THE INVESTMENT ASSOCIATION

Response to Consultation

CP21/10: Investor Protection Measures for Special Purpose Acquisition Companies: Proposed Changes to the Listing Rules.

About the Investment Association

The Investment Association (IA) champions UK investment management, a world-leading industry which helps millions of households save for the future while supporting businesses and economic growth in the UK and abroad. Our 250 members range from smaller, specialist UK firms to European and global investment managers with a UK base. Collectively, they manage £8.5 trillion for savers and institutions, such as pension schemes and insurance companies, in the UK and beyond. 40% of this is for overseas customers. The UK asset management industry is the largest in Europe and the second largest globally.

Executive summary

The IA welcomes the opportunity to provide input into the FCA's consultation CP21/10: 'Investor protection measures for Special Purpose Acquisition Companies (SPACs): Proposed changes to the Listing Rules'.

The IA and its members have an ambition to re-energise public markets and create a savings and investment ecosystem which delivers for end savers and is attractive to both companies and global investors. We seek to widen UK and international businesses' access to long-term pools of capital and maintain robust standards that will help deliver long-term returns to our clients and their beneficiaries, including retail and pension savers. By channelling savings through capital markets, the investment management industry is a key source of funding for the UK economy, providing financing to a wide range of companies.

We consider this consultation to be an important first step in the wider review of the UK's listing regime as per Lord Hill's recommendations. It is essential that the changes proposed are seen as one component of a wider range of reforms which seek to re-energise the UK's public equity markets.

SPACs can play an important role in this eco-system through acting as a bridge between early stage, high growth companies and public capital, providing a structure that, in principle, accommodates the needs of these companies and those of investors. These private companies may wish to access public markets to secure access to larger pools of capital at a reduced cost of capital to fund their continued development. However, some of these companies may be deterred by the listing process. A SPAC provides an alternative route to a public listing; providing greater certainty on the valuation of the company, and the support of SPAC managers through the listing journey to meet the additional governance and disclosure standards required for a public listing.

Investment managers have been cautious about some of the inherent risks of investing in SPAC structures, particularly the risk of suspension of the listing and the misalignment of interests between the SPAC sponsors and external shareholders.

Investment managers have historically not been significant investors in SPACs at the time of the IPO. Active investment managers conduct due diligence and analysis of individual companies to see if the investment will meet the client's objectives and create long-term value for them. When investment managers consider investing in a SPAC at the IPO, the investment manager is delegating the responsibility to select investments and allocate their clients capital to the SPAC manager. Up until the point when investors have visibility over the target company, investors have very little information with which it can assess the potential value of a SPAC. More investment managers are willing to participate in the SPAC at the Private Investment in Public Equity (PIPE) stage, the presumption of suspension that exists in the FCA's existing rules means that their capital could be 'locked up' for an uncertain time period.

The IA therefore agrees with Lord Hill's recommendation that the listing rules applicable to SPACs need to be reviewed to address investor protection concerns. Overall, we welcome the strong investor protections required by the FCA's proposals to avoid a suspension of shares. The UK's leading governance standards and shareholder protections are critical to the long-term success of the UK's equity markets and a key factor in attracting the capital of both domestic and overseas investors.

In our response to the consultation questions, we broadly agree with the changes the FCA is proposing, which will for the most part decrease uncertainty and risk for investors when considering investing in SPAC structures. We welcome the addition of a redemption option and providing shareholders the opportunity to approve the acquisition of the target company, which will serve to enhance the attractiveness of these structures for institutional investors. However, the SPAC should be required to provide clarity in its prospectus on the ongoing running costs of the SPAC and the proportion of proceeds that will be returned to shareholders in the event that no acquisition is completed.

However, we remain concerned about the proposed supervisory approach, which gives little clarity at the IPO stage on the likelihood of suspension. We believe this is not consistent with the FCA's stated aim to enhance investor protections and attract significant institutional investor capital at the IPO stage. Investment managers are reluctant to enter into investments where there is significant uncertainty on whether the shares will be suspended and therefore whether they can sell their clients' holdings. Similarly, when a SPAC's sponsors are considering which market to list on they will assess the likelihood of the listing becoming suspended upon announcing the acquisition and the implications on the speed of the transactions and appetite for investors to participate in the SPAC at IPO or PIPE stage. This will influence the amount they will be able to raise at the public offering. The FCA's supervisory approach will not give SPAC sponsors or investors sufficient confidence that it will not suspend the SPAC's listing. We believe this approach undermines the FCA's aim to encourage a wider range of SPAC listings.

