THE New York Stock Exchange

James J. Needham
Chairman and
Chief Executive Officer

Honorable Ray Garrett, Jr.
Chairman
Securities and Exchange Commission
500 North Capitol Street
Washington, D.C. 20549

October 15, 1973

Re: Proposed Amendment to Exchange Rule 385
Non-Member Access Discount

Dear Mr. Garrett:

Exchange Rule 385 presently allows a 40% non-member commission discount for any qualified non-member broker in transactions in listed securities for non-affiliated customers as defined in Rule 318. The Exchange Constitution (Article IX, Section 7, paragraph (k)) requires that at least 80% of a member firm's transactions on U.S. securities exchanges must be effected for non-affiliated persons and that the primary purpose of every member be the transaction of business as a broker or dealer in securities. Exchange Rule 318 defines "affiliated" to include any controlled person, provided "that the right to exercise investment discretion with respect to an account, without more, shall not constitute control."

The Exchange in a letter to the SEC on July 31, 1973 advised that it had under consideration a proposed amendment to Rule 385 which would add subsection (c) to define "affiliated person" for purposes of non-member access to include managed institutional accounts for which the non-member broker makes investment decisions, thereby making transactions for managed institutional accounts ineligible for non-member discount.

Your letter of August 29, 1973 concluded that the Exchange had not provided "a regulatory justification for the proposed dissimilar treatment on transactions executed on the Exchange for institutional accounts managed by members and non-members" and, therefore, requested that the proposed amendment adding subsection (c) to Exchange Rule 385 be withdrawn. Your letter stated further:

> "It is the Commission's current view that non-member access should be limited only to the extent necessary to prevent receipt of a commission discount by any person other than a broker acting as such for an account other than his own or one with which he

> has a substantial identity of interest. Non-member brokers seeking to utilize Exchange facilities should not be subjected to more rigorous criteria for access purposes than those established for brokers enjoying membership unless some regulatory justification exists requiring different treatment." (emphasis added)

In addition your letter states:

> "It is true, however, as Release No. 9950 points out (page 183, note 519), that access 'was never intended to enable any individual customer to obtain a commission rate advantage'. To the extent a non-member money manager credits any of the access discount it receives on transactions for a customer against advisory fees owed by that customer, such customer does receive a commission rate advantage. While such an arrangement appears inconsistent with the original objectives of non-member access the Commission believes it would be unfair to restrict the use of such an arrangement by non-members while permitting its use by exchange members." (emphasis added)

Since the Commission's current view as indicated by the foregoing language is based on a standard of fairness we ask that the Commission reconsider the proposed amendments to Rule 385 in the light of that standard and the following considerations.

The Commission in a letter dated October 22, 1971 addressed to Robert W. Haack, then President of the New York Stock Exchange, clearly established that different regulatory treatment was to be accorded to non-members as opposed to those who were members of the Exchange by virtue of seat ownership. The Commission, through its then Chairman William J. Casey stated:

> "It is understood, however, that the Exchange's self-regulatory responsibility toward non-member broker-dealers utilizing the access provisions will not be the same as it is for member organizations. Indeed, we believe it appropriate for purposes of the New York Stock Exchange's access proposals to view registered broker-dealers who are subject to NASD or SECO supervision and which are not member organizations of the Exchange by virtue of seat ownership to be a special class of public customers." (emphasis added)

The difference in Regulatory Treatment is therefore the result of seat ownership which imposes more stringent obligations on the owner and a greater duty on the Exchange to regulate his conduct. While Section 3(a)(3) of the Exchange Act would appear to impose the same obligations upon the Exchange to regulate, as a member, any person who uses the facilities of an exchange "with the payment of a commission or fee which is less than that charged the general public" the Commission has indicated that such is not the case with respect to this "special class of public customers" i.e., those who can avail themselves of the access discount. Again, the distinction depends on seat ownership with its concurrent obligation and privileges. To the extent that access is broadened the privileges attending seat ownership are diminished and the value of that property is eroded. The Commission in its Policy Statement of February 4, 1972 on Future Structure of the Securities Markets, recognized this problem when it stated on page 11:

> "As the system evolves toward general access to exchange facilities it may, depending upon the nature of such access, become appropriate to provide for compensation to seat holders who invested in their seats with the reasonable expectation that such access would remain strictly limited."

