

Investors Diversified Services, Inc.
Minneapolis, Minnesota

March 29, 1968

Securities and Exchange Commission
500 North Capitol Street
Washington, D. C. 20549

Re: Securities Exchange Act of 1934 Release No. 8239

Gentlemen:

The following comments are directed to the above captioned release relating to the New York Stock Exchange's proposal for certain revisions of its commission rate structure and to the Commission's proposed Rule 10b-10.

Before commenting in detail on the proposals, we would express certain general opinions. With respect to proposed Rule 10b-10, we are in accord with the broad general objectives sought to be achieved by the Rule, but do not believe that the Rule as drafted and proposed is the most appropriate method by which to achieve the objectives.

With respect to the New York Stock Exchange proposal, we of course concur in the conviction that some form of volume discount is necessary and appropriate, assuming that it would be both meaningful and workable, but do not agree that it is either necessary or appropriate to condition the institution of a volume discount on acceptance of all five aspects of the Exchange's "package".

Proposed Rule 10b-10

To the extent that the proposed Rule is grounded on the proposition that portfolio brokerage should be used for the benefit of the fund and fund shareholders, we are of course in entire accord. IDS has always held that conviction. As the Commission is aware, when it became possible for IDS to recapture a portion of fund portfolio brokerage through the medium of the membership of our subsidiary, IDS Securities Corporation, on the Pacific Coast Stock Exchange, IDS immediately provided for a reduction in the management fee paid by the funds equal to 100 percent of any profits realized from a recapture of the brokerage. We operated on the principle that whatever IDS could accomplish in reducing the brokerage cost for the fund shareholders was simply another

service provided by IDS for the management fee paid IDS, not an additional source of profit to IDS. [Footnote: We do not mean to imply that participation by a fund manager in brokerage profits is per se unlawful or improper. IDS has not chosen to do so. We recognize however that brokerage can be a form of compensation, either alone or in conjunction with other forms, subject of course to full disclosure and the requirements of Section 17(e) of the 1940 Act.]

Our difficulty with the approach of the proposed Rule is that it is directed at one of the mechanics by which portfolio brokerage is allocated among brokers rather than at the purposes for which it is allocated. As a consequence the Rule would foreclose the use of the mechanical device of a customer-directed give-up (other than for recapture) even though used for entirely appropriate purposes; at the same time the proposed Rule does not preclude the use of portfolio brokerage for what might be inappropriate purposes so long as it is allocated directly or by devices other than the customer-directed give-up. The Commission does not suggest that the Exchange rules which permit customer-directed give-ups are in themselves improper. Yet the proposed Rule is aimed solely at a particular means rather than the uses. It assumes that there can be no proper use of give-ups other than for the purpose of recapture. With this we disagree. In effect the proposed Rule goes too far in one respect, and not far enough in another.

Two of the principal purposes for which the directed give-up is used are to reward brokers for the sale of fund shares and, secondly, to compensate brokers for research services rendered. IDS does not and has never used portfolio brokerage for the former purpose.

We believe that research services rendered by brokers are unquestionably beneficial to the funds and the fund shareholders. Recourse to such services should not be inhibited, and it is traditional and appropriate to compensate brokers for such services from portfolio brokerage.

Whether the use of portfolio brokerage to supplement by undisclosed amounts the commissions paid to dealers for selling fund shares is an appropriate or proper purpose is another matter. IDS does not believe that it is. On the contrary, the practice has contributed strong pressures toward the development of abuses in sales practices and the disruption of orderly distribution.

The proposed Rule seems to be premised, however, upon the proposition that the customer-directed give-up is evil per se. With this we do not agree. The device is an appropriate and convenient vehicle which can be used for very appropriate purposes. Were it otherwise, then clearly the approach should be a revision of the Exchange rules so as to prohibit customer-directed give-ups as such -- including their utilization by banks and other institutional investors as well as mutual funds. [Footnote: It would be incongruous to preclude a mutual fund

from directing a broker to give up to other brokers to compensate the latter for research services rendered, while countenancing the practice of banks in directing give-ups from brokerage generated from customer and trust accounts to other brokers to reward them for maintaining deposits in the bank.]

Conversely, if portfolio brokerage is being used for what the Commission believes are inappropriate purposes then the approach should be to prohibit directly such uses of portfolio brokerage, rather than to prohibit the use of a particular means of allocation, without regard to purpose. The proposed Rule prohibits only the use of give-ups, and prohibits the use for any purpose. It leaves a fund free to award brokerage business directly -- reciprocal business -- for any purpose, such as additional compensation in undisclosed amounts for sales effort.

If it is the Commission's conviction that it is wrong to use portfolio brokerage to supplement the compensation to dealers for the sale of fund shares, over and above the commission payable out of the sales load, then it would clearly seem that it is wrong to do so either by utilization of give-ups or by other devices.

The same can be said with respect to the use of portfolio brokerage to compensate brokers for research services rendered. If it is wrong to do so, then the practice should be prohibited. If it is not wrong, then it is inappropriate to prohibit the use of an effective and convenient vehicle for that purpose when there is nothing wrong with the vehicle as such.

For the foregoing reasons we respectfully recommend that the Commission give consideration to employing a different approach to the solution of whatever problems it believes presently exist in the use of fund portfolio brokerage. More specifically, we suggest that if the Commission concludes that it is improper to use fund portfolio brokerage for certain purposes, such as additional compensation for fund sales, the Commission should forthrightly specify the purposes for which the use of fund portfolio brokerage is improper and prohibit the use of brokerage for such purposes. We do not believe that the use of a particular device should be prohibited unless it is the device itself that is wrong. If what is wrong is only the combination of the use of a particular device for a particular purpose, e.g., the use of give-ups to promote sales, then the prohibition should be limited to that combination.

