Josephthal & Co.
New York, NY

March 28, 1968

Mr. Orval L. DuBois, Secretary
Securities and Exchange Commission
500 North Capitol Street
Washington, D.C. 20549

Dear Mr. DuBois:

Purposely, we have delayed our reply to your Release No. 8239 under the Securities Exchange Act of 1934, relating to proposed revisions of the commission structure. For one thing, much as we appreciate your invitation to comment on the proposal, the matter involved is too important for a surface reaction to the proposals. The ultimate decision will have far reaching consequences -- not just on members of the financial community, but on the nation as a whole. Secondly, the more we reviewed the Release, the more we realized that the proposals of the Securities and Exchange Commission, plus those of the New York Stock Exchange, touched on so many matters that the theoretical solution to one question might complicate the answers to another.

As a result, we have had a series of meetings during which all of the partners of the firm who have competence in the areas involved have reviewed each aspect of the problem. This letter, while signed personally by me, as the Managing Partner, therefore reflects our official firm view and suggestions for your consideration.

To get to the heart of the matter at hand, we strongly oppose your proposed rule 10B-10 which would make it unlawful for any registered investment company, or affiliated person of such registered investment company, to direct brokers who execute orders for them to give any part of the commissions thus received to other brokers -- unless such compensation also is returned or credited to the investment company itself. Lest this seem like an arbitrary or out-of-hand rejection of the Commission's views, let me assure you that we are appreciative of the many factors you have had to weigh. Your ten page release bespeaks time, effort and much deliberation. But ours is a very complex business, all of whose facets may not be clear even to men who have made it their life's work. Thus, we would like to offer our background reasoning in the paragraphs which follow.

Although 10B-10, on the face of it, seems like a just proposal, the more we analyze it the more we feel that it could open a whole Pandora's box of problems to the S.E.C. For example, wouldn't this establish two standards -- one "preferred" for investment company shareholders and one "common" for the "other public"? And who is to decide who the "other public" represents? What about individuals who maintain trust or custodian accounts with banks? As we understand it, the bank and trust companies have a schedule of charges for their services. Any decisions whereby a particular security is sold or purchased involves a charge -- irrespective of what the commission rate might be. And how about pension and profit sharing funds? Shouldn't all the individuals who ultimately will receive payments be considered? What about insurance companies and the influence of commissions on dividends paid to policy holders? Aren't they to be considered?

Apropos my mention of banks, insurance companies, and pension funds, we feel strongly in the present right of these institutional investors to direct a broker with whom an order is placed to "give up" to other brokers, or to pay out part of the commission to other brokers. The "give up" practice is one that was started by the institutions themselves as a means of getting the best brokerage expertise and still permit being in a position to reward others for services rendered. Both, -- i.e., a superior execution, a profitable investment idea -- benefit the shareholders, the policy owner, the trust beneficiary, etc.

We could understand your philosophy if there were something inherently wrong or in conflict with the best interests of the public. But reciprocity is a valid and equitable concept that has lived since the beginning of time and is the cornerstone of all human relations. It's true, for example, in real estate where two or more brokers jointly develop the buyer and seller. And there are other areas where, as a result of a business relationship, one type of customer will do whatever he can to favor another customer. Doesn't the answer to this question really relate to whether some one is being "hurt" or benefited?

In our opinion, no changes whatsoever are necessary in the rules or regulations that now permit banks and other like institutions, for example, to have one broker execute a large order because of his superior ability -- and then share the commissions (either by give-up or check) as long as we live within the Stock Exchange commission regulations. We realize "superior brokerage ability" isn't something that can be proven easily -- as in the case of a company with a strong balance sheet. But the institutional investors who reward expertise aren't naive and there is a whole chain of command that must be satisfied. The promise has to be in the performance -- as in the case in every business.

To our way of thinking, the customer's privilege of directing that part of the lead broker's commission be shared with others should not be curtailed. We feel this privilege is inherent in the preservation of the lead broker concept and has great merit. Further , we submit that give-up s by check have certain distinct advantages over the alternative of so-called "floor give-ups" which enable other firms to earn a part of the commission by physically participating in the processing of an order but by so doing multiply and complicate the operations involved and greatly increase the possibility of error and delay. Therefore, we believe the give-up by check, in particular, should be encouraged rather than legislated against.

