FCA Consultation Paper: Investor protection measures for special purpose acquisition companies: Proposed changes to the Listing Rules

Law Society and City of London Law Society joint response

28 May 2021

1. INTRODUCTION

1.1 The views set out in this paper have been prepared by a Joint Working Party of the Company Law Committee of the City of London Law Society (**CLLS**) and the Law Society of England and Wales (the **Law Society**).

1.2 The CLLS represents approximately 17,000 City lawyers through individual and corporate membership, including some of the largest international law firms in the world. These law firms advise a variety of clients from multinational companies and financial institutions to Government departments, often in relation to complex, multijurisdictional legal issues. The CLLS responds to a variety of consultations on issues of importance to its members through its 19 specialist committees.

1.3 The Law Society is the professional body for solicitors in England and Wales, representing over 170,000 registered legal practitioners. It represents the profession to Parliament, Government and regulatory bodies in both the domestic and European arena and has a public interest in the reform of the law.

1.4 The Joint Working Party is made up of senior and specialist lawyers from both the CLLS and the Law Society who have a particular focus on issues relating to capital markets.

1.5 The Joint Working Party thought it would be helpful to set out its overarching comments in relation to the Consultation Paper (the **CP**) (please see paragraph 2 below), before then providing responses in relation to the specific questions set out in the CP (please see paragraph 3 below).

2. OVERARCHING COMMENTS

2.1 We are supportive of the CP and the proposal for an alternative approach to the general presumption of suspension in trading of a SPAC's shares upon the identification of a target (or a leak). The existence of the general presumption of suspension is, in our view, overly prohibitive and significantly disadvantages London as a listing venue for SPACs such that very few SPAC listings are contemplated in London under the current listing regime. The FCA's willingness to consider reform to this area is therefore welcome.

2.2 Whilst we fully support the objective of investor protection, an overarching comment which is reflected throughout our response is that we believe that investor protection is not meaningfully achieved by any form of suspension that is outside the general residual suspensory powers of the FCA; in fact, suspension results in a genuine punitive cost to investors. Our view is that investor protection is achieved, primarily, by a redemption option for shareholders and, in some circumstances, by a shareholder vote. Further, as is the case for other significant transactions by commercial companies, investor protection is driven by applicable on-going disclosure obligations and the ability of the market to function properly in light of any new information. Our concern is that, under the proposed alternative approach, suspension is treated as an almost automatic consequence of any failure to meet the proposed set of criteria on an on-going basis, the majority of which are unrelated to disclosure and, in view of the continued threat of suspension, which would exist until a SPAC contacts the FCA prior to announcing an acquisition, significant risk factors relating to the possibility of a suspension would need to be included in the prospectus. This, we believe, would act as a significant limitation on London as a potential SPAC listing venue without any commensurate benefit to investor protection. As set out in our response to question 17 below, our view is that a preferable approach would be for a confirmation to be provided by the FCA in advance, at the point of the initial listing application, that the SPAC's shares would not be suspended, provided that the SPAC satisfied the investor protection measures. In line with this, we consider that the presumption should be that, provided that the SPAC retains the investor protections at the time of the announcement of the business combination, its shares would not be suspended.

2.3 Finally, we note that there are various other general points concerning SPACs which are not related to suspension and on which we commented in our response to Lord Hill's UK Listings Review, such as the treatment of forward-looking information. Whilst we appreciate that these have not been covered in this phase of consultation, we think it is important that they be addressed in the forthcoming consultation.

3. RESPONSES TO QUESTIONS IN THE CP

Q1. Do you agree with our description of the key features and risks of SPACs for investors?

Yes. However, in our view, it is important to clarify in both the proposed revisions to Listing Rule 5.6 and the Technical Note that the proposed measures apply only to companies that satisfy the definition of a "shell company" in LR 5.6.5A (which will include nearly all SPACs), but not to other types of cash shell or investment vehicle.

Q2. Are there other key features or risks that we should consider?

No, but please see paragraph 2.3 above and our observations set out below in relation to (a) the proposed redemption option criterion and (b) the listing of units.

