Gaston, Snow, Motley & Holt
Boston, Massachusetts

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Mr. Orval L. DuBois
500 North Capitol Street
Washington, D.C. 20549

Gentlemen:

We appreciate the opportunity to comment on Securities Exchange Act Release #8239 and proposed Rule 10b-10.

At the outset, we wish to note that it would appear that the Commission's real concern should be with achieving a workable quantity discount. The proposed rule appears to us to be misconceived in that it ignores the fundamental problem of the size of brokerage commissions and instead focuses only on the effects produced by pressures of sizeable transactions on an outmoded commission rate structure. Clearly the most appropriate way to deal with problems created under the present structure by large institutional trading is to develop meaningful quantity discount rules. It is difficult to understand the seeming reluctance of the Securities and Exchange Commission to address itself to this problem. The Commission not only has the necessary authority under Section 19(b) of the Securities Exchange Act of 1934, but it is also the most appropriate forum for such a task. The necessary balancing of conflicting interests can only be accomplished in a forum possessing both independence and expertise, preferably through a public hearing, as provided for in Section 19(b), at which all interested parties can be heard.

The rationale for the Rule is based on the two premises that (1) "if a mutual fund manager has various means at his disposal to recapture for the benefit of the fund a portion of the commissions paid by the fund, (2) he is under a fiduciary duty to do so."

Both premises appear open to question.

In the Release, notice is taken of the fact that the constitution and rules of many regional exchanges provide that give-ups may be directed to persons who are non-members of the exchange but who are members of the NASD. What the release does not take notice of is the fact that every major exchange has constitutional provisions prohibiting the granting of any rebate, discount or allowance. As far as we are aware, no regional exchange has ever published a

ruling or an interpretation providing that one of its members may, without violating the anti-rebate provisions of the particular exchange, remit a portion of a commission to the customer or to another person for the specific purpose of reducing a customer's expenses. Moreover, if the exchanges were to single out investment companies or institutions generally for favored treatment over other customers in employing devices to reduce directly or indirectly their commission costs, we believe that serious anti-trust questions would be raised.

The Release describes potential arrangements for recapture of commissions earned by brokers on transactions of third parties for the benefit of the investment company. In our view this practice, whether or not condoned by the Commission and the various exchanges, raises serious ethical and legal questions which might, well present a fund with major problems.

Before turning to the assumed fiduciary duty to recapture, we should like to express our view with respect to references to Sections 17(e)(1) and 15(a)(1) of the Investment Company Act of 1940.

It would appear to us, and we are certain that it would appear to the broker who has executed a transaction, that the commissions earned on that transaction are the property of the broker. While he may be willing, within the limits of the exchange on which the business has been transacted, to give away part of the commission at the request of his customer, he is under no obligation to do so. In fact, on many commission transactions, a broker will refuse to give up any part of the commission. To suggest that the manager of an investment company is "accepting ... compensation" when a broker is willing to direct commissions to a third member of the brokerage community at his request is a distortion of statutory language beyond all reasonable bounds.

In this connection, when we approached one major brokerage house on behalf of a client with the tentative suggestion that commissions might be directed to a broker affiliate of the investment adviser, we were told that direction of brokerage in that manner was not in the best interests of the brokerage community and were given an indication that the firm would not honor such a request.

If, in fact, there is substantial doubt that the fund or the adviser can recapture brokerage commissions, the concept that it has "accepted compensation" by directing it to third parties is difficult to comprehend.

With respect to Section 15(a)(1) we should like to point out that adoption of proposed Rule 10b-10 would not make the description of sources of compensation any more precisely describable than they are at present.