Similarly the House Report on the Securities Industry study in August, 1972 stated (page 123):

> "Exchange members who have previously purchased or otherwise acquired seats should be compensated for the diminution in value of their investment."

The Department of Justice has made similar comment (See page 3144 House Committee Hearing, Study of Securities Industry 1972) and has also noted:

> "The question of access for non-member broker-dealers is closely tied in with the question of commission rates. The Department of Justice has consistently argued that the problem would be largely resolved if the New York Stock Exchange were obligated to go to a system of competitive rates. We still adhere to this view."

The Commission has recently announced that fixed commission rates will be abolished by April 30, 1975 and thereafter a system of competitive rates will prevail. Prior to that date we question the "standard of fairness" applied in weighing the proposed amendments to Rule 385 when:

A. The Commission has previously indicated that dissimilar treatment will be accorded to non-members who apply for access to the Exchange:

B. The regulatory responsibility of the Exchange under the thesis advanced by former Chairman Casey under Section 3(a)(3) of the Exchange Act has not been defined by the Commission, and

C. A fair method of compensating seat holders for the diminution in value of their investment has not been determined.

While we believe that the foregoing should provide sufficient justification for the Commission to favorably consider the proposed amendments to Rule 385, it may be helpful to the Commission to briefly review the developments leading to the adoption of non-member access discount in 1972 and the adoption of new rules for stock exchange membership and commission rates.

Developments leading to Adoption of Non-Member Discount in 1972. In 1963 the SEC special study concluded that the question of non-member access was too complex and too involved with other questions to be the subject of specific recommendations at that time and recommended that it should be the subject of joint SEC – Exchange study. Attached as Appendix 1 is a chronology of subsequent developments on non-member access culminating with adoption by the New York Stock Exchange of the 40% discount rule effective March 24, 1972.

The need for some form of non-member access became critical for non-members when the SEC in January, 1968 proposed adoption of Rule 10b-10 to prohibit give-ups of commission and when the Exchange adopted a rule prohibiting give-ups of a portion of the commission in October, 1968. On September 17, 1968 at the SEC hearings on the Stock Exchange Commission Rate Structure representatives of the NASD reported that an NASD survey, based on 1966 income, indicated that for firms with gross income under $2.5 million, give-up income amounted to nearly two-thirds of their net income and that about 85% of all securities firms were in that class (pages 3136-3137). Representatives of the NASD stated (page 3138) that:

> "We understand that the SEC and the New York Stock Exchange are willing to promptly undertake the necessary resolution of this problem. We agree with the New York Stock Exchange's concept that access be made available to 'bona fide' broker-dealers. We will assist in any manner possible and cannot stress too highly the need for prompt steps by all concerned."

The primary reason for allowing non-member access discount on the Exchange was to provide existing non-member broker-dealers some compensation for transactions by their customers in securities listed on the Exchange, and thereby to avoid practices which had developed (a) for Exchange members to give reciprocal business to non-members either on a regional exchange or through some other device and (b) to obtain a "give-up" or rebate of some portion of the commission.

However, the great concern over the consequences of a non-member access discount was with the regional stock exchanges and the SEC.

Regional stock exchanges were apprehensive that the availability of a discount on the New York Stock Exchange would deter firms from joining regional exchanges to obtain a full commission on dually listed stocks or reciprocal business. Mr. Michael Tobin, President of the Midwest Stock Exchange, testified at the SEC hearings on Stock Exchange Commission Rate Structure on September 18, 1968 that full membership on the Midwest Stock Exchange is a significant form of access to securities listed on the New York Stock Exchange and that the higher the rate of discount for non-member access on the New York Stock Exchange, the less likely firms would be to join the Midwest or other regional exchanges and assume the regulatory responsibilities that exchange membership includes (pages 3264-3276).