Similarly, while we agree that the application of a minimum-size threshold for the capital raised at IPO, we are concerned that the threshold level of £200m may be set too high and it is not clear the rationale for arriving at this threshold. Unless there is clarity on the likelihood of suspension it is unlikely that SPACs will attract a sufficient level of institutional money to meet the aims of market integrity.

We recommend that the FCA:

- Take a more proactive approach, providing more certainty to the SPAC and its investors that in the ordinary course of events, the SPAC has taken sufficient measures so as not to require a suspension of shares.
- Reconsider the level of the size threshold and provide greater level of clarity and disclosure on how they determined the proposed size threshold to be the right level, striking the appropriate balance between protecting investors from share suspensions, increasing the attractiveness of the UK, and avoiding a disorderly market.

It is important to note that resolving these concerns may not result in a significant increase in investment appetite for SPAC structures, considering the inherent concerns investment managers have about delegating their capital allocation responsibilities to a third party. There also remains an intrinsic misalignment of interests between sponsors and external shareholders which are of significant concern to investment managers when considering their appetite for risk.

These proposals cannot be seen as the only solution to incentivising high growth companies to list in the UK. As we set out in our submission to Lord Hill's review into the UK listings regime, it is essential that, alongside Government, the FCA considers the broad range of factors that influence the decisions of companies who are considering listing on the public market. One important consideration is how the UK can achieve a cluster of similar companies to list in the UK. This will need a range of requirements from political to regulatory support through to developing the expertise of analysts, legal and advisory banks, including the appropriate research provision for investors. There should be dedicated resources to support the active promotion of the UK as a listing destination with various options for companies to access public markets, from admission to the premium segment through to SPACs. Moreover, there should be a joined-up approach to some of the proposed investor protections suggested here, and those that will be revisited as a part of HMT's review of prospectus requirements. For example, the review of the role of forward-looking disclosures as a part of the prospectus requirements are also an important consideration for the disclosures that SPACs are expected to make upon announcement of a target acquisition.

Questions

1. **Do you agree with our description of the key features and risks of SPACs for investors?**
2. **Are there other key features or risks that we should consider?**

(Please see our collective response to questions 1 and 2 below)

Yes. We would, however, highlight an additional feature of SPACs which is distinct from other equity-based instruments: investment managers will consider investing in SPACs at various stages of their life cycle and will consider different risks at each of these stages:

<u>IPO stage</u>

This is the stage at which investment managers are least likely to invest in a SPAC. As there is little information about the type of acquisition the SPAC will make, the only information on which investors can consider relates to the track-record and expertise of the SPAC's management. For investment managers, investing at this stage is therefore similar to delegating the responsibility for allocating their client's capital to a third party. The investibility of SPACs at this stage is limited as investment managers are cautious about allocating capital when there is no ability to conduct full due diligence on the target company. Some managers may invest at this stage depending on the quality, expertise and track record of the SPAC management team.

The risks associated with investing at the IPO are further compounded by the possibility of share suspension. Managers will be reluctant to enter into investments where there is significant uncertainty around the period over which this capital will be tied up in suspended shares and would, therefore, not be available for other investable opportunities. This opportunity cost may not be in the best interest of their clients.

Private Investment in Public Equity (PIPE)

Some investment managers may be approached by the SPAC sponsors to become PIPE investors and buy shares directly from the SPAC. This usually occurs before the SPAC has publicly announced the proposed transaction. PIPE investors will be brought inside and receive confidential details about the proposed transaction, and so are able to make their own analysis of the target company and assess if they consider the valuation and terms of the target to be in their client's best interests. As a result of this greater clarity investment managers are more likely to be PIPE investors rather than at prior stages. Again though, managers will assess the risk associated with investing in SPACs at this stage and the uncertainty relating to a potential suspension.

Some members have highlighted that there is currently no guidance for valuing PIPE investments during the period between when the investor commits money to the SPAC and the completion of the acquisition. This can create difficulties when pricing and fulfilling the liquidity obligations of the fund.

Post-announcement

At this stage, the details and terms of the acquisition are publicly available and so the risks of investing in a SPAC are similar to that of investing in a standard commercial entity subject to the transaction completing.

