

Legal Commentary

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SPACs March into Hong Kong – Interpreting a New Journey for SPACs from the Perspective of PRC Company Cross-border Finance (III)

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On September 17, 2021, the Stock Exchange of Hong Kong Limited (“**HKEX**”) published a consultation paper (the “**Consultation Paper**”) to publicly seek market opinions on draft amendments to the Rules Governing the Listing of Securities on the Exchange (the “**Listing Rules**”). The amendments aim to promote and implement a listing regime for special purpose acquisition companies (“**SPACs**”) in Hong Kong. The consultation period is 45 days, ending on October 31, 2021.

The Consultation Paper, consisting of five chapters, specifies the background for introducing SPACs in Hong Kong, the basic mechanisms for SPACs, and the main benefits and potential risks that SPACs present to the market and to investors. It further introduces various regulatory and safeguard measures HKEX has proposed to limit relevant investment risks.

Notably, the Consultation Paper sets out a comprehensive comparison of the SPAC listing rules among other jurisdictions, specifically the United States, United Kingdom, and Singapore. The comparison facilitates the understanding of HKEX’s rationale behind its proposed SPAC listing regime (namely, to expand the market), and how HKEX plans to provide comprehensive protections to investors. For each specific issue, the Consultation Paper solicits opinions on the proposed listing regime followed by raising questions and collecting feedback. Schedule D of the Consultation Paper lists HKEX’s proposed amendments to the Listing Rules for SPAC listings.

In order to help our clients and friends quickly grasp the key issues discussed in HKEX’s SPAC Consultation Paper, we have summarized the key issues of the Consultation Paper regarding Hong Kong SPAC listings in the following table:

Subject	HKEX's Key Proposals	Han Kun Remarks
Prior to De-SPAC Transaction		
Investor suitability	<ul style="list-style-type: none"> ■ The subscription and trading of SPAC shares and SPAC warrants will be restricted to Professional Investors¹ only; ■ SPAC shares and SPAC warrants must be distributed to at least 75 Professional Investors, of which 30 must be Institutional Professional Investors; ■ According to the definition of “Professional Investors”, in principle, SPAC securities can only be purchased by (1) an individual having a portfolio of no less than HK\$8 million, (2) a trust corporation with total assets of no less than HK\$40 million; or (3) a corporation or partnership which has a portfolio of no less than HK\$8 million or total assets of no less than HK\$40 million; ■ The shares of the listed company after the completion of a De-SPAC Transaction² (the “Successor Company”) are not subject to the same restrictions, i.e., they are allowed to be traded by other investors. 	<p>As opposed to the flexible system in place for investors in the United States, the United Kingdom, and Singapore, the Consultation Paper would restrict Hong Kong SPAC investors to “Professional Investors” as set out in the Hong Kong Securities and Futures Ordinance, which follows the long-standing threshold of Hong Kong markets and excludes retail investors. This limitation must be thoroughly assessed from a long-term and system-building perspective. Risk control for SPACs is a prevalent concern for capital markets in all major jurisdictions. To an extent, we understand the rationale behind HKEX’s proposed adoption of this restriction. However, whether to establish a more flexible conversion or transition mechanism that guides the active foundation of the Hong Kong SPAC market as much as possible is a system-related discussion that calls for comprehensive research and judgment.</p>
Trading arrangement	<ul style="list-style-type: none"> ■ SPAC shares and SPAC warrants will be traded separately after the initial offering; ■ Measures will be implemented to mitigate the risks associated with the volatility of trading SPAC warrants (including automatically putting the Volatility Control Mechanism (VCM) in effect when trading SPAC warrants and only allowing manual trading of SPAC warrants). 	<p>The practice of allowing SPAC shares and SPAC warrants to be traded separately is common in major active capital markets. However, this practice does, to an extent, create a risk of price volatility in SPAC securities, especially in SPAC warrants. We believe that it is necessary to provide different types of SPAC securities with the flexibility to trade separately. The safeguard measures proposed in the Consultation Paper are expected to</p>

¹ Defined hereunder.

² A business combination between a SPAC and a De-SPAC target that results in the listing of a Successor Company.