While it is impossible to state that a 10,000 share order costs, say, 100 times more to execute than a 100 share order, the difference is much wider than it appears to be on the surface. It often takes many hours and quite often days before a transaction of this size can be consummated. And time obviously is money in a service business. Then, too, the processing of a block order can be extremely difficult (which means costly) when it is bought or sold in many small lots from various brokers.

We can illustrate this point another way via the problem of floor give-ups which invariably cause delays for the firms involved. When a give-up is not followed through on the floor, (and you'd be surprised how often this can happen) the person trading with the lead broker does not receive the name of the broker given up to, but that of the firm represented by the lead broker. This, in turn, tends to cause confusion in the back office of the firms involved in these trades and much communication is needed to clarify such trades. Isn't this another item of costs? We think so. We might add that this means much more work is added on to the already heavy schedule of the Stock Clearing Corporation.

We very seldom receive the give-up names at the time of the entry of the order. Almost without exception, we never know the name of the firm to be given up on the floor until we report the execution and then receive instructions. There are many good reasons for this procedure -- such as the feeling that it is more important to dispatch the order itself for handling without delay for names. Also, and it may even be the number one reason, there is no way of knowing whether the order will be completed at the time it is entered. The larger orders are on the basis of the ability of the market to absorb the order, or an attempt to find a buyer or seller, etc, -- all of which is time consuming.

We can further illustrate our belief that it's sounder to use give-up checks than use the floor give:-up procedure. Just recently, our back office handled a 50,000 share order executed exclusively by our partner who acted as the lead broker. Execution was such that all trades, save one or two, were contracted. If there had been give-ups to other firms, say five or six, past experience indicated that there would have been twenty to thirty executions uncompared. These uncompared executions appear on our contract sheets from the Stock Clearing Corporation because the give-ups weren't processed on the floor.

Another important internal logistic that can't be overlooked is the deliver or receive problem. The current situation usually is about as follows: Fund A buys , say, 10,000 shares of stock. We receive 7,000 shares via the Stock Clearing Corporation But the 3,000 share balance usually is a "fail-to-receive" because the delivering broker or brokers have stock in legal transfer, coming from an out of town bank, etc. Hence, we have to borrow 3,000 shares from another broker to complete the delivery of the 10,000 shares.

True, you might say the mechanics of our business are not your concern. But we think they are -- when they have an important bearing on a matter you have under advisement. We both know that the custodian banks who act as receivers or deliverers of securities for institutions have a labor problem. All this handling and all this work must be completed in three or four hours. Isn't it therefore much easier to handle a delivery through one brokerage firm rather than ten or more? On a give-up basis, ten or possibly more brokers would be concerned with the completion of a delivery. In other words, using one firm on a block order simplifies the handling for the custodian banks. We are not pleading a case for the banking fraternity, but if delivery to the Trustee is via one broker (one item) the cost to the fund is far less than ten deliveries from different brokers. The processing thereof is much easier than handling ten packages from ten different firms. Hence, we believe that here again is another instance where the fund shareholder benefits from the lead broker concept.

We don't want to belabor the point about processing difficulties, but we think you'd be surprised by the number of ways in which concentration by a lead broker can help all concerned. Let's say a fund buys 10,000 shares of stock that goes ex-rights or carries rights. Using one broker concentrates the picture for the bank, because they can look to that one broker for completion. If ten different brokers were used, however, and assuming that six brokers fail to deliver the security, the custodian bank then would get 4,000 rights direct and due bills on 6,000, which would have to be nursed along until collected. What might seem small and inconsequential by itself can grow to monstrous proportions when the situation is multiplied ten times or more.

Or, let us assume a Fund buys 10,000 shares of stock. If a stock power gets misplaced or lost, the transfer agent then returns the stock to the custodian bank, thus holding up the transfer on 10,000 shares of stock. If the bank had received the stock from one broker it can call, him and rectify the problem immediately. If, however, they received 10,000 shares from ten or more brokers, they would have to go over the entire days work to see from whom the stock came.

In short, our opposition to your proposed rule is based upon the efficiency and hence the economies of the present system which has evolved over the years in answer to the day-to-day needs of the market-place. The lead broker concept is a well established and time-proved method of operation in the securities business. It is not the brainchild of the Mutual Fund industry but has been successfully used by all large institutional investors for years.

