Keystone Custodian Funds, Inc.
Boston, Massachusetts

March 27, 1968

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

Re: Release No. 34-3289

Dear Sir:

In the above Release comments on proposed Rule 10b-10 and on the NYSE proposal (which is set forth in an attachment to the Release) are requested.

The Release carefully reviews a good deal of the history of the customer-directed give-up problems. It concludes with a proposed rule which is based on the premise that if commissions are used by a fiduciary to obtain benefits for himself, under the outlined circumstances, antifraud and other provisions of several statutes are violated.

The NYSE memorandum sets forth five proposals. The first of these relates to volume discounts and, despite the fact that a study of this matter was agreed to by the NYSE in 1959 (Special Study Part 5, page 104), the 1968 memorandum states that "details ... will have to be developed subsequently". The second of those five proposals would permit the continuance of customer-directed give-ups. The proposed rule outlaws such give-ups unless countervailing reductions are made in the fees charged to the relative investment company or identical amounts are paid to such company.

While the Release arrives at the proposed rule in a somewhat tentative fashion its effect would appear to be irreversible. Whatever the outcome in other respects, and even if the proposed rule were abandoned, it would seem inevitable -- and regrettable -- that the language of the Release will prove to be the inspiration for litigation.

Customer directed give-ups have been a commonly accepted practice since before I came into the industry in 1944. It is extremely difficult for me to understand how practices which have been prevalent for that length of time and which I would suppose have been well known to the Commission for most of that time are now described as fraudulent. I gather from the Release that there have been variations in the mechanics but the simple directed give-up has been in existence for a great number of years. It has not been secret; many prospectuses have dealt with the subject at length; and the Special Study (Chapter XI, C), while stating that "some reciprocal practices in the mutual fund industry are justifiable...", made recommendations for certain modifications. Accordingly, it appears extraordinary that this practice is stigmatized, at this late date, as infringing antifraud provisions of the 1934 Act.

Not only does the NYSE proposal contemplate the continuance of the present give-up practices (in modified amount) but the Release assumes such continuance. The proposed rule, however, provides that in that event the amount of the give-up must be effectively rebated to the registered investment company.

I assume that the Staff has conducted a comprehensive exploration of this matter and has some basis for the conclusion that the practice will continue. I am unaware of the reasons for that conclusion. The give-up system, at least so far as Keystone is concerned, has been based on the belief that we could not recover commissions for the Funds because of NYSE rules and, as members were prepared to give up (and as the practice was universal), it should be used. In recent years the Regional exchanges have introduced new factors and have had more liberal give-up rules. Even more recently other mechanics have been evolved by means of which NYSE commissions have been conveyed, indirectly, to nonmembers. Should give-ups cease to be available, for whatever reason, I would have assumed that the whole system would collapse. Were it essential, and feasible, to continue the effect of give-ups, that could presumably be accomplished in a more direct fashion by simply making payments to brokers and dealers for investment advice, recognition of sales, etc. It is not clear what purpose would be served by using residual commissions (as contemplated by the second NYSE proposal) to make these payments in the first place and then making identical payments from the underwriter or investment adviser to the Funds.

If, as I understand to be the case, the Commission has authority over stock exchange commissions it could presumably set them at a level which would remove give-ups from the scene. There could then be no possibility of any improper use of such money by any Fund, underwriter, or adviser. Why would this not be more desirable than leaving reduced amounts of brokerage commission available for either use or abuse or as a trap for the unwary? It would seem to be particularly desirable as the give-up mechanics necessarily involves an erosion of intransit commission. The brokers who give up naturally retain part of the commission themselves.

It would seem that the NYSE proposal does not intend to provide the maximum discount but to leave a margin available for customer-directed give-ups. Unless this margin can be directed outside the NYSE membership no means are presently available for the give-ups to be paid to the Fund. As the Commission has the authority to require the NYSE to adopt a discount which would eliminate give-ups, the proposed mechanics could only exist with the Commission's blessing. It is difficult to understand the basis on which the Commission would permit this -- in the light of its proposal that the Funds shall receive directly or indirectly the benefit of all give-ups. Why the roundabout approach? In this connection a comment in the Special Study (Part 2, page 309) may be noted:

"A complex system of arrangements designed to circumvent the strict prohibitions of an antirebate provision would not seem to be a desirable answer to a pricing problem in any industry, even apart from the fact that the Commission is called upon to grant its blessing to such practices, at least tacitly, by approving the commission schedule which begets them."

This matter of give-ups has been a troublesome one in the mutual fund industry and it is to be hoped that now that it is proposed that changes be made that such changes will be conclusive and that no part of the problem will persist, as would seem to be implicit in the NYSE proposal. It seems clear that the Commission has all the authority it needs to remove the problem. It also seems desirable that the cure should be to remove the margin which allows for customer directed give-ups and not by continuing it, in whole or in part, with the admonition that the underwriter or adviser must use it in a given way or subject to certain restrictions. The Commission can make sure of this without the intervention of the underwriter or adviser.

All of the foregoing is predicated on the acceptance of the theory that the use of give-ups in the past has been without compensable benefit to the Funds. The acceptance of such a theory would require much more support than has' been set forth in the Release.

Sincerely yours,

Wilfred Godfrey
President

P.S. Since writing the foregoing I have read a newspaper report of a communication sent to the Commission and "made available" to newspapers by the president of the NYSE. It contains nothing which modifies the views expressed above.