InteractiveBrokers

Interactive Brokers Risk Disclosure for Trading in SPACs

Interactive Brokers ("IBKR") offers customers the ability to invest in special purpose acquisition companies ("SPACs"). Investing in SPACs involves risks that differ from investing in the stock of an operating company. You should carefully consider these special risks, some of which are described below, before making an investment decision.

What is a SPAC?

A SPAC is a shell company that is formed to raise capital through an IPO, where that capital will be used to acquire a private company or business to be identified after the IPO. SPACs are formed by a sponsor or team that makes initial investments in the SPAC alongside outside investors. The sponsor generally has expertise in the industry sectors from which the target company will be selected and will manage the selection, financing and legal processes involved in acquiring the target company. However, there are also SPACs for which the sponsors do not identify an industry or a sector from which the SPAC will select an acquisition target. These SPACs may identify a merger target from a broader range of companies, but may have less expertise about the type of company/industry the SPAC may ultimately merge with.

Information to Consider

You should carefully read the SPAC's prospectus as well as its reports filed with the Securities and Exchange Commission ("SEC"). It is important to understand the terms of your investment. SPACs are often are structured similarly but it is important to understand the specific features of an individual SPAC, including: how the sponsor is compensated; the background of the management team; the terms of the trust account used to hold the SPAC's IPO proceeds; potential conflicts of interest with the SPAC sponsors; details about the initial business combination transaction; and underwriter fees

Risks Associated with SPACs

There will be different levels of risk depending on the specific details of a SPAC investment. Consider the following risks associated with SPACs:

- **Limited Information.** In a traditional IPO, the company seeking to go public is typically required to provide disclosures and go through due diligence processes prior to launch. With a SPAC, there is less required disclosure, and investors may invest solely based on the reputation of the sponsors and management team.

- **Speculative investments.** Investors in SPACs may become exposed to domestic or foreign companies and businesses of varying risk profiles and may encounter business models that focus on high risk, longshot type investments without concern for potential long-term risks. SPACs may focus on trendy sectors or business models that may be short-term fads instead of viable long-term businesses.

- **Fees and Sponsor Incentives.** SPAC sponsors are generally compensated based on the difference between the SPAC's IPO price and the price that a target company may obtain if it opted for traditional IPO. When a SPAC raises money from public investors, the public investors typically pay at least a 5.5 percent investment banking fee and generally give the sponsors a 20 percent interest in the SPAC, and potentially other indirect fees. As a result, some market participants view SPACs as more expensive than traditional IPOs.

- **Conflicts of Interest and Fraud.** The SPAC process relies heavily on underwriters and sponsors who are incentivized to identify an acquisition target. Investors should be aware of the potential for conflicts of interest between SPAC sponsors and SPAC shareholders since sponsors (given their heavily discounted interest in the SPAC's common stock) may profit when an acquisition is completed even if the acquisition proves unsuccessful for the investors. This also raises the risk of potential misuse of funds and potential fraud through misrepresentation or omissions regarding the prospects of the target company.

- **Trading Price.** SPACs are typically priced at $10 per unit during the IPO, but when these units begin trading their market prices may fluctuate—sometimes significantly—even before a merger target is identified. Given the fees mentioned above, buying at an elevated price can make it more difficult for investors to see a positive return on their investment after an acquisition is completed.

Additional Resources

The SEC's Office of Investor Education and Advocacy issued an investor bulletin titled, "What You Need to Know About SPACs" which is available here.