Securities and Exchange Commission
Washington, D.C.

September 20, 1966

Mr. G, Keith Funston, President
New York Stock Exchange
Eleven Wall Street
New York, New York 10005

Dear Mr. Funston:

This refers to your letter of July 5, 1966, commenting upon our May 19 letter concerning the Exchanged proposals dealing with "give-ups, give-aways, commission splitting with non-members, brokers, and volume discounts." As you know, we have also recently expressed our views on these matters to registered national securities exchanges and the National Association of Securities Dealers, Inc.

We note that your committee is prepared to recommend the prohibition of give-aways and is willing to accept the prohibition of give-ups. You go on to state, however, that as you understand our letter of May 19, it would be permissible for the customer to give the order directly to an out of town firm (as long as it does not represent part of a larger order being given to a number of out of town firms with the same correspondent). Your comment points up the possibility that our letter of May 19 may have taken too narrow a view of the action necessary to eliminate the basic problem of payments to firms not performing any necessary services in connection with the transaction. To the extent that institutional investors seek out firms with whom they have no usual, normal and regular brokerage relationship for the purpose of rewarding them for services not connected with the brokerage function, by giving them orders for transmission to an executing firm, we believe this would lead to essentially the same result, i.e., the rewarding of member firms through a division of the commissions under circumstances intended to be proscribed by the prohibition of give-ups and give-aways; this development, too, therefore should be prohibited, However, a meaningful and prompt revision of the present rate structure, including a volume discount, may prevent the problem from arising. Our staff is prepared to discuss promptly this important matter with you.

As we have advised you, we do not intend to disturb the traditional correspondent practices by which a transmitting broker shares the commission with its correspondent who completes the transaction through the facilities of the Exchange. However, that traditional practice involves a sharing of duties, responsibilities and obligations as well as a sharing of rewards. In the situation you describe in your letter, it appears that an out of town broker which does not enjoy the traditional brokerage relationship with the buyer or seller, as described above, is being rewarded at the request of such buyer or seller for reasons unrelated to the execution of the order. That practice is obviously intended to achieve the same purposes now accomplished by the "give-up" and "give-away". Consequently, for the reasons already stated, we believe that it should be prohibited.

As your letter recognizes, the Exchange's proposals on commission splitting with non-members would provide a method by which institutional investors might accomplish the objective now reached by the "give-up" and "give-away." We are receptive, however, to modifications which would restrict the kinds of orders which could be transmitted by non-members to the Exchange to those we believe intended by your original proposal. These might include, among others, limitations on the number of shares to be encompassed by such an order, a bona fide customer relationship to the non-member and provisions designed to assure the probability of execution of the order in the normal auction process, with the purpose of limiting such transactions to those in which the non-member performs services for his customer in connection with such order or has recommended its purchase or sale. Since we appreciate that implementation of this approach presents difficult problems, our staff is prepared to work with you in developing guide lines which would give non-members access to the Exchange under circumstances which would not reopen the "give-up" problem.

We agree with you that the question of volume discounts is linked to the "give-up" problem, and that your members should not be asked to act on either of them without being advised that action on the other is also contemplated. However, this does not mean that both questions must be completely resolved before either one can be submitted to your membership. We realize that a volume discount poses a number of difficult mechanical and conceptual problems, but, as we said in our letter of May 19, we believe some of these problems will be simplified by adoption of a rule prohibiting give-ups. In any event, we believe that our staffs should proceed with discussions of both questions as soon as possible.

We expect our investment company study report to be released in the near future. We do not, however, anticipate that the report, as it relates to the commission rate structure, will provide any fundamental information which is unfamiliar to you or which will help resolve the technical problems involved in the implementation of the program. For this reason and because the solutions reached should be effected on an industry-wide basis, it is urgent that detailed discussions between our staffs begin promptly with the goal of arriving at specific rule changes which the Commission and the Boards of registered national securities exchanges and the National Association of Securities Dealers can act upon.

Sincerely,

Manuel F. Cohen
Chairman