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Dilution cap	<ul style="list-style-type: none"> ■ The number of Promoter shares must be no more than 30% of the total number of outstanding shares on the initial offering date; ■ Likewise, the shareholding ratio after the exercise of warrants must be no more than 30% of the total number of outstanding shares. 	<p>effectively reduce volatility risk.</p> <p>The policy adopted in the Consultation Paper shows an inclination toward the logic behind Singapore's SPAC regime. The overall balance between the interests of SPAC Promoters³ and the original shareholders of the De-SPAC target company is a delicate issue. SPAC Promoters are motivated by the value of their reward, which is, logically, the market basis underpinning the existence of SPACs. However, with regard to how to balance these interests, we suggest exploring the guiding role of institutional regulations for a certain period of time, and then to let the market form demonstrative rules through commercial practice.</p>
Eligibility restrictions for SPAC promoters	<ul style="list-style-type: none"> ■ SPAC Promoters must meet suitability and eligibility requirements; ■ At least one SPAC Promoter must be a SFC Type 6 or 9 licensed company and hold at least 10% of the Promoter shares; ■ Any material change in SPAC Promoters requires approval by a special resolution of shareholders (excluding the SPAC Promoters and their close associates). Shareholders who vote against such material change must be entitled to redemption rights. 	<p>Looking back at SPAC projects with PRC backgrounds over the past few years, the development of SPACs has not been a smooth journey. One of the practical issues is the lack of enthusiasm of leading professional service institutions, such as accounting firms, to participate in SPAC projects. Their concern is risk control, which reflects complex market attitudes toward SPACs.</p> <p>We agree that a threshold for the eligibility of SPAC Promoters should be set. This should have a positive effect in building a solid foundation for the development of the Hong Kong SPAC market.</p> <p>In addition, serious attention should be paid to PRC regulatory issues triggered by the participation of PRC-funded institutions as SPAC Promoters.</p>
Fund raising size	<ul style="list-style-type: none"> ■ The expected funds to be raised from the initial offering must be at least HK\$1 billion. 	<p>This fund-raising size requirement is largely in line with the requirements of the United Kingdom and Singapore, and is higher</p>

³ A professional manager, usually with private equity, corporate finance and/or industry experience, who establish and manage a SPAC. Also known as a "SPAC sponsor" in the US.

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		than the threshold for SPAC listings in the United States. Considering the enthusiasm of the capital markets in Greater China, this fund-raising size is consistent with our expectations and is relatively reasonable.
Issue price	<ul style="list-style-type: none"> ■ The subscription price for each SPAC share unit must be no less than HK\$ 10. 	Setting a threshold for the subscription price is conducive to further prevent and control the risk of price fluctuations. This is also in line with the practices of other capital markets such as those of the United States and Singapore.
SPAC board of directors	<ul style="list-style-type: none"> ■ The majority of directors on the board of a SPAC must be officers of the SPAC Promoter. SPAC Promoters have fiduciary duties to SPAC shareholders and the SPAC itself. 	We support a clarification of the fiduciary duties and responsibilities of SPAC Promoters. We also support the requirement of majority directors being officers of the SPAC Promoters, which is consistent with mainstream capital market practice and is conducive to the order, stability and risk control of the SPAC transaction market.
Use of proceeds	<ul style="list-style-type: none"> ■ All proceeds raised in a SPAC's initial offering must be deposited in a trust account and can only be released under the following circumstances: (1) the completion of a De-SPAC Transaction; (2) the qualified share redemption; or (3) the return of funds to SPAC shareholders. 	The security of funds raised in a SPAC IPO is of vital importance. Certainly, we understand that opinions from more perspectives are needed to decide whether it is necessary to deposit 100% of the proceeds raised into the trust account, so as to improve market enthusiasm and efficiency while ensuring security.
De-SPAC Transaction		
Application of new listing requirements	<ul style="list-style-type: none"> ■ A Successor Company must meet all new listing requirements (including engaging an IPO sponsor to conduct due diligence, satisfying minimum market capitalization requirements and financial eligibility tests). 	This requirement in the Consultation Paper appears similar to the SPAC requirements of other jurisdictions. However, from the perspective of protecting efficient market development, setting a relatively stringent threshold for De-SPAC Transactions would definitely impose certain impacts on transaction efficiency, which may become a key factor in deciding whether the Hong Kong SPAC market can develop rapidly and healthily.

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<p>Investment ratio of independent third parties</p>	<p>Third-party PIPE investment (private placement) is mandatory to verify the valuation of the Successor Company, specifically:</p> <ul style="list-style-type: none"> ■ independent third party investments must constitute at least 25% of the expected market capitalization of the Successor Company (or at least 15%, if the Successor Company's expected market capitalization is over HK\$1.5 billion); and ■ at least one asset management firm or fund with the size of over HK\$1 billion must beneficially own at least 5% of the issued shares of the Successor Company as at the date of listing. 	<p>We fully understand the value judgment for the importance of independent third-party investment in the Consultation Paper. However, in the institutional framework system for the healthy development of the capital markets, it remains to be seen whether "independence" is sufficient to effectively offset and manage transaction risks in the context of De-SPAC Transactions. We still need to consider the market reactions brought about by institutional interventions.</p>
<p>Vote of shareholders' meetings</p>	<ul style="list-style-type: none"> ■ De-SPAC Transactions must be approved by the shareholders' meeting, and SPAC Promoters and their close associates and other shareholders with a material interest must abstain from voting; ■ If the De-SPAC Transaction results in a change of control, any original controlling shareholders of the SPAC and their close associates must not vote in favor of the De-SPAC Transaction; ■ SPAC shareholders will only be able to redeem SPAC shares where they voted against the De-SPAC Transaction. 	<p>The potential affiliated transactions that may be involved in De-SPAC Transactions are technical points that are prone to bring systemic problems in the SPAC regimes of different jurisdictions. We understand that the keys to resolving this issue are formulating predictable and transparent information disclosure standards, constant market integrity supervision rules, and necessary disciplinary mechanisms.</p>
<p>Share redemptions</p>	<p>A SPAC must provide a redemption option for shareholders before the occurrence of the following circumstances:</p> <ul style="list-style-type: none"> ■ A De-SPAC Transaction; ■ A change in the SPAC Promoters, or ■ The reaching and announcement of De-SPAC Transaction terms or the completion of the extending of De-SPAC 	<p>Unlike the U.S. rules, the Consultation Paper does not provide for any restrictions for SPAC shareholders with respect to the number, proportion, price, and other aspects of the shares to be redeemed. This mechanism reasonably balances regulatory protections more favorably for investors, which in effect increases transaction risks and restrictions for SPAC Promoters.</p>