In respect of the proposed redemption option criterion, we believe that it is worth noting that this might create difficulties for certain issuers. Firstly, the implementation of compulsory redemption rights will be easier under the corporate laws of some jurisdictions than others; for instance, it is not necessarily straightforward for a UK plc to redeem its shares on the basis that it would need distributable profits to do so (or the proceeds of a fresh issue). Therefore, presumably, a SPAC that is a UK plc would have to get court approval to reduce its share premium account after its IPO but before undertaking an acquisition, which has both timing and cost implications. Secondly, for certain issuers which are subject to the Takeover Code, for instance, a UK, Guernsey, Jersey or Isle of Man issuer which is London listed, redemptions could lead to a Rule 9 mandatory bid obligation being triggered on remaining shareholders, which would require the issuer to approach the Panel for a waiver. However, an issuer incorporated elsewhere, or, potentially, a UK, Guernsey, Jersey or Isle of Man issuer that is listed outside the UK, may not have that concern. It would therefore be helpful for further clarity to be provided on the interaction between the proposed rules and the Takeover Code in this context.

In addition, we would note that recent SPAC listings on Euronext Amsterdam involve the listing not only of shares and warrants but also units which are a security representing the right to receive ordinary shares and warrants in the SPAC, either at the end of the stabilisation period on some transactions or at any time prior to the business combination on other transactions (the latter being closer to US SPAC model). We would envisage that SPACs looking to list in London will seek to list units and we would encourage the FCA to comment on the listing of units, in particular:

- whether the FCA will separately admit units and shares to the Official List under Chapter 14 of the Listing Rules;
- whether the FCA will separately admit warrants to the Official List under Chapter 20 of the Listing Rules (which we have seen on other UK SPACs); and
- how the FCA will view the application of the FCA's free float requirements during the initial period of the SPAC when only the units will be trading during the stabilisation period (and

the ordinary shares and warrants are held in treasury) and potentially beyond the stabilisation period, should the SPAC wish to have its units traded for the life of the SPAC.

We would also encourage the FCA to liaise with the London Stock Exchange as to how the trading and settlement of units, warrants and ordinary shares would work, assuming they can each be separately listed; for example, whether it is envisaged that the three listed securities would have three separate ISINs or whether the units would have the same ISIN as the ordinary shares and in effect be the ordinary share with a stapled warrant. In the process of sponsors considering London as a potential listing venue, they will have questions on the practicalities of listing and trading these three SPAC securities and we therefore believe that it is important that clarity be provided on this aspect such that SPAC listings in London can be facilitated as soon as possible following the FCA's consultation response.

Q3. Do you agree that SPACs should meet a size threshold as one of the criteria? If you do not think this is the right approach, please explain why.

We do not consider it necessary to introduce a size threshold as one of the criteria. As set out at paragraph 2.2 above, our view is that the principal protection mechanism for investors in SPACs is the redemption option. It would therefore not be logical to treat SPACs with this embedded key feature differently in terms of suspension purely on the basis of size. Further, the size of a SPAC at IPO only has a partial impact on the size of any subsequent de-SPAC business combination given the ability of a SPAC to raise additional equity funding, and so SPAC size on IPO is a function of other, more commercial, considerations and should therefore not be taken to denote that there is a tier of more sophisticated SPACs which would fall within, and benefit from, the proposed regime.

This is supported by the fact that high quality institutional shareholders also take positions in smaller SPACs; their participation in listings is not limited to larger SPACs, as suggested by the CP. For instance, Marwyn Capital I Limited and Marwyn Capital II Limited which raised £6.2 million and £4.9 million respectively both had Fidelity (9.9 per cent), Gartmore (4 per cent and 5 per cent, respectively), and L&G (8 per cent and 10 per cent, respectively) as shareholders from their IPOs (on AIM).

We are also of the view that imposing a size threshold creates the impression that smaller issuers cannot be trusted to comply with the rules of their own accord, which is clearly not correct.

Further, we see no basis for excluding from the requisite amount any funds provided by the sponsors.

Q4. Is our proposed threshold set at the right level and, if not, what threshold would you propose and what evidence can you provide to support this?

In the event that a size threshold is deemed necessary, we believe that a lower threshold would be more appropriate (perhaps £100 million). Please see our response to question 3 above.

Q5. Do you agree with our proposed criterion that proceeds should be ring-fenced by a SPAC so that they can only be used to fund an acquisition, redemption or repayment event?

Yes. We also agree that it is correct not to be overly prescriptive in terms of the manner in which the funds are to be held, for instance, in a trust or an escrow account, particularly in light of the following current concerns: (a) negative interest rates, meaning for some issuers (largely Eurozone) holding cash has a cost; and (b) avoiding classification as an AIF – in other words, the escrow is a means of preserving the cash raised, not investing it. Further, whilst there may have previously been a shortage of independent third parties to hold SPAC proceeds, we understand that this position is changing in the London market; escrow accounts are also becoming increasingly common in the context of Amsterdam-listed SPACs.

