

Clients & Friends Memo

The FCA Consults on UK's Investor Protection Rules for SPACs

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Until the last month, the market in the U.S. for special purpose acquisition company ("SPAC") IPOs has been booming. For example, in the first three months of 2021, there were 298 IPOs of U.S. SPACs, which raised in aggregate \$87.07 billion. That booming market has not included the UK, where during the same period, there were no SPAC IPOs.

U.S. and UK SPAC terms differ in 2 key respects:

- in the U.S., SPAC investors are entitled to redeem their entire investment (UK investors are given no right to redeem their shares) at the time of the initial business combination, regardless of whether they vote in favour of the transaction; and
- trading is suspended on the London Stock Exchange in a SPAC that has announced its initial business combination until disclosure about the initial business combination (including financial statements) is publicly available, a period that in the past UK SPACs has ranged from two months to two years.

Both of those differences were regarded as sufficiently investor-unfriendly that they are believed to have caused the relative dearth of SPAC IPOs in the UK.

On 30 April 2021, the Financial Conduct Authority ("FCA") published a [consultation paper](#) on proposed investor protection measures for SPACs. This follows from Lord Hill's earlier [review of the UK Listing Rules](#), which we analysed in our earlier [update](#).

1. What are SPACs?

SPACs are "cash shell" or "blank check" companies that raise funds through an IPO of a shell company, with the purpose of using that cash to acquire one or more businesses to be identified by the SPAC sponsors at some future point after the IPO. Shares in the SPAC are issued to the public through an IPO at a fixed price per share (generally \$10). In the traditional SPAC IPO each share is typically issued with a detachable fractional warrant (e.g., a 1/3rd warrant), with each whole warrant separately tradeable and entitling the holder to purchase one share at \$11.50. Sponsors are typically issued shares representing 20% of the post-IPO capitalization for a de minimis purchase price (typically \$25,000 in the aggregate), and purchase additional warrants for cash in order to provide the SPAC with working capital and to pay underwriting fees and other offering expenses.

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Although SPACs are not a new concept, they have exploded in popularity in the past year. Hundreds of SPACs have been listed in the U.S. since July of 2020 when Pershing Square raised the \$4 billion [Tontine Holdings Ltd.](#), raising among them hundreds of billions of dollars to be put to work in searching out and acquiring targets.

2. Problems With the Existing UK Regime

Despite this dramatic increase in SPAC-raising, sponsors have steered clear of the London markets for these vehicles. The rules applicable to SPACs on the London Stock Exchange are considered inhospitable, among other reasons, because unlike the U.S. rules, the UK Listing Rules treat the transaction as a 'reverse takeover' and include a rebuttable presumption that a SPAC's listing will be suspended by the FCA when an acquisition target is identified and announced. Although the presumption for suspension is rebuttable, it is rarely if ever actually rebutted, and historically London-listed SPACs have had listing suspensions of several months upon announcement of their business combinations. Investors are therefore trapped in a stock which has announced a very significant and material development, a problem which is exacerbated by the fact the UK rules (again, unlike the U.S.) do not currently require a shareholder vote on the acquisition or an option to elect the return of their cash instead.

3. Most Important Takeaways

In its consultation, the FCA has proposed that SPACs which meet certain higher investor protection levels will no longer be subject to the presumption in favour of listing suspension. Other SPACs will remain subject to the existing rules.

The new regime crucially provides for the removal of the trading suspension presumption in otherwise qualifying SPACs if they offer investors the right to redeem their shares prior to the initial business combination. These changes could result in SPACs becoming more popular in the UK

4. The Proposals

To fall within the new regime, a SPAC would need to meet the following criteria:

- i. Minimum size threshold: the IPO of a SPAC must raise at least £200 million aggregate gross cash proceeds to encourage a high level of institutional investor participation. In the U.S., 125 of the 298 SPACs listed in the first three months of 2021 raised more than the USD equivalent of that £200 million threshold. SPACs typically seek targets with a valuation 4-6x the SPAC's own valuation (because the dilution caused by the warrants is generally considered unacceptable in a smaller transaction). This UK rule, therefore, sets a meaningful qualification around the size of the SPACs the UK market is seeking to attract and the likely size of transaction targets.
- ii. Ring-fenced cash for acquisition, redemption or repayment purposes: ring-fencing proceeds raised from public shareholders via an independent third party to protect investors from misappropriation or excessive running costs being incurred by the SPAC's management. The only allowable use of the proceeds would be an acquisition, redemptions of shares from shareholders, or capital repayment to public shareholders if the SPAC winds up.
- iii. Time limit for making an acquisition: 2 years, potentially extendible by further 12 months with the approval of public shareholders. If the extension of the term is approved by public

shareholders, the ring-fenced investor contributions will remain locked up, and no shareholder will have the right to redemption of their cash until the SPAC enters a transaction or expires on the extended date.

- iv. Board and shareholder approval of a transaction: the acquisitions must be approved by the SPAC's board and the SPAC's shareholders, with the SPAC's sponsors excluded from voting.
- v. Fair and reasonable statement on the terms of an acquisition: if any of the SPAC's directors are conflicted, the SPAC's board would be required to publish a statement that the proposed transaction is fair and reasonable as far as the public shareholders of the company are concerned. This statement would be required to reflect advice by an appropriately qualified and independent adviser.
- vi. Redemption option for shareholders: SPACs should provide a redemption option that would specify a predetermined price (listed in the SPAC's prospectus) at which shares will be redeemed, which could be a fixed amount or fixed pro-rata share of the cash proceeds ring-fenced for investors, less pre-agreed amounts the SPAC retains for its running costs. Consistent with U.S. practice, the redemption option will be available to the shareholders whether or not they vote in favour of the acquisition.
- vii. Adequate public disclosure: sufficient disclosures should be provided to investors on key terms and risks throughout the SPAC's life cycle, from IPO through to the announcement and conclusion of any reverse takeover deal, including: (A) a description of the target business and the material terms of the proposed transaction, (B) an indication of how the SPAC has assessed the value of the target business and (C) any other details of which investors should be aware for making a properly informed decision.
- viii. Supervisory approach: to avoid a suspension, a SPAC would need to contact the FCA before announcing an acquisition and indicate that it has met the relevant criteria from IPO and will continue to do so until the completion of the acquisition. The presumption would still apply where there is a leak and the suspension would be lifted once the issuer demonstrates that it meets the relevant criteria. The FCA will not provide any indication at the time of listing whether a suspension will be unnecessary in future because this can only be agreed when SPAC contacts the FCA about a potential acquisition.
- ix. SPACs focussed on sustainability: the FCA also invited views on whether it should differentiate SPACs focussed on sustainability and investing based on environmental, social and governance factors.

In addition to meeting these criteria, UK-listed SPACs will remain subject to the UK Market Abuse Regulation and the FCA Disclosure Guidance and Transparency Rules.

5. Next Steps

If implemented following consultation, the FCA's newly proposed rules will bring UK practice in relation to SPACs much closer to the rules of the U.S., which is by a long way the leading listing venue for such vehicles, including a number of UK-founded and Europe-focused SPACs. In order for the UK to be competitive, hopefully the consultation will result in a balance being struck between appropriate shareholder control through voting and redemption rights whilst reducing execution risk and ensuring timetables do not risk becoming too protracted. We also hope the FCA will be prepared to permit greater certainty around the presumption being rebutted where

the issuer confirms the criteria have been met on an ongoing basis rather than having to await its confirmation. The consultation on these proposals will last until 28 May 2021, with the aim to introduce the investor protection measures by summer 2021.

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If you have any questions, please feel free to contact any of the following Cadwalader attorneys.

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