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29 October 2021

**By email: [response@hkex.com.hk](mailto:response@hkex.com.hk)**

**Re: Consultation Paper on Special Purpose Acquisition Companies**

Dear Sir or Madam,

The Asian Corporate Governance Association (ACGA) is a non-profit membership association founded in Hong Kong in 1999. We conduct independent research on corporate governance and ESG, and advocate at the regulatory and corporate level across Asia-Pacific to improve standards and practices. ACGA is entirely funded by a network of 112 member firms, of which 80% are institutional investors with more than US\$36 trillion in assets under management globally.

We welcome the opportunity to respond to the HKEX consultation paper on Special Purpose Acquisition Companies (SPACs). As an organisation focused on improving corporate governance in the Asia Pacific we view SPACs as a backward step in achieving this goal. While we understand the need for global exchanges to remain competitive and innovative in attracting capital, it is our view that this particular fundraising mechanism is unsuitable for markets with high retail participation and negligible legal recourse for minority shareholders in the event of corporate malfeasance.

In Hong Kong's case, the market has also historically suffered from manipulation of shell stocks. Such "problematic corporate behaviour" as discussed in the consultation paper led to a significant tightening of rules on backdoor listings and reverse takeovers in 2018. It is difficult to reconcile SPACs—which are essentially shells who merge or acquire entities—with this strategy and Hong Kong's long-term policy of only listing companies with real businesses.

**The problem with SPACs**

SPACs in the US and other markets evade traditional "front door" IPO regulatory scrutiny. There is an inherent risk that they will be used to list sub-standard businesses or assets, particularly as they are on a deadline to merge or acquire a target company. In the same rush to seal a deal and allow SPAC promoters to cash out, targets may be deliberately over-valued.

While the US has seen exceptional levels of capital raised through SPACs throughout 2020 and in the first quarter of 2021, the market for these fundraising vehicles has cooled and valuations are waning. Meanwhile, regulatory scrutiny is escalating. Just this week, the Securities and Exchange Commission (SEC) ordered music streaming firm Akazoo to pay US\$38.8m to settle charges that it defrauded investors out of tens of millions of dollars. Criminal charges were brought against the founder of alternative fuel truck firm Nikola in July for defrauding SPAC retail investors. Parties involved in the Stable Road Acquisition Company SPAC were also charged that same month for misleading disclosures. At the time, SEC chair Gary Gensler noted: "This case illustrates risks inherent to SPAC

transactions, as those who stand to earn significant profits from a SPAC merger may conduct inadequate due diligence and mislead investors.” In the Stable Road case, the SEC took action even before shareholders voted on the merger.

The unravelling of these SPACs has been in plain view and it would be naïve to brush off the SEC enforcement drive as just a few bad apples. The SPAC structure and its speculative nature makes it inherently risky, particularly for a market such as Hong Kong. It was disappointing that the debate among policymakers here has not been posed as a question of if but rather one of how.

ACGA acknowledges that the consultation paper works within this political context and in our opinion HKEX has reached a compromise to allow the introduction of SPACs while attempting to mitigate the most egregious risks. We realize certain corners of the market may be unhappy with this structure and anticipate pressure to relax the rules to bring Hong Kong’s SPAC regime on a par with Singapore and the US. In our view, this would be to the detriment of Hong Kong’s market quality, resilience and reputation.

### **The quality of Hong Kong’s market**

ACGA shares regulatory concern over shell manipulation activities in Hong Kong. As mentioned above, this led to a tightening of rules on backdoor listings and reverse takeovers in 2018. There has also been a notable increase in delistings by HKEX since. Yet we are aware of such manipulation still being common. Indeed in May this year a joint statement by HKEX and the Securities and Futures Commission (SFC) warned that some IPOs were essentially being manufactured for the purpose of “ramp and dump” schemes. ACGA is also concerned with the 18 October 2021 decision by the companies judge in **HKCFI 3095 [2021]** to wind up a solvent listed company which had been manipulated by majority shareholders to promote their own financial interests. The judge took the view that the affairs of the company were conducted in such a way that was so dishonest, unfair and prejudicial to minority shareholders that the only fair remedy would be a winding up order. It is difficult to view these as isolated incidents.