Although we are supportive of the proposed ring-fencing criterion, we are of the view that it is important to provide SPACs with greater flexibility in this regard and to align the rules more closely with market practice in other jurisdictions. We would therefore propose that SPACs should be permitted to ring-fence funds simply by declaring that they are held on trust for shareholders or by being placed in escrow as opposed to being required to have "adequate binding arrangements in place with an independent third party" as per the proposed new condition. In line with this, we would suggest that this rule be modified such that the SPAC must "have in place suitable arrangements to ensure that the aggregate gross cash proceeds received […] are protected from being used for any purpose other than [those specified in LR 5.6.18(2)]" and that "for such arrangements to be considered "suitable" they must involve either an adequate binding arrangement with an independent third party or a trust or escrow arrangement that provides a similar level of protection to public shareholders."

Q6. As one of the criteria, do you agree that SPACs should set a time limit on their operations from the point of admission to listing? If not, please explain why.

Yes. We agree with the concept of an initial time period which is subject to extension.

Q7. Do you agree with the 2-year period we propose for the time limit, and flexibility for an extension of up to 12 months?

Yes, but we believe that the ability to extend operations by 12 months, which would be subject to shareholder approval, should not be limited to a single extension, as suggested in the CP. We also note that the initial 2-year period is currently tied to completion of an acquisition. In this regard, we are of the view that if an acquisition has been announced but has not completed within the relevant deadline, an automatic extension should apply (which would therefore not be subject to a shareholder vote), on the condition that the acquisition is completed within a specified period, for example, within six to nine months of the end of the initial 2-year period.

Q8. Do you agree that a board approval should be required, and that this should exclude directors that are also directors of the target or a subsidiary of the target?

Yes, in principle we agree that board approval should be required, although we believe that any conflicts should be addressed via the application of usual conflict of interest rules, such as DTR 7 and those set out in typical company articles of association, together with the company law applicable to the jurisdiction of incorporation of the issuer.

Q9. Do you agree that the board approval should exclude directors who have an associate that is a director of the target or any of its subsidiaries? Furthermore, are there other circumstances where we should consider conflicts of interest arising from associates of directors of a SPAC?

- Yes, in principle we agree that board approval should exclude directors who have an associate that is a director of the target or any of its subsidiaries on the basis that this is a reasonably precise test, but please see our response to question 8 above.

- No.

Q10. Do you agree that the board approval should also exclude any director who has a conflict of interest in relation to the target or its subsidiaries?

- We are of the view that the introduction of overly prescriptive provisions in respect of other conflicts that are not clearly defined risks creating a significant disadvantage for the UK listing regime. We therefore suggest that the rules in this area should be very clear, avoiding the use of imprecise language, and be simple to assess, particularly in view of the fact that, pursuant to the proposals, the ability to avoid suspension depends on this. Given the nature of many sponsors, we think it is likely that they would have some form of relationship with some of their targets – and that broader conflicts could therefore arise in such a context, which would, as a result, materially increase the uncertainty surrounding a possible suspension. Our preferred position would therefore be in line with our responses to questions 8 and 9 above, with a reliance on the existing conflicts and disclosure regimes to manage these issues.

- Please also see our response to question 17 below in respect of the publication of FCA guidance.

Q11. Do you agree that approval from shareholders, excluding SPAC sponsors, should be required in order to proceed with a proposed acquisition?

As we have set out, our view is that the principal protection mechanism for investors in SPACs is the redemption option. In the event that it is considered desirable to also include a shareholder vote, we do not think that SPAC sponsors should be excluded from participating. SPAC sponsors are able to participate in the vote to approve the de-SPAC transaction in the main competitor jurisdictions, namely the US and Amsterdam. Their proposed exclusion would therefore be a significant departure from current practice and act as a further barrier to the creation of a London SPAC market. In addition, any conflict of interest on the part of the sponsors would be disclosed in the prospectus in the usual way. The participation of the SPAC sponsors in the vote should not therefore be prohibited.

Q12. Do you agree that a "fair and reasonable" statement should be published to shareholders based on advice from an appropriately qualified and independent adviser where any of the SPAC's directors have a conflict of interest in relation to the target or its subsidiary? Do you have feedback on who should be considered an appropriately qualified and independent adviser for this purpose?

