

*U.S. house of Representatives  
Committee on Energy and Commerce  
Room 2125, Rayburn house Office Building  
Washington, DC 20515*

April 19, 1990

The Honorable Richard C. Breeden  
Chairman  
Securities and Exchange Commission  
450 Fifth Street, N. W.  
Washington, D. C. 20549

Re: Release 33-6806, File No. S7-23-81  
Release 33-6839, File No. S7-23-88

Dear Chairman Breeden:

This is with reference to the Commission's action today in adopting Rule 144A. This new rule has the potential to effect far-reaching changes in the structure and functioning of the U.S. capital markets. Accordingly, we request that the Commission, as part of its oversight of the rule's implementation, report to us on a periodic basis as to the impact of the rule, whether it is achieving its aims, and how it is affecting investors, both individual and institutional.

We strongly endorse what we understand to be the policy goals underlying the Commission's adoption of Rule 144A. The Commission staff is to be commended for its creativity, hard work, and the high quality of its efforts in seeking to enhance the competitiveness of the U.S. in today's global markets. Nonetheless, we are concerned about the specific mechanism established to achieve these goals. In particular, we are concerned about the possible development of a two-tiered securities market for U.S. investors, one public and one private, and the serious negative implications of such a development; the diminished availability of many quality investments to smaller investors and, conversely, the greater likelihood that poor investments will be passed on to unwitting investors through mutual and pension funds or other avenues of leakage; and the rule's diminution of the amount and type of disclosure, particularly with regard to foreign companies about which U.S. investors have historically had little information.

On a fundamental basis, however, we are concerned that Rule 144A may be ultra vires, i.e., beyond the scope of the powers of the Commission.<sup>1</sup>

Congress, in enacting the federal securities laws, created a continuous disclosure system designed to protect investors and to assure the maintenance of fair and honest securities markets. The Commission, in order to administer and implement the objectives of the Securities Act of 1933, has been vested with rulemaking authority to implement the fundamental purposes of the Act as expressed in its preamble: "To provide full and fair disclosure of the character of the securities sold in interstate commerce and through the mails, and to prevent fraud in the sale thereof ...."

Exemptions from the registration requirements were provided for certain types of securities and securities transactions where there was no practical need for registration or where the benefits of registration were deemed to be too remote.<sup>2</sup> Among these exemptions is that provided by Section 4(2) of the Act for transactions by an issuer not involving any public offering, i.e., so-called private placements. This exemption was originally intended to permit an

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<sup>1</sup> Section 6(c) of the Investment Company Act of 1940 vests the Commission with broad exemptive powers to exempt any person, security, or transaction from any provision or provisions of that Act as follows:

The Commission, by rules and regulations upon its own motion, or by order upon application, may conditionally or unconditionally exempt any person, security, or transaction, or any class or classes of persons, securities, or transactions, from any provision or provisions of this title or of any rule or regulation thereunder, if and to the extent that such exemption is necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of this title.

There is no corollary to this provision in the Securities Act of 1933. See also discussion in text following this footnote.

Our concern is not hypothetical. The impact of Rule 144A is to repeal the operation of the Section 5 registration requirements for resales of restricted securities to any institution with assets invested in securities that were purchased for a total of more than \$100,000,000. During Commission debate, considerable support was expressed for lowering that threshold in the near future. In response to a question about the effect of lowering the level from \$100,000,000 to zero, the staff responded that such action "would repeal the 1933 Act for institutions."

<sup>2</sup> H. Rep. No. 85, 73d Cong., 1st Sess. (1933), p. 5.

issuer to make a specific or isolated sale of its securities to a particular person.<sup>3</sup> The exemption is available for offerings to persons having access to substantially the same information concerning the issuer which registration would provide and who are able to fend for themselves.<sup>4</sup> Resales of securities acquired in private placements are frequently made under claims of an exemption pursuant to Section 4(1) of the Act, that is, a transaction by a person other than an issuer, underwriter, or dealer. This Section was intended to exempt only trading transactions between individual investors with respect to securities already issued and not to exempt distributions by issuers or acts of other individuals who engage in steps necessary to such distributions.<sup>5</sup> Rule 144A appears to exceed these authorities and may be in conflict with the fundamental purposes of the Act.

