shares.

- **Fair and reasonable statement** - The Board publishes a ‘fair and reasonable’ statement if any of the SPAC’s directors have a conflict of interest in relation to the target or any of its subsidiaries, which reflects advice from an appropriately qualified and independent adviser. This departs from the approach in other major jurisdictions, although “fair and reasonable” statements are often used as a tool by SPACs at their discretion in other markets. The FCA explained that it felt this was a necessary investor protection to keep but did make clear it does not extend beyond those cases where a director has a conflict of interest in relation to the target or its subsidiaries.

- **Shareholder approval** - Shareholder approval with a majority vote in favour is a prerequisite for any proposed business combination, with SPAC founders, sponsors and directors prevented from voting. Whilst the exclusion of SPAC founders, sponsors and directors from the shareholder vote differs to the approach in some other jurisdictions, the FCA felt this should be retained to incentivise SPAC sponsors to ensure a deal is likely to be acceptable to shareholders. Should shareholders reject a deal, a SPAC can seek another deal or improve the terms of an existing deal rather than relying solely on the redemption option, at which stage a deal is committed to and the only outcome for investors is to proceed or exit.

- **Redemption option for shareholders** - Provides a ‘redemption’ option allowing investors to exit their shareholding before any business combination is completed. The redemption option should specify a pre-determined price at which shares will be redeemed, which could be a fixed amount or a fixed pro rata share of the cash proceeds ring-fenced for investors, less pre-agreed amounts the SPAC retains for running costs. This seeks to address some of the market risks involving SPAC listings including the risk that the breadth and vagueness of some SPAC’s investment strategies at IPO can lead to risk of changes at a later date or selection of high-risk targets. This redemption and exit option, combined with ring-fencing proceeds and a limited operating period, are generally considered the principal investor protection mechanisms in SPAC IPOs.

- **Disclosure** - Investors being given sufficient disclosures on key terms and risks from the SPAC IPO through to the announcement and completion of any business combination. Clearly, the starting position is compliance with existing disclosure requirements in the Prospectus Regulation Rules and the Market Abuse Regulation (MAR), with additional clarity and more specific disclosure being provided once a target has been identified and a business combination announced.

FCA Supervisory Approach for SPACs

In response to feedback that prospective SPAC issuers and investors want more comfort at the point of listing that the presumption of suspension will be dis-applied on announcement of a de-SPAC transaction, the FCA has confirmed that it will modify its supervisory approach to provide this comfort at the time of IPO rather than only at the time of an announcement of a business combination. However, at the same time such comfort will not endure if circumstances/arrangements have changed or have not been adequately described. At the point of announcement, the FCA would not expect to revisit their previous assessment provided the SPAC issuer confirms the conditions are met.

Where the FCA has given comfort prior to admission, a SPAC should still contact the FCA:

- Before announcing a business combination which has been agreed in order for the SPAC to re-confirm (via written board confirmation) that it meets the conditions and to discuss its proposed announcement.
- If there has been a leak, to inform the FCA and request a suspension. The FCA clarified, however, that it would not expect to reconsider its previous assessment of whether the SPAC meets the above prescribed conditions or take action to suspend at such stage if the SPAC has acted in compliance with MAR and provides a written confirmation to the FCA from the board that it still meets the conditions. Suspension of trading in shares may still be necessary, but the FCA would consider this under its general suspension powers as it would for other listed commercial companies.

Other SPAC Features

The FCA recognised that the regulatory and market landscape for SPACs continues to evolve and therefore the FCA will keep these measures under review. Interestingly, it did note that its proposals could be considered as a basis for a specific listing “segment” for SPACs at a later stage and become entry criteria for all SPACs seeking access to the Official List.

In terms of some other features of SPACs addressed by the FCA in its policy statement, it confirmed that it was not its intention that the package of changes consulted on should bring a SPAC within the scope of the UK Alternative Investment Fund Managers (AIFM) regime. In response to whether ring-fenced funds can be invested in low risk liquid investments, which is not uncommon on some US SPACs, the FCA noted that its changes were intended to protect the cash raised and not to invest it. The FCA believes this will provide sufficient flexibility to allow SPACs to structure their arrangements in a way that means they do not come within the scope of the UK AIFM regime. In any event, the FCA made clear that whether or not a SPAC is an alternative investment fund is a matter for each SPAC to consider on an individual basis.

Moreover, in response to how the US SPAC structure will be treated under the Listing Rules, including what listing category is appropriate and how the underlying shares are treated if placed in treasury such that there is no public free float during an initial period, the FCA noted that it is giving this further consideration so watch this space. By way of background, in the US, a common model is for the SPAC issuer to initially list and offer a "unit", representing the right to receive an ordinary share, which may be issued at the same time but held in treasury by the issuer, and a fraction of a warrant. Following a pre-defined stabilisation period, the units are automatically exchanged for shares and warrants.

Summary

Whilst the FCA has sought to open the door to more SPAC listings in London in light of the recent (albeit less frenzied) trend of SPACs crossing the pond and finding homes on European exchanges, the FCA has, for the most part, held its ground and sought to strike a balance between, on the one hand, increased flexibility for larger sized SPACs and, on the other hand, maintaining what it considers to be sufficient protections for investors. It will be interesting to see how the SPAC market develops in London in the coming period in light of the above.

FCA Policy Paper (contains revised Technical Note)

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