Some of the SEC staff was also concerned that access would simply provide a straightforward give-up. Mr. Eugene Rotburg, then Assistant Director of the SEC Division of Trading and Markets, during testimony by representatives of the NASD at the Commission Rate hearings on September 17, 1968 stated:

> "…And, frankly, one of the things that is concerning the staff is the possibility that access will be, despite all good intentions, turned into a form of straightforward, simple give-up, and that being, it will open up unnecessarily, and in an inappropriate fashion, without the study that is needed, the question of institutional membership. And I haven't made many comments during these hearings -- I usually restricted myself to asking questions -- but I think it is very important to have this record show that the New York Stock Exchange, in its delaying of the access question, has not done so because of just a desire to avoid providing some simple access for some small NASD dealers who don't want to use, or can't use other forms. But the delay is, accordingly, for very good and complete reasons at this time. I think the record -- and the purpose of this whole testimony, and the questions, is to show the complexity and the difficulties of that particular issue." (page 3219)

Following the extended discussions and revisions of proposed non-member access rules summarized in Appendix 1, the Exchange initiated non-member access for a one year trial period beginning in March, 1972 in Rule 385 which initially allowed 40% non-member discount to qualified non-member broker-dealers if the primary purpose of such non-member and of any parent of such non-member was the transaction of business as a broker or dealer in securities. In March, 1973 the rule was extended indefinitely and it was amended effective June 4, 1973 to eliminate the "parent" and the "primary purpose" tests and to limit the discount to transactions for accounts of customers who are not affiliated persons.

Adoption of New Rules on Exchange Membership (19b-2) and Competitive Rates. The Commission has recognized in related developments the need to move in appreciable steps without making an immediate complete change which would disrupt securities firms and markets. In adopting Rule 19b-2, requiring that a member of a securities exchange conduct only 80% of its exchange securities transactions with persons other than affiliates (rather than require that 100% of its transactions be with other than affiliates), the Commission (in Exchange Act Release 9950) allowed a three year phase-in period for members to comply with the 80-20 requirement.

Similarly, in approaching competitive commission rates, the Commission followed the wise approach of gradual steps and (after negotiated rates had been introduced into the commission rate structure on the portion of orders exceeding $500,000 on April 5, 1971) in its Policy Statement of February 4, 1972 on Future Structure of the Securities Markets stated that:

> "It is necessary to measure the effect of competitively determined commissions very carefully on a step by step basis." (page 30)
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> * * * * *
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> "Nevertheless, we have determined that a reduction in the breakpoint to $300,000 should take effect in April, 1972, after a year's experience with competitive rates on that portion of an order exceeding $500,000. As noted above we have also determined to move toward the point at which commission rates on all orders of institutional size will be, at least in part, subject to competitive rates." (page 33)

Particularly in point was the Commission's statement at page 107 of Exchange Act Release 9950, in the section discussing the utilization of exchange membership:

> "The Commission believes it is necessary, as a matter of public policy, to implement lower competitive rate

> breakpoints on a prudent and gradual step-by-step basis, while maintaining active and continuous programs to monitor the impact and interrelationship of all these changes in order to minimize possibly damaging consequences. Even those commenators most vocal in support of fully competitive rates have agreed that the implementation thereof must be completed in a time frame which permits an orderly transition. 337/ To the extent that most, or even a large percentage of, institutions were to seek exchange membership for recapture purposes, however, that would be tantamount to competitive rates (or no commissions at all) on all size orders for those institutions immediately; the Commission's phase-in program would then become an academic exercise, at best. 338/"

Phase-In for Non-Member Access. The Exchange has come a long way in 18 months, moving from no non-member access prior to March, 1972 to a 40% non-member discount for transactions for non-affiliated persons. We urge that it would be consistent with other steps taken by the Commission, in allowing a phase-in period for new requirements on stock exchange membership and for competitive commission rates, to allow a similar phase-in with respect to non-member access by permitting the Exchange to amend Rule 385 to allow the 40% non-member access for the present for transactions by qualified broker-dealers for customers other than affiliates and managed accounts (including managed accounts as affiliates for purposes of this rule).