At a policy level, we would encourage an increased focus on how quality and market liquidity could improve in Hong Kong, rather than on short-term capital and business gains that might accrue from SPACs. As SFC Deputy Chief Executive Julia Leung noted in a speech “Supervising sponsors in a changing IPO landscape” in 2019, although Hong Kong ranks as one of the top markets in fundraising, it lags its global peers in liquidity. We note that her observation that Hong Kong ranked fifth in terms of market capitalisation and eighth in terms of average daily turnover value in 2018 still held true in 2020<sup>1</sup> despite the sizeable IPOs of China tech giants.

### **The consultation**

While ACGA believes SPACs are a retrograde step in improving both corporate governance and market quality, we credit HKEX with taking a pragmatic approach to safeguarding investor interests. We make a number of suggestions below as to how the consultation proposals could be further tightened to protect shareholders within this framework.

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<sup>1</sup> World Federation of Exchanges figures

### Elite investors only and treat the de-SPAC as an IPO

ACGA agrees that simply cloning the US regulatory framework on SPACs would pose a huge risk to the quality of Hong Kong's market. The consultation paper summarises these in **Chapter 4: Major Issues**: from the trading concerns mentioned above (opportunities for market manipulation, insider dealing and intense volatility) to the suitability of SPAC promoters, lack of management and ownership continuity and ability of these firms to avoid regulatory scrutiny. There is also a perverse incentive for promoters to find a target as quickly as possible in order to get paid. As the United States is now finding out, this is often contrary to the best interests of investors. Unlike the US, Hong Kong investors cannot take comfort in a robust class action landscape.

HKEX proposes to allow SPACs to list as empty shells but once they have acquired a target or merged with an entity (the de-SPAC) the Exchange will require the successor company to meet all new listing requirements. In other words, the SPAC transaction will be held to the same regulatory standard as an IPO. We have no objection to this proposal.

Meanwhile it is proposed that the pre-merger subscription and trading of SPAC shares be limited to Professional Investors only. Only the shares in the successor company would be freely traded in the market. The hypothesis is that the population of Professional Investors in Hong Kong is relatively small and these investors are better placed to assess, monitor and mitigate the risks involved with SPACs. While ACGA is in favour of restricting retail access to SPAC shares before the entity merges, we believe the financial thresholds of the Professional Investor rules in Hong Kong to be out of touch with reality. Individuals must have a portfolio of at least HK\$8m, while the same figure applies for corporations (although companies can also show they have assets of at least HK\$40m). These minimum requirements were set in 2003 and have not been adjusted since. We would suggest the portfolio threshold for investing in SPACs should be significantly higher.

It is also proposed that at least one SPAC promoter be a Type 6 (corporate finance) or Type 9 (asset management) licensed firm which holds at least 10% of the promoter shares. Again, we have no objection to this. We also agree that any material change in the particulars of the SPAC promoter (departure, change in control, revocation of license etc) must be approved by shareholders by special resolution. Failure to obtain approval within a month should require the return of funds raised at IPO to shareholders. All SPAC proceeds should be held on trust, as proposed.

### Trading halts and suspensions

It is proposed that the Exchange apply the existing trading halt and suspension policy required by Chapter 6 of the Listing Rules to SPACs. Under these rules, any trading halt or suspension should be "for the shortest period possible." The longevity of a SPAC turns on its ability to find a suitable target to merge with or acquire. This constant hunt for a target arguably heightens the opportunity for speculation in a SPAC stock. Given the likely volatility of SPAC stocks—particularly as the de-SPAC deadline looms—ACGA is of the view that these companies should not be granted open-ended trading halts but rather be required to provide information within a specified timeframe. For example, the ASX requires that issuers provide information no longer than the second trading day following the day on which a halt was requested. On a broader note, we believe Hong Kong's listing rules on trading suspensions in general are overdue an overhaul.

