United States Senate

COMMITTEE ON BANKING, HOUSING, AND
URBAN AFFAIRS

WASHINGTON, DC 20510-6075

October 5, 1989

Richard C. Breeden
Chairman
Securities and Exchange Commission
450 Fifth Street N.W.
Room #6000
Washington, D.C. 20549

Dear Chairman Breeden:

Recent events, particularly the financial difficulties of Campeau Corp., have focused attention again on so-called "junk bonds" and the financings in which they have played a major role. These financings have typically resulted in debt-equity ratios vastly in excess of those which have traditionally been regarded as prudent by American businessmen and financing instrumentalities. They have, in effect, displaced significant amounts of equity in many American corporations with potential consequences which have not to date been sufficiently discussed or understood.

Junk bond financings have been part of a broader capital market process involving the "privatization" of the equity markets and the "securitization" of the debt markets. This process, particularly the "securitization" of debt, has exposed markets to new risks and involves issues of control and disclosure that do not appear to me to be adequately addressed by current regulations and oversight practices.

Today, in a highly leveraged corporation, control is often not in the hands of the shareholders. True, they may have certain rights resembling those possessed by shareholders in conventionally financed corporations, but in truth the exercise of those rights and the destiny of the corporation is heavily influenced or controlled by the holders of the debt securities of the corporation.

Moreover, there has been expressed in Congress, and elsewhere from time to time, concern over the concentration of economic power through the ownership of corporate equities in various institutions and entities. This concern has always been related to equity ownership concentration.

Further, in view of the widespread belief that we will witness an increasing parade of troubled LBO's which may cause serious losses to holders of "junk bonds" (already "junk bonds" and "junk bond funds" have been discounted in the market), it is important for the nation and its policy-makers to know which types of financial institutions are holders of significant amounts of this jeopardized paper. To the best of my knowledge no one has assembled this information, which could be of significant interest to those vested with the responsibility for developing major financial policies in this country.

For example, if the Senate Banking Committee wanted to find out in any detail the size and ownership of the holdings of junk bonds by pension funds, insurance companies, banks and securities firms, that information would be very difficult to come by since it is not accumulated on a centralized basis anywhere within the government. What information is currently available in the aggregate is at best suspect.

I would urge that the Treasury Department, in collaboration with other relevant agencies of the government, develop the means of securing, assembling and publicizing information concerning the holders of "junk bonds." Knowing who are the risk-takers in this new financial environment could be very helpful to you and others in developing policies for dealing with what increasingly appears to be the likelihood of wide-spread defaults under such securities, and such information would be helpful to the public in formulating its convictions with regard to economic policy.

In addition, thought must be given to improving the information about the market for these less than investment grade securities so that individual investors and others may be informed on a real time basis what the bid and ask price are for these instruments and the extent to which they are liquid and marketable in the secondary market. Given the fact that public markets have been a central element in the growth of junk bond financing, the SEC must take steps to ensure that a modernized quotation system is put into place.

There are undoubtedly other issues related to the proliferation of new and inventive debt securities and to the use of the public securities markets to leverage the U.S. economy that the Treasury and the SEC might feel appropriate to address.

I appreciate your attention to these issues and look forward to your written response to the suggestions I have made.

Sincerely,

Don

Donald W. Riegle, Jr,
Chairman

cc: Nicholas F. Brady