In light of these concerns and the significance of the rule, we request that the Commission report back to us on a consistent basis. Each of the Commission's reports should, at a minimum, respond to the following questions:

1. Is Rule 144A serving the policy purpose of attracting more foreign issuers to the U.S.? How many foreign issuers have entered the U.S. private placement market since the rule's adoption, and for what percentage of the gross dollar amount of offerings in that market are they responsible? What is the percentage of foreign versus U.S. issuer participation in this market?

2. Who are the purchasers (e.g., mutual funds, pension funds, insurance companies, etc.) of securities placed pursuant to the Rule 144A safe harbor in both the primary and secondary markets? Please indicate the percentage of the overall market commanded by each type of purchaser.

3. To what extent are banks and thrift institutions (by number and with respect to the percentage of the overall market for which they account) participating in this market? Of these, how many have established separate broker-dealer entities through which all such activity is conducted? Are these institutions participating as purchasers in this market, and if so, is there a need, for safety and soundness or other prudential reasons, to limit their ability to do so, either by raising the net worth qualifying threshold or by other means?

4. Is the dollar threshold for participation as a purchaser sufficient for purposes of investor protection? Have investors in funds that purchase securities issued under the Rule 144A safe harbor received adequate and effective disclosure of the risks associated with those securities? Please assess on an ongoing basis the quality, quantity, and effectiveness of disclosure in this market.

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<sup>3</sup> Id. at 15-16.

<sup>4</sup> Securities and Exchange Commission v. Ralston Purina Co., 346 U.S. 119 (1953).

<sup>5</sup> Securities and Exchange Commission v. Chinese Consol. Benev. Ass'n. 120 F. 2d 738 (2d Cir. 1941), cert. denied, 314 U.S. 618.

5. To what extent has there been a shift of offerings from public to private markets among U.S. issuers? Has there been a discernible impact on the depth and liquidity of the public markets for securities? Has there been a decrease in pricing efficiency and, consequently, a diminution in investor confidence, in the public securities markets? Does the response differ according to whether debt or equity is at issue?

6. To the extent that debt issued under Rule 144A is rated by the ratings agencies (e.g., Moody's Investors Service and Standard & Poor's Corporation), how do these ratings break down? How do these issues compare to public issues?

7. What has been the rate of default on debt securities issued pursuant to the Rule 144A safe harbor?

8. How are Rule 144A securities priced on issuance and in the secondary market and how reliable have such prices proven to be to market participants and investors? Should our regulators more closely scrutinize pricing practices for potential abuses? To what extent has the NASD's PORTAL system addressed any of these problems?

9. Please explain and assess the effectiveness of any and all safeguards imposed in the rule or otherwise regarding leakage. Notwithstanding the rule's attempt to exclude fungible securities, have there been any "leaks" of Rule 144A-issued stock fungible with publicly-traded and registered stock from the private into the public markets? Have any parallel public and private markets developed as a result of an issuer of securities traded in the Rule 144A market thereafter listing those securities on an exchange or as a result of those securities being quoted on an automated inter-dealer quotation system?

10. Is there any evidence that Rule 144A has provided an alternative for controlling interests in companies that have been taken private in leveraged buy-outs to withdraw their investment without taking the company public again?

11. Of the companies issuing securities pursuant to Rule 144A, how many of them have been participants in the public U.S. markets within the past ten years?

12. For purposes of the investment restrictions in the Investment Company Act, has the market in Rule 144A-issued securities been sufficiently liquid to justify investment in such securities by investment companies in excess of the 10% statutory limitation? Please assess the quality of the performance of the boards of directors of such companies in measuring and responding to changes in liquidity for purposes of that limitation.

13. Is there any need to amend Rule 144A in light of the above or any other considerations, and if so, in what ways? Is there any need for legislation in this area to address any outstanding issues?

We understand that it may take some time before the markets acclimate themselves to the new rule and for information of the sort solicited above to become available. That is why our

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request is of a continuing nature. We would, however, appreciate an initial response to the above questions by November 1, 1990, with follow-up reports due at six-month intervals. If you or your staff have any questions about this request, please contact either Consuela Washington or Elise Hoffman of the Committee on Energy and Commerce and the Subcommittee on Telecommunications and Finance, respectively.

Sincerely,

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JOHN D. DINGELL

Chairman, Committee on Energy  
and Commerce

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EDWARD J. MARKEY

Chairman, Subcommittee on  
Telecommunications and Finance