- On the basis that the parameters of the conflict of interest in relation to the target or its subsidiary are clearly defined, we agree with the requirement for a "fair and reasonable" statement. This is consistent with current market practice and we do not believe that this requirement would be detrimental to London as a SPAC listing venue.

- No.

Q13. Should a fair and reasonable statement potentially be required to support any proposed transaction, regardless of any conflict of interest being present for SPAC directors?

No. We do not think that it is appropriate to require a "fair and reasonable" statement in relation to any proposed transaction. It is neither necessary nor proportionate as shareholders in the SPAC have the option to redeem their shares in the event that they do not support the transaction and the requirement is likely to entail significant expenditure; further, the availability of this type of supporting statement cannot be guaranteed. The requirement is not part of broader UK market practice and would merely result in SPACs being treated differently from other companies without delivering any obvious benefit, thereby putting London at a disadvantage to its principal competitors.

Q14. Do you agree with a criterion that a SPAC should include a redemption option for shareholders? If not, please explain why.

Yes. However, we are not suggesting that the proposals should be extended to other types of cash shell or investment vehicle (please see our response to question 1 above).

Q15. Will the proposed disclosure requirements be sufficient, when taken together with wider existing disclosure obligations, to protect investors and ensure the smooth operation of markets?

Yes. We are of the view that a separate disclosure regime is not necessary for SPACs. On the premise that SPACs are required to comply with their obligations under the UK Market Abuse Regulation (**MAR**), in the same way as other listed companies, it is not appropriate to impose additional disclosure obligations on SPACs.

Whilst we agree with the proposed criteria to be disclosed at the point of an initial target announcement, we think it would be helpful if the FCA were to clarify that, in the event that the specific disclosure requirements have been met, the SPAC is presumed to have complied with its obligations under MAR.

Q16. Is there any additional information that we should explicitly require to be disclosed, which won't be addressed by the above, or are any elements likely to be difficult to satisfy for SPAC issuers?

- Please see our response to question 15 above.

- Yes. We are of the view that the words "or ought reasonably to be aware of" should be deleted from proposed LR 5.6.18DR(2)(f) (and (3)(b)) on the basis that they impose a particularly burdensome disclosure standard and, granted that as drafted the requirement is linked to potential suspension, this risks creating an overly onerous regime.

  The reference to the "proposed timetable for negotiation of the transaction" in proposed LR 5.6.18DR(2)(d) is unclear and it would therefore be helpful if some guidance could be provided on this. As drafted, it is not clear whether this is a reference to the history of the transaction negotiations, which we would not regard as useful or relevant disclosure, or the timetable to the close of the transaction, or whether it is intended to apply exclusively in a leak situation.

- It would also be helpful if additional clarity could be provided in respect of the specific disclosure requirements that would need to be met in the context of a leak situation for a suspension to be lifted. We note that the CP is proposing that, in the event of a leak, there would be a "short period of suspension" until the SPAC can confirm in writing to the FCA that it continues to satisfy the conditions of the guidance and has made an announcement to the market of the detail of the acquisition, and anything of which the issuer is aware that the market should be informed of. This is very similar to the current position under the Listing Rules as it is possible to rebut the presumption of suspension if an announcement can be made which contains sufficient information on the target. However, we are of the view that this kind of detailed announcement is difficult to achieve commercially, particularly where the acquisition process is competitive (as many sellers might not be willing to engage in preparing and agreeing a dynamic leak strategy during the life of the transaction purely for the purpose of satisfying a SPAC's suspension risk) and also where the SPAC is subject to an NDA. In practice, therefore, the proposed disclosure threshold runs the risk of a suspension being triggered even where the regime is otherwise complied with - in other words, where all the structural protections have been adopted. We believe that this might make any investment in a London-listed SPAC unattractive to many investors, as discussed in more detail in question 17 below. We would also expect, as highlighted below, that a SPAC prospectus would need to contain risk factors on the additional suspension risk imposed by this proposed disclosure regime. It is therefore our view that the leak scenario needs careful consideration and to reflect what can realistically be announced at the time of a leak, beyond the usual MAR disclosure requirements. We would also highlight that Amsterdam, for example, does not stipulate any requirements along these lines and we believe that the proposed approach would put London SPACs at a disadvantage vis-à-vis SPACs in other listing venues, which would undermine the spirit of the CP.

