Weeden & Co.
New York, NY

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Securities and Exchange Commission
Washington, D. C. 20549

Gentlemen:

In Release No. 8239, dated January, 25, 1968, the Commission has set forth, in summary, the background which has given rise to the New York Stock Exchange's five-point Commission Rate Structure proposal and the Commission's proposed Rule 10b-10. The Commission has invited public comment.

Weeden & Co. is a public corporation with capital on January 1, 1968, of approximately $16,000,000. We are not a member of the New York Stock Exchange nor any of the regional exchanges. Our principal business is as a primary market-maker in high grade securities -- mainly tax exempt bonds and investment grade common stocks. Our customers are institutional investors and other dealers and brokers. We carried average inventories in these securities in 196? of $65,000,000. Our sales totaled approximately $3 billion. We are part of what the Commission has labeled the Third Market -- that is, most of the common stocks in which we make markets are listed on the New York Stock Exchange arid on one or more of the regional exchanges. Accordingly, we have a heightened interest in the proposals under discussion as they undoubtedly would affect our business and that of our customers.

We have studied Release No. 8239 which appears to us to be a reasonable summary of the background issues, events and procedures which gave rise to these proposals. As we understand the Commission's remarks, it believes that the use of "give-ups" and reciprocal practices, in circumstances where a portion of the commissions given up or reciprocated could in fact be obtained for the benefit of investment company shareholders, calls into question the fiduciary responsibility of the management company directing the commission rebate. The Commission in fact questions whether a fiduciary using commissions to obtain benefits for himself under such circumstances is not in violation of the anti-fraud provisions of the Securities and Exchange Act of 1934 and the Investment Advisors Act of 1940. The Commission has proposed as a solution to the problem, Rule 10b-10, which would prohibit investment company directed give-ups unless the benefits of such give-ups accrue to the shareholders of the investment company.

The Commission's Proposal

The nature of our business, buying and selling stocks as principals at net prices with no commission charged, precludes our becoming involved with mutual funds in give-ups or reciprocal practices. We have never solicited this business nor accommodated it when proffered. [Footnote: Our business with mutual funds on a net basis is not insubstantial, amounting to roughly 10,000,000 shares in 1967.] In fact the findings and opinion of the Commission, dated July 19, 1967, in the matter of the Delaware Management Company, Inc., indicate to us that attempts by a management company to interposition another dealer or broker between ourselves as market-maker and the fund would be considered by the Commission as fraud against the fund and its shareholders. Thus, while our interest in this matter is not direct, we are fairly certain that imposition of Rule 10b-10 would have a beneficial effect on our business in that it might encourage managers of mutual funds to be more responsive to competitive markets that do not make provision for the use of give-ups.

Nonetheless, we would like to express our concern to the Commission regarding imposition of Rule 10 b-10 without further study. There are constructive aspects to the give-up mechanism. To many firms dispensing primarily research and investment advice and not suited to the role of lead broker, give-ups or reciprocals from commission income originating with management companies are a major source of income which may not be connected in any way with fund sales. We would hate to see the good aspects of the give-up eliminated along with the bad.

We have no way of determining whether the use of give-ups and reciprocals under circumstances where part of the commission could be but is not returned to the benefit of fund shareholders is fraudulent and illegal as the Commission claims. We do know that these practices have existed for a long time without public criticism from the Commission, with the result that the industry is structured to and dependent on them. Prohibition of investment company directed give-ups would undoubtedly have a greater impact on the profitability of the smaller member and non-member firms than the Commission imagines or desires. Perhaps larger load charges could in some manner replace the type of give-up the Commission finds offensive. The broker-dealer distributor of funds is entitled to adequate compensation for his efforts. This seems a more reasonable approach than use of a practice whose propriety is in question.

The Exchange Proposals

In its release the Commission observes that "competition in the securities industry between institutional managers and brokers and between exchanges has operated to reduce very substantially the amount of commissions actually retained by executing brokers -- but with relatively little impact or effect as yet on the commission actually paid by the public investors who invest through institutional media." We believe that this is a temporary phenomenon which will correct itself given sufficient time and the free interplay of competitive forces as among the New York Stock Exchange, the regional exchanges and the Third Market. Practices involving the giving up to others of commissions much in excess of the true cost of executing this business cannot long survive in a truly competitive environment. To the extent that the proposals made by the New York Stock Exchange are designed to adjust its procedures and commissions in reaction to competition from others, these actions can scarcely be argued against.