We emphasized in our earlier letter of July 31 that the proposed amendment, including managed accounts as "affiliates", is in accord with language in Section 2 of Senate 470 as passed by the Senate and Section 205 of H.R. 5050 under consideration in the House -- both of which would include managed accounts as "affiliates" in the criteria for exchange membership, under requirements that exchange members effect 100% of their exchange transactions for non-affiliates. Therefore, we believe there would be particular wisdom in basing the access criteria on the same criteria proposed for membership in the pending legislation.

Your letter of August 29 stated, as noted above, that it is the Commission's current view that non-member access "should be limited only to the extent necessary to prevent receipt of a commission discount by any person other than a broker acting as such for an account other than his own or one with which he has a substantial identity of interest" (emphasis added). The term "substantial identity of interest" seems to go beyond the strict legal concept of "control" used in defining "affiliate" in Rule 19b-2 and we submit that the proposed amendment of Rule 385 is compatible with this view of the Commission because a broker-dealer has a "substantial identity of interest" with a managed account.

Regulatory Justification. We now turn to the regulatory justification for the proposed amendment to Rule 385, which would allow non-member access to qualified non-member broker-dealers only for transactions for customers other than "affiliates" (including managed accounts as affiliates). We also include here some of the points made earlier in this letter. Regulatory justification is provided by several critical factors-

(a) The Commission has previously indicated that a different standard will be applied to non-members as opposed to members of the Exchange. The difference in regulatory treatment results from seat ownership. With respect to those who own seats, the Exchange has a greater regulatory responsibility. It may not impose all its Constitutional provisions, rules and procedures on non-members. It is therefore not inconsistent to permit seat owners to execute transactions for certain accounts where a non-member would be denied the access discount where he seeks to execute an order from a similar type account.

(b) The Commission, the Justice Department and the Report of the House Committee Study of the Securities Industry have all recognized that members of the Stock Exchange have an investment in their exchange seats and that they should be compensated for diminution in value of that investment where access is give to non-members. The Commission in its Policy Statement of February 4, 1972 on Future Structure of the Securities Markets noted at page 11:

> "As the system evolves towards general access to exchange facilities it may, depending upon the nature of such access, become appropriate to provide for compensation to seat holders who invested in their seats with the reasonable expectation that such access would remain strictly limited. This could be done by means of a transaction surcharge or some form of tax relief, as the Department of Justice has suggested in its statement recently filed with the Commission."

Similarly, the House Report on the Securities Industry Study in August, 1972 stated at page 123:

> "Exchange members who have previously purchased or otherwise acquired seats

> should be compensated for the diminution in value of their investment. One proposal is that this be done by means of a tax credit. Another possibility would be to treat the contribution of seats to a central market system by owners like any other contribution of property, to be paid for by other members of the system through suitable assessments. This has the advantage of insuring that the central market facilities will be paid for (and maintained) by those who use them, rather than through a tax subsidy from the Federal government. It is, accordingly, the Subcommittee's recommendation."

We believe that it would constitute an improper taking of property of members of the Exchange to permit a 40% non-member discount for transactions for managed accounts prior to the time when some arrangement has been made to compensate members of the Exchange for the diminution in value of their Exchange seats resulting from such non-member access.

At the present time however no form of compensation has been determined or offered. The proposed amendment to Rule 385 is a legitimate effort by the Exchange to preserve its members from further erosion until reasonable compensation has been provided to seat holders. At the same time Rule 385 provides a reasonable access to non-member broker-dealers who seek to execute transactions for accounts with which they do not have a substantial identity of interest.

(c) The Commission has announced that fixed commission rates will be abolished by April 30, 1975. At that time the question of access will become largely moot. But until that time the right to access should not be broadened so as to adversely affect the value of seats unless reasonable compensation is provided.

(d) A reasonable step-by-step phase-in period has been allowed on the directly related problems of criteria for exchange membership and competitive commission rates. It is consistent to allow a similar phase-in for non-member access, particularly recognizing the major steps which have been taken in the last 18 months in allowing such access.

