August 20, 1968

Honorable Manuel F. Cohen, Chairman
Securities and Exchange Commission
Washington D.C.

Dear Mr. Cohen:

In reply to your August 9, letter requesting comments on the New York Stock Exchange proposals in its letter of August 8, 1968, we believe the Exchange's approach is not equitable in several particulars.

First, the New York Stock Exchange has changed its position and now strongly supports prohibition of customer directed give ups. As we outlined before, we believe the question of an adequate sales load on mutual fund shares and the question of customer directed give ups are related. We are strongly opposed to the present provisions of S. 3724, for example, which would turn over to the NASD the authority to determine whether or not a sales load is "reasonable". This puts mutual fund salesmen at the mercy of their competition, i.e., salesmen of broker dealers who do not specialize in mutual funds. Mutual fund investors usually are in for the long term, and we are dealing constantly with a "new issue" which requires much more effort, education, call backs, telephone services, literature, and other overhead expense. It is wholly unfair to compare the sales load on mutual fund shares with commissions on the sale of other types of securities. Other securities involve a "round trip" commission, and a normal amount of trading in the customer's account throughout the year.

We do not believe you have given adequate attention to this problem, and we would hope that the SEC does not take any action with respect to its proposed Rule 10b-10 until adequate amendments to S. 3724 in the House can be proposed to cover this problem.

With respect to the New York Stock Exchange letter, it insists on maintaining a minimum rate structure, rate discrimination between members and nonmembers, inadequate access of non members and at the same time advises the SEC to prohibit customer directed give ups. We think this position is simply unfair and unrealistic, and would have the result of depriving non member local and regional firms of substantial revenue, and at the same time driving business into the offices of exchange members at the expense of non exchange members. If this matter is to be resolved, it is perfectly obvious the SEC itself must do it, under Section 19 of the 1934 Act. Rate discrimination between members and non members of exchanges should be eliminated, and some other means of incentive to join the exchange and pay its dues must be found.

Commission sharing between members and non members must be adequate, up to the equivalent of the existing give ups, i.e., not one third, but at least 50%, and better yet, up to 75%, the same is now done under the existing give up structure. Further, non members should have access to the exchanges to the same degree that they are able to work it out indirectly under the existing give up structure.

Finally, we believe the New York Stock Exchange is wrong in advocating elimination of give ups. Many of our members, although by no means all, depend upon give up as supplement to the sales load. An individual investor pays the sales load, as he properly should, since this is a cost of doing business with him, personally. However, the overhead costs of maintaining literature, servicing, information, customer service, and a distribution system to keep new sales ahead of redemptions, to avoid forced portfolio sales, is in the interest of all shareholders. This is properly chargeable to brokerage on portfolio transactions, a portion of which should be diverted back as a supplement to sales commissions, in addition to providing compensation for research, pricing, statistical assistance, servicing, and the general overhead of maintaining a distribution system on a local and regional basis.

In the light of the above, it is our judgment that some minimum rate structure is certainly justified, and at an adequate level to provide for customer directed give ups. Customer directed give ups should be recognized as a necessary and essential part of sales compensation, as well as a necessary and proper charge against mutual funds and their shareholders for the maintenance of a local and regional system. Customer directed give ups can be handled by a much more complete revelation and disclosure in prospectuses, and can certainly be more closely regulated by the SEC in terms of making sure the customer directed give up is related to benefits which accrue to the shareholders who pay it. After all, the give up is not an expense, it is treated for accounting purposes as a capital item. By the same token, give up income to broker dealers is taken into our accounting without any allocation of offsetting expenses, since it is net. Therefore, the prejudice of brokers and dealers by elimination of give up income is seriously understated in terms of accounting, and the criticism of customer directed give ups by the SEC is based on the idea that it is an “expense” and not a capital item. We think the whole approach should be reviewed carefully in terms of proposed legislation, and that the New York Stock Exchange proposals are wholly inadequate as presented.

We appreciate very much having an opportunity to express our views, and hope you will include us in any industry consultations on Exchange proposals.

Sincerely yours,

Raymond W. Cocchi
President