General Features

There are risks that investors will be concerned about throughout all the stages outlined above. These have been highlighted in the consultation document, but the following are of particular concern to investment managers.

There is an inherent mis-alignment of incentives between public investors and the SPAC's sponsors. Sponsors typically acquire equity in the SPAC for a substantially lower price than public investors. Accordingly, their economic interest in the SPAC will vary greatly from public shareholders and their rate of return from the completion of any acquisition will be greater. In addition, some SPAC structures may result in sponsors incurring losses on their initial investments if the SPAC fails to complete an acquisition. When this is combined with the sponsors control over the SPAC's decisions on proposed acquisitions, they are heavily incentivised to ensure that the SPAC completes an acquisition, even where this acquisition is not in the best interest of public shareholders.

Further concerns about incentives relate to the advisory banks which underwrite the SPAC's IPO and often have an exclusivity agreement in place with the SPAC to advise it through the reverse takeover phase. These arrangements mean it is in the bank's interest for the SPAC to complete an acquisition, regardless of the strength of the underlying business and the interests of public shareholders.

The money raised by SPACs in the US at IPO has grown exponentially over recent years, and there are significant concerns about the availability of suitable target companies to match such growth. This may lead to increased competition for suitable target companies, and inflationary pressure on valuations. It may also lead to SPAC sponsors acquiring companies that are not sufficiently developed to be listed on public markets in order to complete an acquisition.

As a result of these risks, the importance of the governance of SPACs takes increased precedence. Several of these risks can be mitigated by ensuring that the SPAC has a strong and robust corporate governance regime. We consider it important for SPAC boards to have sufficient independent oversight through the appropriate representation of independent non-executive directors. This independent oversight will help to ensure that decisions will be made that reflect the best interest of public shareholders.

3. **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.**

Yes. The IA's members agree that applying a size threshold is a reasonable and prudent criterion as it increases the likelihood that there is a greater level of institutional investment in the SPAC. This will support market integrity as there is greater price formation.

4. **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?**

Whilst the IA agrees with the inclusion of a size threshold criterion, we consider the proposed limit of £200m may be too high and could mean that too few SPACs would be eligible to be considered for the 'alternative route to market'.

In the IA's members' experience of the US market, a substantial proportion of SPAC listing do not raise more than £200m from public shareholders, and a SPAC with a market capital of £200m would not be considered 'small'.

We are concerned about the adverse effect that implementing the size threshold at £200m would have on the ambition to increase the attractiveness of the UK as a listings destination for SPACs.

We encourage the FCA to reconsider the level of the size threshold and provide greater level of clarity and disclosure on how it determined the proposed size threshold to be the appropriate level, striking the right balance between protecting investors from share suspensions, increasing the attractiveness of the UK, and avoiding a disorderly market.

5. **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. Ring-fencing proceeds is a vital mechanism for protecting investors' capital. The degree to which their funds are segregated from the SPAC's operational running costs is an important consideration for investors when they are deciding to invest in a SPAC. Ring-fencing IPO proceeds also gives investors greater confidence that they will be able to redeem their shares. The SPAC should also be required to provide clarity in its prospectus on the ongoing running costs of the SPAC and the proportion of proceeds that will be returned to shareholders in the event that no acquisition is completed.

We agree with the rationale for not specifying that the proceeds must be held in escrow or trust. However, when considering whether the SPAC satisfies the criteria so that the suspension presumption will not apply, the FCA will need to be confident that shareholders' funds are adequately protected and can be returned to investors in full, less any agreed costs. We consider that the SPAC should have to provide evidence to the FCA on how the investor's funds will be ringfenced and protected from the general running costs.

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

Yes. IA members agree with the FCA that setting of a finite life span for SPACs reduces some of the uncertainty of investing in a SPAC.

Setting a time-limit on the lifespan of a SPAC will also safe-guard investors from losses incurred from accumulated running costs.

7. **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. A 2-year limit with the possibility of an additional 12 months is a balanced and pragmatic approach. Providing a mechanism to extend the life of the SPAC by an additional 12 months, subject to public shareholder approval, provides for a level of shareholder accountability while allowing shareholders to capitalise from any opportunity that arises later in the SPAC's lifespan.