Q17. Do you have any comments on our proposed supervisory approach? We also welcome any feedback on proposed amendments to our Technical Note on cash shells and SPACs in Appendix 2

As it is proposed that no indication will be provided by the FCA at the time of the SPAC listing application process as to whether a suspension at a future date might be necessary, as set out in paragraph 2.2 and our response to question 16 above, significant risk factors and other disclosure relating to the possibility of suspension would need to be included in the prospectus. We believe that the resultant threat of suspension is problematic and may well have a negative impact on the attractiveness of London as a SPAC listing venue in view of the significant consequences of suspension for all investors and hedge funds, in particular. Many investors in typical US SPACs are hedge funds that invest in a SPAC's shares on a leveraged basis, borrowing money from investment banks to partly fund their acquisition of a SPAC's shares. The terms of their loans are typically margin loans where the collateral the hedge fund has to post against the loan is the SPAC's shares. Whilst the shares are traded, this construct functions well, but the collateral ceases to be "eligible collateral" in the event that the SPAC's shares cease trading. Upon a suspension, the hedge fund would have to post other collateral of the same value to back the loan and, if it is unable to do so, the loan would be called, the investment bank would seek to sell all the collateral (which it would not be able to do as trading is suspended) and the hedge fund would need to also repay any losses of the investment bank.

As per paragraph 2.2 above, in our view, a preferable approach, which would enhance London as a potential venue for SPAC listings, would be for the FCA to provide a confirmation in advance, at the time of the listing application process, that the SPAC will qualify to avoid suspension in the event that the criteria are met by the SPAC and the SPAC complies with its MAR obligations. In line with this, we believe that suspension should be the exception and that the expectation would be that, provided the SPAC retained the investor protections at the time of the announcement of the business combination, its shares would not be suspended.

In addition, it would be helpful if the FCA were to publish Technical Notes and/or guidance setting out its expectations on disclosure in respect of SPAC conflicts of interest, including in relation to conflicts which would trigger the obligation to publish a "fair and reasonable" statement. This would mirror the approach of the SEC which publishes guidance on disclosing conflicts on a SPAC IPO and a de-SPAC event; the guidance identifies the numerous potential conflicts and results in fulsome conflicts disclosure[1].

Further, we are aware that the Dutch AFM on recent SPAC IPOs on Euronext Amsterdam has required the prospectus to contain detailed calculations of the dilution of SPAC investors, based on different scenarios for business combination size and size of equity issuance or "PIPE" to fund

[1] https://www.sec.gov/corpfin/disclosure-special-purpose-acquisition-companies

the business combination. As with conflicts of interest, dilution is an area where the FCA might consider publishing a Technical Note on its expectations for disclosure in the prospectus for the IPO and also the de-SPAC transaction.

Q18. Do you agree that it will be necessary for SPACs to contact us to request suspension in the event, post announcing a reverse takeover target, it no longer satisfies the proposed investor protection provisions?

As previously indicated, we do not believe that suspension is the optimal way of protecting shareholders but that suspension instead has a punitive cost for shareholders, by creating uncertainty and, ultimately, by preventing them from selling their shares.

Q19. Given the risks posed by SPACs, are there other investor protections than those we have proposed, that we should consider? This could include, for example, exploring marketing restrictions or other means to limit access for individual investors who are less sophisticated.

No. We would note that the MiFID II product governance regime requires that a target market is assigned to financial instruments such as units, shares and warrants issued by the SPAC vehicle to investors. Typically, shares issued in the context of a traditional IPO will attract a target market of eligible counterparty, professional and retail investors. However, considerations for SPACs may differ due to the different financial instruments being created throughout the SPAC lifecycle and the fact that certain instruments may constitute PRIIPs. Where an instrument does constitute a PRIIP, a separate consideration is whether it is intended for retail distribution, thereby requiring a Key Information Document (**KID**) to be produced. It is therefore already common on a SPAC IPO to limit access to units and warrants to eligible counterparties and professional investors (such that no KID is required) and to permit access to the shares to eligible counterparties and professional and retail investors (such that no KID is required).

Q20. Should we explore providing differentiation in our measures applying to SPACs where they have a specific focus, eg on targets that develop green technologies? We welcome views on any benefits and risks this may have, and how this could be effectively implemented to avoid regulatory arbitrage.

No. We are of the view that any new measures should apply to all SPACs, irrespective of sector.

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