The Department of Justice has also clearly stated its acceptance of a program for gradual transition to centralization of the market system and equal access. In its December 1, 1971 statement to the SEC, the Department of Justice in discussing non-discriminatory access for all qualified broker-dealers stated:

> "We think that any centralization of the market system must be accomplished by a program for an orderly transition to an open market in which all can participate on equal terms.
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> * * * *
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> A transitional program to an open national market system must gradually eliminate the vested interests in the existing barriers, perhaps with reimbursement by some sort of transaction surcharge or tax relief." (emphasis added)

(e) The Commission in its August 29 letter expressed particular concern over competitive advantages for exchange members as money managers if non-members were not allowed the access discount on transactions for their managed accounts; but (i) many other money managers have other types of competitive advantages over exchange members, including exemption from SEC and New York Stock Exchange Regulation, (ii) other money managers are now free to join the Exchange if they become qualified broker-dealers, and (iii) money managers who do not qualify under the new criteria of Rule 19b-2 for membership are permitted to retain their existing memberships in other exchanges during the phase-in period.

(f) Without the proposed amendment, many money managers for institutions will organize as broker-dealers solely to handle the brokerage business of their managed institutional accounts. This would permit large amounts of commission revenue to be diverted from both New York Stock Exchange member firms and regular over-the-counter broker-dealer firms to a new class of broker-dealers serving no purpose other than to obtain the non-member discount on

(g) brokerage for their managed institutional account.* This diversion of commission revenue from the securities industry at a time when a high percentage of member firms already are operating at a loss could be a critical blow. It is expected that the increase in commission rates and improved market conditions will partially remedy this situation, but a substantial diversion of commission revenue to new broker-dealers created to obtain access discount from managed accounts could be critical.

(g) Without the proposed amendment, the door again will be open for a variety of give-up arrangements between non-members and the managed institutional accounts which would reverse some of the major steps taken by the SEC in recent years to eliminate give-ups.

(h) Without the proposed amendment, it is probable that many of the new broker-dealer firms organized to obtain the non-member discount for managed institutional accounts, will not qualify for Exchange membership and presumably would not qualify for the non-member discount (or membership) is legislation now pending in Congress is adopted (Section 2 of Senate 470 and Section 205 of H.R. 5050). It would be a disservice, not only to firms presently in the securities business, but to those new broker-dealer firms which are established specifically to qualify for non-member discount for managed institutional accounts, to adopt rules encouraging the organization of such firms, with the probability that federal legislation may be adopted during the coming years which would eliminate the reason for their existence.

For the reasons stated above, we respectfully request the Commission to consider further the proposed amendments to Exchange Rule 385 which were submitted with our letter of July 31, 1973. The Exchange believes that the proposed amendments should be adopted immediately. Three copies of this letter also are attached for the Section 17a-8 file.

* See Appendix 2: Wall Street Letter, October 15, 1973, page 2 "Connecticut General Uses the 40% Non-Member Discount. Will Other Institutions Follow Suit?"

Any questions concerning the amendments can be directed to Gordon Calvert, 1800 K Street, N.W., Washington, D.C. 20006, (202) 293-5740.

Sincerely,

James J. Needham

c.c. Hon. Hugh Owens
Hon. Philip Loomis
Hon. John Evans
Hon. A.A. Sommer, Jr.
Mr. L. Pickard
Mr. J. Liftin

Enclosures

Appendix 1

Chronology of Developments on Non-Member Access to New York Stock Exchange

In 1963 the Special Study concluded that the question of non-member access was too complex and too involved with other questions to be the subject of specific recommendations at that time, and recommended that it should be the subject of joint SEC - Exchange study.

On August 11, 1964, the Exchange advised the SEC that the Exchange's Special Committee on Costs and Revenues would review certain topics, including splitting of commissions with non-member broker dealers and possible creation of associate memberships.

In the fall of 1964, in response to a request by the SEC, the Exchange submitted to the SEC its first proposal with respect to non-member broker access.

One problem that concerned the Exchange was whether a non-member broker who received a discount from the public commission rate would, under Section 3(a)(3) of the Exchange Act, be considered a "member" whom the Exchange would be obliged to regulate under Section 6 of the Exchange Act.

On September 7, 1965, the Exchange resubmitted its access proposal to the SEC, asking for clarification of the definition of "member" under Section 3(a)(3) of the Exchange Act.

An internal SEC memorandum on Section 3(a)(3), dated September 14, 1965, stated that the problem raised by the Exchange appeared to be valid.

