Special Purpose Acquisition Companies: Regulatory feasibility in India under the IFSCA Regulations

Special Purpose Acquisition Companies or SPACs are popularly known as "*blank cheque*" companies due to the purpose for which they are incorporated. SPACs are incorporated for listing on equity markets but do not own any assets or business since their primary objective is to effect a merger, amalgamation or acquisition of shares or assets of a company having legitimate business operations. SPACs raise funding from the process of Initial Public Offering (IPO) to subsequently invest in a company while avoiding the arduous procedures involved in listing through traditional means. Typically, upon formation, SPACs execute share swaps or merger proceedings. Currently, SPAC's are regulated and recognised in the United States of America, United Kingdom, Canada, Singapore and Malaysia.

Earlier this year, the Primary Market Advisory Committee of Security Exchange Board of India (SEBI) was formed to assess the viability and associated risks of such structures in the Indian market. Accordingly, the International Financial Services Centre Authority (IFSCA) published a consultation paper on the International Financial Services Centres Authority (Issuance and Listing of Securities) Regulations, 2021 which was subsequently codified into law on July 19, 2021[1].

SPAC Regulations

The International Financial Services Centres Authority (Issuance and Listing of Securities) Regulations, 2021 ("**IFSCA Regulations**") have paved the way for a much needed regulatory clarity on SPAC. The IFSCA Regulations regulate not only the sponsor of SPAC but also the SPAC transactions, business combinations, fund management or merchant banking activities. The public issue may be underwritten which shall be disclosed in the offer document. Similarly, the the IFSCA Regulations also list the initial disclosures which are to be mentioned in the offer document including risk factors, capital structure, redemption rights, liquidation, objects of

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[1] The International Financial Services Centres Authority (Issuance and Listing of Securities) Regulations, 2021 (https://ifsca.gov.in/Viewer/Index/202)

the issue, use of proceeds, interim use of funds, related party transactions etc. Additionally, at least 50% of the underwriting commission shall be deferred until successful completion of the business combination, and shall be deposited in the escrow account.

Other important regulatory aspects introduced by IFSCA Regulations are as follows:

S. No.	Particulars	Regulation
1.	SPAC Eligibility	• The target business combination should not have been identified prior to the IPO; • The SPAC shall have the provision for redemption and liquidation in line with the IFSCA Regulations.
2.	Sponsor Eligibility	Sponsor should not have been debarred from accessing the capital market, a willful defaulter or a fugitive economic offender.
3.	Offer Timing	Offer shall be made within a period of 1 year from the date of issuance of observations by IFSCA.
4.	Offer Period	The initial public offer shall be kept open for 3-10 working days only.
5.	Issue Size	• The issue size shall not be less than USD 50,000,000 (or any other amount that may be specified by IFSCA from time to time); • The sponsor shall holder 15-20% of the post issue paid up capital; • The sponsor shall hold an aggregate subscription (prior or simultaneous to the IPO) of at least 2.5% of the issue size or USD 10 million, whichever is lower, or any other amount as may be specified by the IFSCA.
6.	Pricing	The price of the equity shares in the IPO shall not be less than USD 5 per share.
7.	Application & Allotment	• Minimum application size in an IPO shall be USD 100,000; • Minimum subscription receives shall be at least 75% of the issue size; • Minimum number of subscribers shall be 50, or an amount as may be specified by IFSCA; • Allotment and refunds shall be completed within 5 days from the date of closing the issue.
8.	Management of proceeds	• SPAC shall ensure entire proceeds are kept in an interest-bearing escrow account controlled by independent custodian until consummation of business combination; • The interest and other income derived from the amount placed in the escrow account may be withdrawn only for the purpose of payment of taxes and/or general capital working expenses (subject to approval of shareholders of the SPAC).
9.	Prospectus	The SPAC is required to file a detail prospectus with the recognized stock exchange containing disclosures such as: • Overview of the business, management structure, financials of the target company(ies).; • Information about the business combination transaction including their

