

SPACs, Complex Investment Products, and Disclosure

SPACs are popular investment vehicles. The number of IPOs involving these investment vehicles has increased significantly in recent years. For example, from 2019 to 2021, the number has increased by about a factor of 10. Yet not long ago these investment vehicles were called “blank check” entities because investors purchased shares not based on valuing the business the firm may be in but rather who will pick the business – the only business of the blank check company has is to invest the money entrusted to the vehicle by the public in a business selected by the insiders. That contrasts sharply with the traditional IPO.

While the number of IPO’s involving SPACs has increased, the Commission has made it more than clear that these vehicles are not favored. In recent remarks Chair Gensler discussed his views of these vehicles. Gary Gensler, Remarks Before the Healthy Markets Association Conference, Washington, D.C., December 5, 2021.

Mr. Gensler began with what he called a basic public policy point: Like cases should be treated alike. Yet, the structure of SPACs, which differ from that of the traditional IPO, can create investment pitfalls for investors. For example, typically the sponsors have two years to find an investment vehicle for the merger which ultimately launches the actual business of the firm. In addition, before the ultimate merger is consummated, there is typically another round of financing, often through a PIPE offering involving institutional investors. Then, if a deal is located the initial investors have an opportunity to cash out at the IPO price. Collectively, these steps can result in misaligned interests and conflicts.

Chair Gensler highlighted concerns regarding SPACs after detailing the points above. First “there is inconsistent and differential disclosure among the various parties involved . . .” by virtue of the fact that different investor groups join the deal at different points. There are initial investors, later PIPE investors and still later the merger investors. These asymmetries can create issues.

Marketing practices used by SPACs can also create issues. The deals are often

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launched with “a slide deck, a press release, and even celebrity endorsements.” This is not necessarily the kind of full disclosure that investors need.

Finally, there are questions about who is performing the role of gatekeepers. In the traditional deal the issuer often works with the investment banks and underwriters. In contrasts, there may be some “who attempt to use SPCs as a way to arbitrage liability regimes.” This is not really the way to handle the obligations of a gatekeeper – Chair Gensler made it clear that nobody gets a “pass” on doing this.

Comment

Chair Gensler presented a series of serious concerns regarding SPACs. At the same time, if the disclosure is adequate so that investors can assess the issues what is the proper role for a disclosure agency like the Commission?

While a SPAC blank check company launches with less disclosure than a traditional IPO, and perhaps more investment dangers despite adequate disclosures, this may simply be another way to say that the vehicles are very high risk and thus not for the average main street investor. That is the same problem with many very complex investment vehicles however -- the disclosure is adequate but many investors still suffer large losses from the risks. This point is will illustrated by a number of recent cases bought by the Commission. In the end, there are instances when disclosure is not really enough. The question of how to solve that issue in the context of the federal securities laws presents a most difficult puzzle.