In addition, we feel that, consideration must be given to the adverse effect abolition of the give-up procedure would have on the regional firm and the smaller firm. You are as cognizant as we of the vast changes that lie ahead for the financial community -- partly as a result of the insurance companies and banks entering the mutual fund business. This alone will put a severe strain on the ability of many firms to survive. If they don't, it could mean greater concentration of business in a few large hands -- and lessened over-all marketability. Isn't it incumbent on the Commission to determine the long-range good of the investing public?

We feel that the proposals of the New York Stock Exchange, as a package, are far more practical than your proposed rule 10B-10. For example, we favor the volume discount in principle. We might point out, however, that:

1 -- 1967 was a year of many special "pluses" to the brokerage income account.

2 -- The profitable transactions (i.e. 100 shares and multiples thereof) subsidize many of the unprofitable transactions (i.e. odd lots, inactive accounts).

3 -- While every transaction should stand on its own feet, it is impossible to handle only profitable ones. In other words, if the S.E.C. reduces the profitable areas of the business to an irreducible minimum, something will have to be done in the opposite direction to equalize matters.

Similarly, we support the Exchange's thinking with respect to continuation of customer-directed give-up s of commissions. In our opinion, there is no reason why part of the commission cannot be passed on by payment via check. We feel the attached copy of a memo we received from one of the funds we are privileged to serve is illustrative of an approach that is constructive for all concerned.

In our opinion, institutional investment costs would be increased materially if they had to have a staff to follow developments throughout American industry. The attached list of all major industries is illustrative of the point -- just as it illustrates why funds like to reward outside sources with commission credit checks from a lead broker.

Having had practical experience in this type of broker-institutional investor relationship, i.e., one which is based upon ideas, we know that even the specialists in the institutional investment departments welcome a fresh viewpoint from an outside source. It is not that the institutional investment department knows less than the brokerage firm research analyst. In most cases the opposite is true. But no one physically has the capabilities of traveling around the country and visiting with each company in each industry. In addition, research today is a profession and the institutional investor welcomes an exchange of ideas with his contemporaries an exchange which is without cost to the institution but which obviously could not be done unless the broker could look forward to compensation.

Thus, we feel strongly that not only are costs of operating an institutional investment department less than they would be if today's practices were. prohibited, but the actual results are better than they might otherwise have been. This is not in any way meant to imply that the institutional investor lacks sufficient capabilities to manage the funds under his supervision. Far from it. But just as doctors call in other doctors for consultation, so investment analysts consult with each other. This time, however, there is no extra charge to the patient.

But, we are getting away from the points meant to be covered in this section. Specifically, we favor the NYSE proposal against reciprocal practices which results in de facto rebates. We feel that they are simply a device to circumvent current regulations.

We feel the Fourth proposal of the Exchange, allowing a discount in the minimum commission schedule for non-members -- when coupled with this prohibition -- is much more comprehensive. We suggest, however, that this discount be limited to a percentage that is tied to the cost of handling the transaction. We have no quarrel with the non-member broker-dealer; we are all part of the securities business. But the non-member broker or dealer whose interest primarily is in merchandising a worthwhile over-the-counter security, or a new issue, or a mutual fund -- and who handles a listed order on the customer's direction -- certainly is not entitled to a wide profit on NYSE commissions. This comes under the heading of "accommodation" and the discount shouldn't go far beyond the approximate cost of handling the transaction.

Supplementing these observations, it seems to us that a somewhat involved commission discount will be required for domestic non-member brokers who qualify. Furthermore, whatever is decided upon as an irreducible minimum commission allowance, can only come into being after NYSE members have covered the cost of handling the transaction, plus a profit. This is the only basis on which consideration can be given to allowing part of the commission to an outside source. At the present time, many odd lot transactions are handled without profit, some on only a break-even basis. This also applies to 100 share lots of low priced securities. Consequently, fee sharing would mean an additional burden to brokerage house overhead which widens the basically unprofitable portion of the business.

We doubt very much whether a discount in the commission schedule to a non-member is going to make for an improvement in sales of listed securities by a non-member. As far as we are concerned, he is not entitled to special consideration unless he has done something to earn it, i.e., to recommend listed securities. Doesn't this logic also apply to even the third market dealers? If they effect a transaction in the over-the-counter market and then decide to use the New York Stock Exchange market as an "out", what selling job has been done which contributes to the over-all welfare?