In addition to our concern with the fundamental approach taken by the proposed Rule, the Rule as drafted would have certain consequences which we doubt were intended. The proposed Rule as drafted would require that there be remitted to the fund, directly or indirectly, an amount equivalent to 100 percent of the amount which the executing broker is directed to give up. Under the present rules of the various exchanges it is not always possible to recover in gross an

amount equivalent to 100 percent of the amount which the executing broker is directed to give up. IDS Securities Corporation ("IDSS") receives 100 percent of the amount which a Pacific Coast Exchange member is directed to give up to IDSS on direct transactions executed on the Pacific Coast Exchange. However, when a broker is directed to give up on transactions executed on the New York Exchange, the amount ultimately received by IDSS from reciprocal give-ups on unrelated transactions executed on the Pacific Coast Exchange is significantly less than the amount given, up on the New York Exchange. In addition, IDSS has certain administrative and other costs, including state income taxes, which reduce the gross amounts received by IDSS before determination of the net amount by which the management fee may be reduced. As presently drafted, the proposed Rule consequently would make it economically impossible to use give-ups even for the purpose of recovering brokerage for the fund shareholders. We are confident that this was not intended.

In connection with the problem discussed in the preceding paragraph, it should be noted that those considerations make it more economical to use give-ups to compensate brokers for research and related services than it would be to recover the give-ups through the present procedures while paying the brokers directly from other funds.

New York Stock Exchange Proposals

We strongly endorse the proposal for a volume discount. We would much prefer to see a direct reduction in portfolio costs by means of a volume discount than indirectly to reduce those costs by the circuitous methods presently employed. On an equivalent dollar basis the volume discount would be more economical. We visualize many problems in the devising of an appropriate and workable volume discount. It is important that any volume discount not be so devised as to create a conflict between the utilization of the volume discount to minimize brokerage costs and other decisions, relating to execution such as timing, selection of brokers, selection of exchange, etc. Without knowing either the amount or the nature of a volume discount, however, it is difficult to comment further.

The second aspect of the Exchange's proposal would limit the percentage amount which could be given up. The obvious purpose is to limit competition among brokers. We question the justification for this proposal and believe the matter should be left to private negotiation. If one broker is able and willing to give up a larger percentage than another, we see no reason why the Exchange should prohibit him from doing so or deny the customer the opportunity of obtaining the benefit therefrom.

The third aspect of the Exchange's proposal seeks to have the SEC impose upon the regional exchanges the same limits upon, give-ups as the New York Stock Exchange would impose upon its members. The obvious purpose of course is to supplement the second aspect of the Exchange proposal so as to limit competition not only among members of the New York Exchange but also among exchanges. This raises the entire question of the appropriate function of regional exchanges and the interrelation among exchanges. We assume that the regional exchanges perform, a useful and desirable function; else they would not exist or be permitted to continue to exist. That being so, we question the advisability of fettering the innovative function or the competitive influence which the regional exchanges provide by subjecting them directly or indirectly to the control and restraining dictate of the New York Exchange. This is particularly important to institutional investors so long as the New York Exchange continues its restrictive membership policies.

We have no comment on the fourth aspect of the Exchange's proposal.

We are of course strongly opposed to the fifth aspect of the Exchange's proposal, which would prohibit "institutional membership" on any exchange.

While the letter of the Exchange was somewhat ambiguous as to the intentment [sic] of the proposal, the release of the Commission amply clarified the ambiguity, for which we are grateful.

This last subject raised by the Exchange's proposal is, we believe, fundamental to all of the questions raised and discussed in the Commission's release, and to many others as well.

We do not see how any questions raised by the increased institutional participation in the market can be appropriately resolved without an open and fresh consideration given to the entire question of the propriety of direct access to the market by institutional investors through membership on the New York Exchange. We appreciate that this is a complex subject; but it should not be disposed of, as the Exchange would do, by refusal to examine it on the basis of an unchallengeable assumption that direct access to the market must remain a private preserve. [Footnote: We cannot but note that for near two millennia it was a fatal heresy to question the divine right of kings.]

If bona fide reasons exist why in the public interest institutions should be denied membership on the New York Exchange so as to preserve to the brokerage community an exclusive right to extricate a profit on the investment and reinvestment of the investing public's funds, such reasons should be stated and their validity examined.

Normally a company may either purchase or sell any commodity, property or service it wishes without employing the services of a broker or intermediary. This opportunity is in effect denied to institutions with respect to securities traded on the New York Stock Exchange. Most institutions would probably not have sufficient business to make it economically advisable for them to perform the functions of a broker. Where, however, an institution has sufficient continuous business to make it economically advisable and feasible for it to do so, there is no immediately apparent reason why the institution should be required to employ the services of other brokers and denied the opportunity to act for itself. Accordingly, we respectfully request that in considering the Exchange's proposals, examination be given to whether any justification continues to exist for the Exchange's restrictive membership rules.

We previously discussed the subject matter of the Commission's release with the Director of the Division of Trading and Markets and his staff. We wish to express our appreciation for the courtesies and time which we received. We also wish to reiterate our desire to cooperate with the Commission and its staff and to be of any aid that we can in the search for viable solutions to these difficult and complex questions.

Yours very truly,

Robert M. Loeffler
Vice President -- Law