### **Eligibility of de-SPAC targets and WVR**

HKEX is proposing that a SPAC could become a successor company with a WVR structure through a de-SPAC transaction, “as long as the de-SPAC target and the structure resulting from the de-SPAC transaction meet all applicable requirements of the Listing Rules.”

ACGA seeks clarification on this. Under Chapter 8A of the Listing Rules, the Exchange will only consider applications for listing with a WVR structure from **new applicants** only. These companies must have a market capitalisation of at least HK\$40 billion at the time of listing or HK\$10 billion at the time of listing plus revenue of at least HK\$1 billion for the most recent audited financial year. Yet the consultation paper describes the SPAC successor company as being a “deemed” new listing because the successor company must meet IPO requirements. Given that the SPAC can list with assets of at least HK\$1 billion, we would appreciate if HKEX could clarify whether the intention is to treat a successor company as a new applicant for the purpose of the WVR rules and that the same market capitalisation thresholds would apply.

If SPACs are permitted to have WVR structures, investors should be made aware of this possibility at the time of IPO. The issuer’s intentions as to whether it would consider a merger/acquisition which result in a WVR structure should be made clear: our concern is that investors purchase SPAC shares and ultimately be presented with a WVR successor company they had not bargained for.

### **Shareholder votes and connected de-SPAC targets**

We agree with the proposal to require a shareholder vote at general meeting on a de-SPAC transaction and restrict shareholders and close associates with a material interest from voting. We also encourage any outside investment obtained for the purpose of completing the de-SPAC to be disclosed in the resolution. ACGA is wary of de-SPAC targets being chosen on the basis of promoters’ personal networks and related interests, personally benefiting the controlling shareholders of a SPAC. Connected transaction rules should apply. We note that the Exchange is proposing additional safeguards (paragraph 334) however ACGA wonders how these would work in practice. For example, further elaboration (and examples) could be given how a SPAC could “demonstrate that minimal conflicts of interest exist” in relation to the proposed acquisition.

### **Redemption**

It is proposed that public shareholders who vote against a de-SPAC transaction be entitled to redeem their SPAC shares. However, shareholders who vote *for* the deal will not be able to redeem their shares. The aim of this proposal is to help limit abusive practice, notably the over-valuation of a transaction. We have no objection to this proposal. In addition, we support the proposal for SPAC shareholders to be able to redeem their shares for full compensation of the price they paid at IPO plus interest. There should also be no limit on the amount a shareholder should be able to redeem.

### **Deadlines, extensions and de-listing**

HKEX proposes setting a time limit of 24 months for the publication of a de-SPAC announcement and 36 months to complete the transaction. Failure to meet these deadlines would result in suspension of a SPAC listing. The SPAC would then have to within a month return the funds it raised from IPO to shareholders, liquidate and de-list unless granted an extension. However, HKEX is proposing that

SPACs be able to apply for an extension of these deadlines if it has gained shareholder approval at a general meeting. We would urge HKEX to take a robust approach to extension applications and put a cap on the number that can be granted.

### Exemptions

The consultation paper asks whether SPACs should be exempt from Listing Rule disclosure prior to a de-SPAC transaction, such as corporate governance and ESG reporting requirements, or whether these requirements should be modified given the lack of business operations. ACGA believes SPACs should as a matter of practice be required to issue CG reports which document the entity's policies on board governance and diversity. This would include disclosure on gender composition and board performance, training and remuneration during the year. While these entities have no business operations, they should still be accountable to stakeholders in this respect.

We would be pleased to discuss any of the points above further with the Exchange.

Yours truly,

A handwritten signature in black ink, appearing to read 'JA', written over a light blue horizontal line.

Jamie Allen  
Secretary General

A handwritten signature in black ink, appearing to read 'Jane Moir', written over a light blue horizontal line.

Jane Moir  
Research Director, Hong Kong