		valuation; • Information regarding the statutory approvals involved in the completion of the transaction; • Information about the resulting issuer company that would be formed after completion of the business combination.
10.	Shareholders' Approval	• The SPAC is required to seek prior approval of majority of the shareholders for the proposed business combination; • Shareholders shall have the right of redemption for converting its securities into pro-rata portion of the aggregate amount held, in the event they have voted against the proposed business combination.
11.	De-SPAC transaction	• The SPAC issuer shall complete the business combination within the timeline disclosed which shall not exceed 36 months from the date of listing on the recognized stock exchange; • If the combination is not completed within the specified timeframe, the escrow account shall be liquidated and in the event of delisting and liquidation, the sponsors shall not participate in the liquidation distribution; • The SPAC issuer shall ensure that the businesses acquisition shall have an aggregate fair market value not less than 80% of the aggregate amount deposited in the escrow account, excluding deferred underwriting commissions held in escrow and any taxes payable on the income earned on the escrowed funds; • The sponsors of the SPAC shall ensure that there is no related party transaction or connection of sponsor or any of their associates with the business combination.
12.	Warrants	In the event warrants have been issued in the IPO, the SPAC is required to comply with the following: • Each unit shall not consist of more than one share purchase warrant; • the exercise price of warrants shall not be lower than the price of the equity shares offered; • The warrants shall not be exercisable prior to the completion of the business combination; • The warrants shall not have any entitlement to the funds lying in the escrow account upon liquidation or redemption
13.	Post De- SPAC transaction	• The shareholding of the sponsors in the resulting issuer shall be locked for a period of 1 year from the date of closing of the business combination; • The shareholding of the promoters, promoter groups, controlling shareholders, directors and key managerial personnel of the resulting issuer shall be locked up for a period of 1 year from the date of closing of the business combination.

Going forward, the IFSCA Regulations could potentially put India on the map of reinventing the path of investment not just in the Indian market but also for overseas listing, which is currently restricted under the extant Indian laws. SPACs could potentially provide Indian entities access to foreign capital. However, despite the introduction of IFSCA Regulations there still exist legal impediments towards that end.

Existing impediments

Listing Restrictions

Section 23 of the Companies Act 2013 was amended in 2020, to enable listing of companies in foreign jurisdictions; however, SEBI permits equity listing of only operational companies with reported and proper financials. Notably, Regulation 6 of the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018[2] sets out the conditions for listing in equity markets. The provision requires an issuer to have net tangible assets of at least INR 30 million in each of the preceding three (3) years, and distributable profits for at least three of the preceding five (5) years, and a net worth INR 10 million. Till its amendment, Regulation 6 of the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 shall continue to pose a great threat to the overall permissibility SPACs in India.

Operational Restrictions

As per Section 248 of the Companies Act 2013, any company failing to commence its business operations within a period of 1 year from the date of incorporation is liable to be struck off from the register of companies by the Registrar of Companies. Given the fact that SPACs do not own any kind of business prior to a De-SPAC transaction (one which entails acquisition of an existing business), the provisions of the Companies Act 2013 are yet to incorporate a company of this nature.

Conclusion

Besides the above, there could be subjective restrictions such as levy of high stamp duty foreign exchange control and tax implications. Sponsors and shareholders of SPAC will be required to be mindful of the taxability of capital gains which may incur on the swap or transfer of shares of the SPAC. The quantum taxability on the transfer would depend the type of business combinations, residential status of the shareholders mode of transfer etc. The IFSCA Regulations holistically regulate the pre and post De-SPAC Transactions which help manage companies to seek and implement lucrative funding opportunities. As a result, it is predicted that India's start-up ecosystem could heavily benefit from the increasing permissibility on floating of SPACs. However, an amendment in the extant laws to form in line with the IFSCA Regulations is a much awaited for the marketability of such securities in India.

[2] SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 (https://www.sebi.gov.in/legal/regulations/sep-2018/securities-and-exchange-board-of-india-issue-of-capital-and-disclosure-requirements-regulations-2018-_40328.html)