The language asserting a "fiduciary duty" to recapture is unfortunately broad. If, as stated, there is a duty, it would appear that the duty would require an investment adviser to go the whole way and copy those New York Stock Exchange members which have wholly-owned investment adviser subsidiaries in order to maximize the possible recapture of commissions or reduced commission rates. Only by putting itself in this structure and becoming a member of every significant exchange could the investment adviser feel safe that it had fulfilled the "fiduciary duty", with which the Release's language so casually endows it. A "fiduciary", after all, cannot be only a little bit fiduciary. To us it is extraordinary that the Commission has proposed a rule which might have the effect, intended or unintended, forcing such a major change on the investment industry. In its overall relationship with the fund, the best interests of the fund, shareholders may often be better served by directing the commissions which an executing broker allows to be directed to a third person. This is particularly true in the area of research where our clients inform us that the technique of give-up has permitted brokerage firms, including New York Stock Exchange members, to develop highly specialized research and other services without the necessity of expanding and developing the special techniques required to execute transactions of the size which a mutual fund would normally place. These firms would not exist, they tell us, if they could be paid only on a retainer basis.

If they were large firms who could execute large orders efficiently, they would earn commissions on the basis of transactions put through them. The investment adviser, in directing commissions to them, is only giving them what they would have earned on the transactions which their ideas have generated, while insuring that the fund is protected on best price and best execution by going directly to an expert in that phase of the brokerage business. There are many other types of specialized service provided by brokers which are of value to a fund and its shareholders by helping the investment adviser increase, directly or indirectly, the scope of its investment advice to the fund or the service it provides to fund shareholders. If the technique of give-up is removed, it is far more likely that these will disappear because they cannot be paid for than it is likely that investment advisers will make direct payments to continue their existence.

The implementation of proposed Rule 10b-10 will without question have a serious impact on the competitive structure of the securities industry. To the extent that a fund can execute securities transactions with the captive broker affiliated with its investment adviser, which the investment adviser's "fiduciary duty" may impel it to employ, at cost or a price approximating cost, there would be no justification for going to the third market. This would result in the drying up of the third market, a development which would remove an important competitive force. The proposed rule will also tend to concentrate those portfolio transactions which can only be executed on the NYSE in the hands of those NYSE brokers who are volume sellers of mutual fund shares. The maintenance of at least an

equilibrium between sales and redemptions is vital to the efficient operation of a mutual fund. The larger the fund the greater dollar volume of sales that is necessary to maintain this equilibrium. As is pointed out in the Release at page 4 there is already some pressure on fund managers from NYSE member firms selling fund shares to place portfolio transactions with such firms. As long as it is possible to direct commissions this pressure can be off-set. If give-ups are outlawed there will be no way to resist this pressure so long as execution and price are equivalent, and the temptation will exist to be less vigilant on what is "equivalent". As a result, portfolio transactions will be confined to those firms which sell fund shares, cutting off those firms who do not.

The above comments should not be taken as a complete exoneration of the present commission structure and-of give-up practices. Clearly no system can be defended which provides for artificial commission rates. On the other hand the present system of give-ups and reciprocals permits a mutual fund manager to successfully satisfy the many legitimate, competing demands of brokerage firms for portfolio transactions on which they can earn commissions or realize net profits on resale without compromising the primary interest of the fund, i.e., best price and best execution. To date a fund has been faced with fixed commission expenses which, contrary to the Release's assertions, do not appear readily recoverable in significant amounts. The interests of the fund and of its shareholders would be maximized by a system which provided for a reduced commission expense and a continuation of a give-up system. If, in this connection, it is thought too difficult to strike a balance between the pure investment company situations and the conglomerates where the fund is an adjunct of an active stock exchange member, consideration could be given to requiring an organization to decide which kind of business it wants to be in, thereby segregating the brokerage business from the institutional investment business. It is respectfully suggested that it is to the goal of promoting a fair and equitable commission rate schedule that the Commission should be directing its energies rather than to the development of a rule which simply substitutes new and greater problems for those currently existing without improving the basic short coining. It is further respectfully suggested that the promulgating language in the Release be reconsidered and specifically revised in view of problems it appears to raise for all registered investment companies.

Very truly yours,

Gaston, Snow, Motley and Holt

[by John W. Belash]