However, the Exchange proposals are presented as a package. At least two of these proposals would require that the Commission aid in mandating upon other markets the same prohibitions and practices adopted by the New York Stock Exchange. We hardly think that this is designed to increase competition. Rather, we are fearful that the all-or-none condition attached to the package proposal would, if accepted, so restrict the regional exchanges in their ability to compete that they would cease to be an effective force in the industry. In effect, they would be regulated out of contention by New York Stock Exchange conditions as to whom they may accept as members, to whom they may give broker-dealer allowances, and in what form reciprocal arrangements may be made. We not only believe that these consequences would be unhealthy, but warn that they very likely would bring into consideration the antitrust implications that the Commission mentions in its release.

If the Commission accepts this point of view, it can hardly fail to act against the dangers implicit in the Exchange proposals. As the Commission stated in its Report on Investment Companies, submitted to Congress on December 2, 1966:

"(O)ne of the principal policies underlying the Commission's regulation of the securities markets has been the promotion of fair and effective competition among the various securities markets. As both the Senate Committee on Banking and Currency and the House Committee on Foreign and Interstate Commerce have noted, the Exchange Act reflects an endeavor by Congress to --

. . . create a fair field of competition among exchanges and between exchanges as a group and the over-the-counter markets and to allow each type of market to develop in accordance with its natural genius consistently with the public interest."

As the Report of Special Study of Securities Markets (1963), at pp. 956-77, pointed out:

"Where there are multiple marketplaces for particular securities, they may be responsive to differing or changing needs and their very existence may add to total market depth and may provide incentives toward better executions in each marketplace. . . .

. . . The extent of needed regulation of markets in the public interest surely depends, at least in part, on the effectiveness of competition among markets ... not merely competition for the handling of transactions in multiple traded securities but competition to become the primary market for particular securities ... in maintaining high standards of performance. Indeed, in the absence of effective competition among markets in both senses, the sheer size and power of any one or two markets might enlarge the scope and degree of needed governmental intervention to the point where the adequacy of present regulatory concepts would be open to question. . . .

The factor of depth in the primary market thus must be looked at, not in isolation, but in relation to the factor of competition ... based on the study's analysis, the basic policy would still be 'to create a field of competition' among markets and generally to foster free and open competition rather than restrict competition."

We are also concerned that promulgation by the New York Stock Exchange of its proposals and the Commission of Its Rule 10b-10 marks only the beginning of protracted secret negotiations between the two that could result in a compromise privately arrived at. As the Commission pointed out in its release, the problems under consideration affect the entire industry. A private compromise reduces the likelihood of a viable solution and increases the possibility that practices and restriction on competition previously ignored or merely tolerated by the Commission will be structured into the system by explicit regulation.

We remind the Commission that this essentially is what happened in the negotiations leading to the enactment of Rule 394-b by the New York Stock Exchange. The Commission had said in the Edison Electric Illuminating Company of Boston case, 1 SEC 909, 913 (1936), and cited again in its Report of Special Study, Part 2, p. 958, Fn. 277:

". . .(A) well-governed exchange recognizes limits to its operation as an automatic auction market ... (It) should ... recognize and enforce the duty of a broker to get the best price for his client, even though that price is only obtainable off the floor of the Exchange. . ."

The Commission's efforts to implement these sentiments through private negotiations with the New York Stock Exchange resulted in a rule that has proven unworkable despite what we consider maximum efforts by the Third Market to make it function. Yet, the rule exists today with the Commission's apparent endorsement.

If asked to comment on the Exchange's proposals individually, we would repeat our contention that any adjustments in commissions or practices made to increase their competitiveness can scarcely be objected to. We would hope that any volume discount adopted by the Exchange would be on each transaction, rather than on the accumulated amount of business done. This would permit the customer in each transaction to seek the best possible market place and the best price to him. It would also avoid the antitrust problems inherent in a cumulative volume discount. We would also say that a discount to non-member broker-dealers on the part of the New York Stock Exchange is probably long overdue, although we would expect that this would reduce considerably the business that we do with these customers.

As to the other New York Stock Exchange proposals, we can see no reason why the Commission should accept their imposition on other market places as the quid pro quo of the Exchange adopting competitive changes in its own procedures.

<u>Conclusion</u>

There is wisdom in preserving the option as to where, how and by whom securities will be bought and sold. The number of investors using the market place and the amount of money they command is constantly increasing. The size and influence of institutions as investors pose specific problems to the industry and . demand innovations. A geographical shift in population is contributing to the development of new centers of finance. Advances in electronic data processing plus improvement in communications offer unknown possibilities in improving the efficiency and capability of market places. Protection of the public interest requires that regulation be so fashioned and administered that maximum change is encouraged, rather than the status quo maintained

Very truly yours,

Alan N. Weeden
President