

*United States Senate*  
COMMITTEE ON BANKING, HOUSING, AND  
URBAN AFFAIRS  
WASHINGTON, DC 20510-6075

March 23, 1987

The Honorable John Shad  
Chairman  
Securities and Exchange Commission  
450 Fifth Street, NW  
Washington, DC 20549

Dear Chairman Shad:

Since my letter to you dated February 17, 1987 requesting information regarding the activities of risk arbitrageurs and the impact of such activity on the explosive growth of merger and acquisition activity in the last five years, the Office of the Chief Economist of the Securities and Exchange Commission published its report titled "Stock Trading Before the Announcement of Tender Offers: Insider Trading or Market Anticipation".

As you are aware, the report specifically detailed the almost universal severe pre-announcement run-up in the stock prices and trading volume of the common stock of companies which subsequently become the targets of takeover bids. Although there is evidence that some of the pre-announcement activity may be the result of legitimate informed trading decisions based on astute research (including analysis of observable data such as stock accumulations by the bidder) or newspaper reports of takeover activity, it is an almost inescapable conclusion of the Report that a substantial portion of the control premium allocable to shareholders of a target corporation in an acquisition situation is being siphoned off by market participants executing trades in violation of the federal securities laws. In fact, the cold statistical data compiled by the Chief Economist tends to demonstrate that illegal insider trading may be more prevalent than even the events surrounding the Levine, Boesky and Siegel indictments have suggested.

For the United States to continue to attract capital from all over the world, our markets must be perceived as fair and honest. Unfortunately, the spreading view of our markets is that certain market participants may not be playing according to the rules.

The circumstances surrounding recent indictments raises the possibility that a large portion of the profits generated in recent years by investment banks may have arisen in connection with the arbitrage departments of such banks taking substantial pre-announcement positions in stocks which subsequently became the targets of tender offers. In fact, the growing perception that substantial pre-announcement purchases of targets' stock by the arbitrage departments of major investment banks resulted from a breach of the "Chinese-Wall" between investment banking and trading functions or from the swapping of information by arbitrageurs

which was received in connection with consultations with members of the investment bank's merger and acquisition team is leading to a weakening of public confidence in the functioning of the capital markets.

The purpose of this letter is to supplement my letter of February 17, 1987, requesting information on the risk arbitrage business. In particular, to the extent the information is presently available to you or may be obtained by your making requests to the major investment banking houses which have arbitrage departments, I would like you to provide the information detailed below. For purposes of this request please consider the following institutions to be the major investment banks with respect to which I need information: Bear Sterns, Drexel Burnham, First Boston, Goldman Sachs, Merrill Lynch, Morgan Stanley, Salomon Brothers, and Shearson Lehman.

1. With respect to the 172 successful tender offers between 1981 and 1985 referred to in the Report of the Chief Economist, a detailed breakdown of the pre-announcement purchases by the arbitrage department of each of the investment banks listed above. For purposes of selecting the pre-announcement date, the investment banks should use the news-adjusted date ("N.A. Date") referred to in the Report. Such breakdown should provide the date, number of shares purchased and price of each such purchase by such arbitrage department.
2. The annual profits of the arbitrage department of each of the investment banks referred to above for the years 1981-1985. The percentage and dollar amounts of such profits which may be attributable to purchases of stocks referred to in the Report made prior to the "N.A. Date" with respect to each such stock.
3. The internal guidelines or procedures of each of such investment banks relating to consultations between such bank's arbitrage and merger and acquisition departments in connection with mergers or acquisitions with respect to which such investment bank's merger and acquisition department is rendering services. In connection with the response to this question, the investment bank should also provide any guidelines and procedures relating to contacts between its arbitrage department and other arbitrage departments with respect to a company's stock when the investment bank's arbitrage department is consulting with its merger and acquisition department in connection with the merger and acquisition department rendering services with respect to such stock.

I would appreciate a response to these inquiries by June 1, 1987. Please view this request and the accumulation of this data as a top priority matter.

Sincerely,

William Proxmire  
Chairman