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	Transaction deadline.	
Forward-looking information	<ul style="list-style-type: none"> ■ The existing requirements for any forward-looking statements in the Listing Rules must apply to De-SPAC Transaction listing documents to the same standard as that required for a normal IPO, including the requirement for reports from the reporting accountant and IPO Sponsor on such forward-looking statements. 	<p>Considering the characteristics of SPACs, a primary focus of investors is the forward-looking statements in the listing documents, especially statements on future financial expectations. In the U.S. SPAC rules, whether to grant a “safe harbor” exemption for the accuracy of SPAC forward-looking statements has continuously been under discussion. The Consultation Paper specifies that HKEX will not lower the responsibility requirements for the accuracy of forward-looking statements in SPAC listing documents, which is also in line with the recent general trend of countries strengthening the supervision of SPAC transactions.</p>
Open market in successor company shares	<ul style="list-style-type: none"> ■ The shares of a Successor Company must be held by at least 100 shareholders. 	<p>Compared with the requirement that normally at least 300 shareholders are required for listed companies to ensure liquidity, we understand that HKEX would lower the requirement for the number of shareholders in order to reduce the stock price fluctuation of SPAC companies. Considering the particularity of SPAC companies, we believe this proposal is reasonable.</p>
Post De-SPAC Transaction		
Lock-up period	<ul style="list-style-type: none"> ■ SPAC Promoters must not transfer or dispose of their shares in the Successor Company in the 12 months after the completion of the De-SPAC Transaction; ■ The lock-up period requirements for controlling shareholders in a normal listing company apply to that in a De-SPAC Transaction (a controlling shareholder cannot sell its shares in the first 6 months upon listing, and cannot dispose of its shares in a way that would result in it ceasing to be a controlling shareholder within 7 to 12 months upon listing); 	<p>Compared with the major capital market systems in Asia, the lock-up period requirements of Hong Kong’s capital markets have been more market-oriented, especially compared with the current lock-up system in the A-share market. We agree with the requirements proposed by HKEX with regard to the lock-up period, so much so that this arrangement is worthy of technical consultation and reference for the A-share market.</p>

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Liquidation and De-Listing		
Return of funds to shareholders	<ul style="list-style-type: none"> ■ If a SPAC fails to announce a De-SPAC Transaction within 24 months, or fails to complete a De-SPAC Transaction within 36 months, the SPAC must liquidate and return to its shareholders 100% of the funds it raised plus accrued interest. HKEX will thereafter de-list the SPAC. 	<p>We support setting an appropriately accommodative time limit mechanism for completing de-SPACing, especially for transactions with target companies in China, which will naturally involve regional characteristics such as the cross-border restructuring of the target and uncertainty in obtaining regulatory approvals. It is indeed necessary to provide a certain flexible mechanism for the transaction schedule, which will create an appropriately accommodative trading system environment for various participants in the de-SPACing market.</p>

The Consultation Paper conveys the determination of HKEX to open up new channels, actively attract capital from all parties to invest in Hong Kong and further enhance its status as an international financial center. The various threshold restrictions and safeguard measures proposed in the Consultation Paper reflect the position of HKEX to encourage SPAC Promoters with ample strength and solid background aiming to promote high-quality SPACs to list and complete transactions in Hong Kong, so as to maintain the order of Hong Kong's capital markets and the stable confidence of investors.

Nonetheless, certain proposals in the Consultation Paper, especially the restrictions on the subscription of SPAC securities to Professional Investors only, the requirements for the eligibility and license of SPAC Promoters as well as the requirements on the investment ratio of independent third-party investment (i.e., 25%), all reflect the concept of a more stringent system compared with the SPAC listing rules in the United States and other markets. It is not easy to meet all the above requirements at the same time. Therefore, to some extent, market participants will inevitably face pressure. We reasonably expect that the industry will offer positive adjustment suggestions and opinions on the practicability of certain proposed rules. We will provide our professional opinions and feedback to HKEX as soon as possible by taking into account key market concerns. We also look forward to discussing with our clients and friends and to contributing our professional strengths to the improvement of Hong Kong's SPAC listing regime.

Important Announcement

This Legal Commentary has been prepared for clients and professional associates of Han Kun Law Offices. Whilst every effort has been made to ensure accuracy, no responsibility can be accepted for errors and omissions, however caused. The information contained in this publication should not be relied on as legal advice and should not be regarded as a substitute for detailed advice in individual cases.

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