The FCA should clarify the mechanics of the 12-month extension vote, specifically:

- the timing of when the vote may be proposed;
- what level of shareholder approval is required (ordinary or special resolution); and
- any disclosures required when seeking an extension.

As mentioned in response to questions 1 and 2, the SPAC's sponsors are heavily incentivised to ensure that the SPAC completes an acquisition- any time limit may further incentivise the managers of a SPAC to pursue a take-over towards the end of the two-year period which may not be in the best interest of the public investors.

8. ***Do you agree that a Board approval should be required, and that this should exclude directors that are also a director of the target or a subsidiary of the target?***
9. **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?**
10. ***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 subsidiary?***

(Please see our collective response to questions 8,9, and 10 below)

Yes. Any SPAC director who:

- holds directorships at a target company or its subsidiaries;
- has an associate that is a director of the target or its subsidiary;
- is considered to have a conflict of interest in relation to the proposed acquisition; and or
- has an existing or previous relationship with the SPAC's sponsors,

should not be included in a vote for Board approval as it cannot be guaranteed that they are acting independently and in the best interest of public shareholders.

We are aware that there may arise some scenarios where a large number (or a majority) of the Board have a conflict of interest. This would compromise a failing of corporate governance on behalf of the SPAC. IA members would expect the Board to ensure that there is a sufficient number of independent directors on the Board so that they may provide appropriate balance to the board, challenge the management of the SPAC, and apply independent judgment in its valuation and over the terms of the acquisition.

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

Yes. The proposed acquisitions should be subject to shareholder approval. A vote on the proposed acquisition is the only opportunity for shareholders to hold the sponsors accountable on how their funds will be invested and ensure that the proposed acquisition is in the best interests of public shareholders.

In addition, the sponsors' economic interest in the SPAC is likely to be different from that of public shareholders. The relative attractiveness of the acquisition for public shareholders and sponsors differs as sponsors will likely benefit more from any completed acquisition. It is these sponsors who have a significant role in agreeing the terms of the acquisition. They may, therefore, be incentivised to complete an acquisition that has little benefits, or even be detrimental to public shareholders. As such, it is imperative that the SPAC's sponsors are excluded from a shareholder vote, and the proposed transaction should require majority approval from public shareholders.

12. 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 is a subsidiary? Do you have feedback on who should be considered an appropriately qualified and independent adviser for this purpose?

Yes. The disclosure of such statements provides assurance to the public shareholders that the directors of the SPAC have acted in their best interests.

13. 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?

Yes. As previously stated, the incentives of a SPAC's sponsors are not aligned with those of its public shareholders and may be incentivised to act in ways that are not consistent with the best-interests of public shareholders. Regardless of any conflict of interest, the SPAC should be required to publish a 'fair and reasonable statement', prepared by an appropriately qualified and independent advisor.

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

Yes. A redemption right reduces the downside risk of investing in a SPAC and is an important shareholder protection. The structure and operation of a SPAC makes it an inherently risky investment, especially so for those who invest at the IPO stage, and the right to redeem shares is a vital protection in reducing the downside risk for investors.

It is also important that the redemption right is present in conjunction with ring-fenced proceeds. Sufficient ring-fencing is required to give assurances to investors that their shares will be redeemable in practice and that the SPAC will have sufficient capital to return funds to shareholders.

There should be clarity surrounding the terms of the redemption. The SPAC should make clear in its prospectus the timeline of the redemption process, clearly indicating at which stage of the SPAC's life cycle the shares become redeemable, and the length of the period which they are redeemable for.

15. **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. When combined with improved wider disclosure obligations, these provisions will protect investors from some of the inherent risks associated with SPACS, and so remove some of the impediments for investors when considering investing in SPACs.

16. **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?**

At the IPO stage, shareholders would value disclosures detailing the approximate size of company the SPAC intends on acquiring and the sectors in which the SPAC will be looking for a target company.

In addition, to specifying a pre-determined redemption price, the prospectus should provide disclosure on the SPACs anticipated running costs, giving clarity to investors on what proportion of the IPO proceeds will likely be returned to shareholders in the event that the SPAC does not complete an acquisition and is wound-up. Without these disclosures there will be sufficient uncertainty to undermine the security offered by ring-fencing IPO proceeds, reducing the investibility of SPACs for institutional investors.