In a letter dated October 8, 1965, the SEC responded that it could not give a precise answer until a more definite access proposal had been submitted, but expressed the belief that Section 3(a)(3) did not create "an insuperable obstacle."

On November 11, 1965, the Exchange submitted to the SEC a proposal that non-member brokers be granted a discount of 25%. At that time, the Exchange stated its view that it should not act unilaterally in granting non-member access and that it had to obtain from the SEC "explicit protection against the impact of Section 3(a)(3).

The SEC did not approve the Exchange's access proposal. In a letter dated December 22, 1965, the Commission expressed its concern that institutions might use the discount as another form of give-up. As to the Section 3(a)(3) problem, the SEC assured the Exchange that this would be resolved -- by an SEC rule if necessary -- after resolution of the give-up problem. In the words of Francis Wheat, an SEC Commissioner at that time: "[W]e [the Commission] were lukewarm to non-member access, and we did not pursue the matter."

Discussions between the SEC and the Exchange with respect to non-member access continued throughout 1966, 1967 and into 1968, but the issue of Section 3(a)(3) was not resolved.

By letter dated May 19, 1966, the SEC disapproved of discounts in which commissions paid to the correspondent would arise directly or indirectly out of customer request, direction or understanding. In the eyes of the SEC, customer-directed give-ups were inconsistent with the principle of providing equitable treatment for various classes of customers, and such give-ups might interfere with the orderly functioning of the securities markets and complicate the administration and assessment of the reasonableness of commission rates.

In a letter dated July 5, 1966, the Exchange requested that the SEC delineate what kind of commission splitting should be prohibited and what kind should be permitted. Subsequent to this letter, discussions on the access proposal took place between the Exchange and the SEC, but the Exchange's 25% proposal faded from the picture. There were no further proposals on non-member access until January of 1968.

On January 2, 1968, the President of the Exchange, Robert Haack, presented to the SEC five interrelated proposals revising the commission rate structure which included a proposed one-third discount to non-member brokers. The package was presented orally to the five commissioners and many staff members of the SEC by Mr. Haack, Mr. Levy (the Chairman of the Exchange's Board of Governors) and Mr. Calvin (the Vice President of the Exchange for Civic and Governmental Affairs).

The SEC would not approve the discount for non-member brokers because it feared that non-member access to the exchange would have a deleterious effect on the volume of regional stock exchanges and would become another vehicle for the development of reciprocity.

On January 26, 1968, the SEC issued a release containing a proposed Rule 10b-10. This rule provided that an institution could not direct that a portion of a commission be given up unless that money came back to the institution. In the same release, the SEC asked for comments on both proposed Rule 10b-10 and the proposals made by the Exchange on January 2, 1968.

The major regional exchanges submitted comments both on the SEC's proposed rule on give-ups and on the Exchange's five-part proposal. The Pacific Coast Stock Exchange, the Boston Stock Exchange and the Midwest Stock Exchange all opposed the Exchange's proposal for non-member access on the grounds that such access would weaken regional exchanges. The NASD, however, supported the Exchange's proposal.

In July, 1968, the SEC commenced an extensive series of hearings designed to investigate, inter alia, the possibility of non-member access. The hearings lasted for some two years and were participated in by 80 different organizations and approximately 150 witnesses.

Chief executives of the Exchange appearing at the SEC hearings in July 1968 supported non-member access. However, action on a proposal for non-member access was deferred in 1968 because the SEC did not want the Exchange to proceed with it at that time because it was considered to be an integral part of the commission rate structure, which was being actively considered in the hearings being conducted at the time.

When the SEC hearings resumed in 1969 the Exchange reaffirmed its support for non-member access.

At the conclusion of the hearings, in a letter dated October 22, 1970, the SEC requested the Exchange to submit to it for consideration, no later than June 30, 1971, a new proposal for reasonable non-member access.

On June 28, 1971, the Exchange complied with the SEC's direction and submitted a plan for economic access to the SEC for qualified non-member broker-dealers on a one-year trial basis -- by means of a 30% maximum discount to be allowed to such broker-dealers with respect to transactions in listed securities executed on the Exchange for the accounts of customers.

