Steadman Security Corporation
Washington, D.C.

March 29, 1968

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

Re: Proposed Rule 10b-10

Gentlemen:

Steadman Security Corporation ("SSC"), its wholly-owned subsidiary [of] Republic Securities Corporation, a member of the Philadelphia-Baltimore-Washington Stock Exchange, the Steadman mutual funds with assets of approximately $80 million and the officers, directors and stockholders of these companies are interested persons for purposes of commenting on proposed Rule 10b-10. We present herewith the views and comments of SSC because the proposed rule is directed primarily at the mutual fund manager.

Our objections to proposed Rule 10b-10 are as follows:

I. <u>The proposed Rule will abolish our arrangements for returning a portion of the commissions to the mutual fund.</u>

Republic Securities Corporation ("Republic") was created by SSC following conferences with the staff of the Commission and the Philadelphia-Baltimore-Washington Stock Exchange. A minor portion of the portfolio transactions for the Steadman mutual funds is traded through Republic and 40% of the net income of Republic on such transactions is returned to the mutual funds on a formula basis by reducing the amount of the management fee otherwise payable to SSC by the mutual funds.

In our operations since June 1967, we have found the PBWSE to be a surprisingly good market for trading blocks of securities at prices equal to or better (our standard for execution) than found at the same time on the New York Stock Exchange (where the securities held by the mutual funds are predominantly traded). Thus, almost all Republic transactions for the Funds have been executions on the PBWSE. In some instances, we have found it necessary to split a block between the two exchanges at the same price (except for New York tax) and in these instances are able to obtain a give-up of 50% of the commission on the NYSE portion on an unrelated trade by a dual membership firm. However, the give-up has been related to the Fund trade and allocated to the particular fund for purposes of month-end reductions in the management fee. Perhaps because the volume of our business is small or the recipient is associated with the customer fund, give-ups have been insignificant and almost wholly related to split trades on the two exchanges. It will be noted that this form of give-up has benefited the mutual funds while at the same time SSC benefits because of the profit-sharing relationship. On the other hand, SSC has had to tie up certain of its capital, personnel and facilities in order to create and operate Republic.

While we will have something further to say about the defects in draftsmanship of the proposed Rule, it is apparent that paragraph (a) would prohibit any part of a give-up from being used to defray the operating expenses of Republic. Paragraph (b) of the proposed Rule would apparently prohibit executions on the PBWSE as well. Therefore, the arrangement which is embodied in the management agreement approved by the shareholders of the three mutual funds, as well as in the prospectuses of the three mutual funds would be abolished. This, in effect, is contrary to the suggestion of the Commission that the mutual fund manager attempt to recapture part of the portfolio commissions.

II. T<u>he proposed Rule as drafted goes beyond the rationale and would amend the Investment Company Act of 1940 without recourse to Congress.</u>

The proposed Rule is presumably designed to stop give-ups unless they are channeled 100% to the mutual funds, but it goes beyond this as drafted. Paragraph (a) can be read to define as unlawful the action of a director of the mutual fund in directing a give-up on a transaction for his personal account. This could be clarified by adding after the word "transaction" the words "for such registered investment company." Also, unless the word "other" is inserted between "any broker" and the words "any other person" are clarified, there will be ambiguity in a rule that purports to define an unlawful activity with criminal penalties attached.

Paragraph (b) as presently drafted suffers from the defects cited as to paragraph (a). It is also broad enough to encompass the floor brokerage or correspondent relationship which an affiliated broker may have with another firm. Because of this, it is inconsistent with Section 17(e)(2) of the Investment Company Act of 1940 which permits a transaction through an affiliated broker at a normal commission. To prohibit the normal commission transaction by an affiliated broker will require a change in the Act by Congress. There are also other sections of the Act which contemplate the affiliated relationship between mutual funds and brokers subject to certain prohibitions.

III. <u>The rationale behind adoption of the proposed Rule is questionable and will interfere with the managers freedom of action.</u>

If as indicated in Release 34-8239, the mutual fund manager has a duty to recapture a portion of the commissions for the mutual funds which it serves, in its effect, the proposed Rule does away with just such an arrangement as we and a few other managers have established. Also, the suggestion that the mutual fund depart from the pool of assets arrangement and get into the brokerage business through a wholly-owned subsidiary is essentially unhealthy for the mutual fund and brokerage industries. We believe that Section 12(d)(3) of the Act did nothing more than recognize one such arrangement existing at the time the Act was passed, and was not intended to encourage the formation of brokerage firms by mutual funds.

We believe that allocation of brokerage commissions is an important part of the overall management of mutual funds comprised of administration, portfolio management and sales. All three are important for a healthy operation. The Commission appears to overemphasize the benefits to the manager, whose reason for existence is to serve the funds and hopefully make a profit in doing so. It is essential that the manager whose personnel frequently (as in our case) are officers of the Fund, be well advised. Many mutual fund managers, as we have done, employ a skilled trader who accumulates current information and in effect is exercising part of the function of the broker in seeking the best price and execution. The manager must know what others are doing to perform his function well. Allocation of commissions is important in this information-gathering function. If the give-up is prohibited, the information-gathering function is inhibited. Of course, it is possible to go direct to the broker with particular knowledge who normally might receive a give-up for his assistance, but another broker may in our opinion have greater skill in executing a transaction. In the absence of a give-up, the source of information may dry up and the manager may lose his freedom of action in the selection of his broker.

Sales are vital to the healthy operation of a mutual fund and of interest to the stockholders as well as the manager. There is a normal attrition in any mutual fund through redemptions which must be replaced by new money in order not to compel an investment decision which might not otherwise be made. The .alternative of maintaining a large cash reserve for redemptions is unpalatable for the manager and the stockholders. It is appropriate and beneficial to our stockholders, in our judgment, to allocate portfolio commissions to brokers who provide new capital through sales (subject to price and execution). In prior years when one of our mutual funds was suffering a large capital outflow, the Board of Directors of that fund (a majority unaffiliated) directed that the manager use greater efforts to reward brokers who provided capital. This interest in new capital was appropriate.

We are of the opinion that there is not a fiduciary duty to recapture commissions or give-ups in the amount of 100% as contemplated by proposed Rule 10b-10. The fiduciary duty is to see that they are managed for the benefit of the mutual funds and this contemplates information gathering and rewards for sales.

IV. <u>We conclude that the proposed Rule is defective in draftmanship, premised upon a partially correct rationale, partially in excess of the powers granted to the Commission and should be scrapped in favor of quantity discounts for institutions.</u>

The negative views and comments have been presented above. We believe as mutual fund managers that we would regret the slowing of the growth and competitiveness of the regional exchanges and also any changes which would harm the base for liquidity of our portfolios now primarily represented in New York, and admired throughout the world. It is vital that our financial markets remain healthy. Commission rates are of prime importance in this context. Rather than breaking down the reciprocal system built up by the brokerage community (which the mutual funds have tried to use to their advantage), the Commission would be better advised to take a cautious step first and review its impact. We recommend a reduction in the commission rate or quantity discount. This will help our funds directly since there will be a savings in payment of commissions. This may also help to alleviate the give-up problem without major injury to the brokerage community which though imperfect serves the public well now.

Very truly yours,

Allin P. Baxter
Secretary and Counsel