An important disclosure for SPAC shareholders will be the terms of the relationship a SPAC has with the bank that underwrites its IPO, including the anticipated fees, any deferred underwriting fees, and exclusivity arrangements that are in place with the bank to act as an advisor through the PIPE and reverse takeover phases. In addition, the SPAC should have to disclose any relationship between the SPACs directors and any third parties. These disclosures will help investors to assess risks associated with any conflicts of interest.

The IA also believe that where the SPAC is incorporated outside of the UK, any risks associated with the jurisdiction of incorporation should also be set out in the prospectus

In the IAs response to Lord Hill's listing review we advocated for a thorough review of the Prospectus and Track record requirements to assess what information is important to allow investors to make informed investment decisions. We advocated for the inclusion of forward-looking disclosures in prospectus requirements to give confidence to investors about the company's strategy and financial resilience. This review will also need to assess what information will be most valuable to support shareholders to make informed voting decision on proposed acquisitions, and may need to consider the role of forward looking statements as part of a SPAC's disclosures.

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

The IA is concerned that the proposed supervisory approach gives little clarity at the IPO stage regarding the likelihood of suspension and is not consistent with the FCA's stated aim to increase investor protections and attract institutional investors to SPACs. As such this approach is likely to undermine the positive impact that the proposals will have on increasing the UKs attractiveness as destination for SPACs.

One of the largest risk that investment managers consider when assessing the investibility of a SPAC is the possibility that the capital they invest may be 'locked-up' in a listings suspension. Similarly, when a SPAC's sponsors are considering which market to list on they will assess the likelihood of the listing becoming suspended upon announcing the acquisition and the implications this has on the amount they will be able to raise at the public offering.

The FCA's supervisory approach will not give SPAC sponsors or investors sufficient confidence that it will not suspend the SPAC's listing, it is based on guidance and market practice. Market participants need more certainty that there will not be a suspension. Therefore, markets that give greater certainty on the likelihood that a SPAC's listing will not be suspended may remain more attractive venues for SPACs.

We believe this approach undermines the FCA's aim to encourage a wider range of SPAC listings, and does not provide investors with any additional protections. Instead, the FCA should take a more proactive approach, providing more certainty to the SPAC and its investors that in the ordinary course of events, that the SPAC has taken sufficient measures so as not to require a suspension. The FCA will retain the right to suspend the listing if it has other concerns that the smooth operation of the market is, or may be, temporarily jeopardised or is necessary to protect investors.

We believe that such an approach will provide investors with greater clarity about the risk of suspension thereby increasing the investibility of SPACs for investment managers, which may subsequently increase the attractiveness of the UK as a listings venue for SPACs. To support this, the FCA will need to ensure that it has sufficient resources and expertise to promptly analyse and assess if a SPAC has the necessary shareholder protections to be exempt from the general presumption of suspension.

18. 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?

Yes. IA members believe that each of the shareholder protections outlined in the proposals are necessary and that a SPAC should notify the FCA in the case that it no longer satisfies each of the criteria.

19. **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.**

As noted above, the incentives of SPAC sponsor and its public shareholders are not always aligned, and sponsors may be incentivised to make decisions that are not consistent with the interests of public shareholders. In addition to this, other parties with relationships to the SPAC, namely banks involved in underwriting the IPO and who facilitate the acquisition and subsequent takeover phase, are incentivised to ensure that the SPAC completes an acquisition which may not be in the interest of public shareholders.

Given this, the role of independent directors in applying independent and objective oversight and constructive challenge to the opinions and actions of sponsors and the Board is especially important. Independent directors will have an important role in providing Board approval and providing shareholders with fair and reasonable statements for proposed acquisitions. This is especially pertinent where the Board may otherwise be controlled by the SPAC sponsors or those with conflicts of interest. The Board should have a sufficient number of independent directors to represent the interests of wider stakeholders and protect shareholder value.

The IA does not believe that SPACs are suitable to be considered for admission to premium listing. Due to their inherent characteristics, SPACs are disproportionately risky investments and investors in funds that use an index strategy should not be exposed to these risks through the inclusion of SPACs to the premium segment and its indexes.

The FCA should consider the impact that celebrity endorsement will have on the smooth operation of the market and the protection of retail investors and how such endorsements are regulated.

20. **Should we explore providing differentiation in our measures applying to SPACs where they have a specific focus, e.g. 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. IA members believe that the rules should apply consistently to all SPACS. We do not see the value in applying divergent rules.