While awaiting SEC comment on its commission-rate package, on August 5, 1971, the Exchange submitted to the SEC pursuant to Rule 17(a)-8 proposed amendments to Article XV of the Exchange constitution and a proposed new Rule 385, which would implement the non-member access proposals made by the Exchange on June 28, 1971.

The access proposals made by the Exchange were the subject of further hearings conducted by the SEC in July, 1971.

Following the hearings, on September 24, 1971, the SEC placed certain conditions upon its approval of the proposal made by the Exchange, among which was an increase in the maximum 30% discount proposed for non-member brokers to a maximum of not less than 40%, to allow for a minimum meaningful test of this proposal. At that time, the Commission also rejected the Exchange's requests that the SEC itself enforce the antirebate aspects of the proposed access rule and adopt a rule in connection with Section 3(a)(3).

Implicit in the Commission's letter of September 24, 1971, to the Exchange was a preliminary determination that the introduction of a 40% discount from the Exchange public rate for non-member broker-dealers was necessary or appropriate within the standards of Section 19(b).

Following receipt of the SEC's September 24, 1971, letter, details of the Exchange compliance with the SEC's conditions to its access proposals were ironed out in correspondence and meetings between the Exchange and the SEC.

A number of questions regarding changes in the access rules were discussed with the SEC during October 1971. One issue, whether the non-member broker discount should be available for agency transactions only or for both agency and principal transactions, was discussed at some length, and the SEC approved its limitation to agency orders.

In a letter dated October 8, 1971, the Exchange notified the SEC that the maximum discount would be fixed at 40% as requested by the SEC. The letter also requested the SEC to adopt a rule providing that a broker receiving a commission discount was not to be considered a "member of the Exchange."

On October 12, 1971, the SEC began further hearings in order to consider modifications in the structure of securities markets, including restrictions on access.

By letter dated October 22, 1971, Chairman Casey notified the Exchange that the SEC did not object to the Exchange's access proposal but that this determination was not final since issues relating to the access question were being considered in the then pending hearings which had begun on October 12, 1971. In his letter he added that the SEC did not think that a rule on the Section 3(a)(3) problem was necessary but did not give any reason for this change in the SEC's point of view.

The only evidence of the SEC's position in 1971 with respect to the percentage of access is its approval of the Exchange's action to provide access up to a maximum 40%.

In the course of the correspondence and discussions on non-member access in 1971, no one at the SEC suggested to the Exchange that the amount of the non-member discount should not be left to negotiation between members and non-member brokers.

The SEC, in announcing the adoption of Rule 19(b)-2 in January 1973, explained that:

> "nonmember access was adopted by the exchanges, at the Commission's request, to provide an opportunity for broker-dealers which are not exchange members to earn reasonable compensation for executing orders in listed securities . . . . It was never intended to enable any individual customer to obtain a commission rate advantage . . . ."

In a letter dated January 6, 1972, the SEC complained to the Exchange that the Exchange's proposed changes in its constitution and rules respecting 40% access for non-member brokers did not permit access for organizations which introduced accounts to other firms on a fully disclosed basis, and urged that it would be appropriate for the Exchange to permit access to non-member introducing organizations as well as to those which carried accounts.

On January 20, 1972, the Exchange submitted, pursuant to Rule 17(a)-8, proposed amendments of Article XV of its constitution and Rule 385 to comply with the SEC's request that the 40% access proposal be extended to introducing non-members.

On February 3, 1972, the SEC requested a further change in the wording of a subsection of Rule 385 and stated that the staff had no further comments on the Exchange's proposals designed to implement non-member access.

Because of the various changes requested by the SEC and the fact that approval of the Price Commission had to be obtained before a new fixed commission schedule could be made effective, the 40% discount rule was not implemented until March 24, 1972.

The 40% discount rule provided that in order to qualify for the discount, a non-member broker had to sign an agreement to charge its customer the full public commission rate.

Since April 1972 when the 40% discount rule went into effect, approximately 1,700 non-member broker-dealers have qualified for the discount.

At its March 1973 meeting, the Board of Directors of the Exchange decided to continue the non-member discount beyond the original one-year trial period.