With regard to the allowance of a discount to foreign non-member brokers may we point out that this probably would include many of the banks that operate for so-called numbered accounts. Although the banks are responsible for making the investment decisions, they add an extra commission as well as the commission we charge. In other words, they charge the customer the regular NYSE commission plus an added commission for making investment decisions. Where is the discount to apply? The first commission, or the "add on"? Are they entitled to it? We don't think so.

Last, we favor the Exchange's Fifth proposal to limit membership and broker-dealer allowances to bona fide broker-dealers since it would be the only fair and equitable result of adoption of the first four items. In other words, our approval is as a package. Actually, if the first four proposals of the New York Stock Exchange are adopted, it no longer will be necessary for anyone but a bona fide broker-dealer to obtain or retain memberships on the various Exchanges. The execution of orders is a professional business which is best left to people specializing in that area. The reason we make this point is that the institutional investor's basic responsibility is in the area of investment policy, rather than the execution of orders. Their second responsibility is to direct the orders to the proper place where the best price possible will be obtained.

Mr. Ralph S. Saul, President of the American Stock Exchange, made an address which complements the thinking we have tried to convey to you. Fact that his observations were made a year ago makes them no less timely and his speech is therefore attached herewith.

In closing, permit us to make the following Points:

1) Even with the best of information and a sound investment decision, it takes specialized ability to put the idea into action. The handling of an order is a

science in itself -- and a lead broker is required to recognize and solve the marketing problems.

2) Not only does no one have a monopoly on ideas or information, but it seems to us that any prohibition against a reward to firms who provide research services overlooks the facts that: a) Mutual fund and other institutional investor costs are not in any way increased through the use of a lead broker and the practice of rewards to others via commission credit checks; b) If such reward were prohibited, institutional investment costs might increase for they then would have to have the talent to cover all aspects of the investment business -- and couldn't rely on others for assistance. In the end, therefore, stockholders of these funds would be affected.

3) Basically, we believe that the S.E.C. concept that a give-up check represents a rebate of commission is a fallacious assumption. We also feel that any change in current policies and practices would tend to complicate market conditions and hamper the liquidity which is so important to the American investing public. We wonder if the S.E.C. is confusing its concern over the commissions received from the sale of funds with the mechanics of our industry which help the institutional investor put his ideas into action.

Our industry, as well as the entire world, is in a period of great change. Competition itself will be a most important leveling influence. By "competition" we mean not just that which takes place within our industry daily and which is likely to intensify in coming years, but competition from outside the business for the investor dollar. For example, Sears, Roebuck & Co, via its subsidiary Allstate Insurance and its thousands upon thousands of salesmen, is planning to enter the mutual fund industry as you will note from the attached news item. And hardly a week goes by without an announcement of a planned mutual fund by a life insurance company. Note, if you will, the attached news item from the Wall Street Journal plus an article from Best's Insurance Reports.

As you review the article from Best's Life News, you will note that there are 26 different life insurance companies with 34 separate mutual fund affiliates. You also will note that 5 other major insurance companies were planning to organize or acquire mutual fund operations as of last December. The list is even larger today. We wonder if you fully appreciate how many hundreds of thousands of new securities salesmen this will bring into our business. As you will notice from the Boston Herald Traveler news item, the Prudential Insurance Company -- which incidentally is not mentioned in the Best's article -- alone has 25,400 salesmen.

The reason we emphasize this point is that the S.E.C. could be in the position of altering a financial structure which has been a constructive influence on the

American scheme of things. You might say that the end result of our fears is unintentional on your part and stems from conditions beyond your control. But the threat nevertheless is a major consideration which must be recognized and weighed carefully in your deliberations. If drastic new regulations are added to the equation, the entire shape of a business which everyone agrees is vital to the American economy could be seriously altered.

We strongly suggest that in the process of trying to effect changes you do not end up in a position where the result is the patient's demise rather than recovery. We recognize the fact that you undoubtedly are cognizant of the various trends -- for it's your business to be aware of all the forces at work, just as it is ours. But we wonder if you fully appreciate the serious and potentially destructive long term implications of your proposed regulations. Why compound the already existing threat to our free society by changes which will hurt rather than help its well being?

Cordially yours,

Bernard E. Pollak
Managing Partner