The Wellington group reports that, to the extent consistent with best execution and price—

but without any prior agreement, a majority of such orders, exclusive of Government bonds, are placed with investment dealers who sell shares of Wellington Fund and Wellington Equity Fund to investors, and the amount of such sales is a factor in placement of brokerage business.

Distributors Group, Inc., states that where dealers in the company's shares act as brokers or principal dealers—

their relative sales volume in shares of the fund is a factor in the allocation of this business and a majority of such transactions ordinarily are placed with such dealers

Continental Research Corp., which sells only about 10 percent of its fund shares through independent dealers, reports that—

it is a practice of Continental to place purchase and sale orders with or to request "giveup" commissions to broker-dealers who emphasize the sale of United Funds shares as an integral part of their entire operation.

In most instances where dealer sales are stated to be of no relevance in brokerage allocations, the open-end assets managed by the adviser are relatively small. In the case of one respondent adviser, for example, it is stated that—

due to the size of the fund, approximately 4.3 million as of December 1960, we find it expedient and practical to deal primarily with one broker. As we do not have a so-called dealers selling group we accordingly do not have dealers who share in the commissions of executing portfolio transactions.

Another company, with assets under $1 million at the end of 1960, reports that:

It is the policy of * * * [the] fund to purchase and sell portfolio securities on a net basis from investment dealers who maintain a market in the particular stock involved in the transaction. This is done without respect to the sales of shares of the fund generated by the dealer through whom the portfolio securities are bought and sold. In short, this fund does not believe in the general industry practice of reciprocity. We will transact business only with investment dealers who sell our shares only if they are able to handle stock for us at an equal or better price than other dealers who have not handled our shares.

(2) Provision of investment research and statistical information

Thirty-eight of the eighty-three respondents referred to in table VIII–70 listed investment research and statistical information as one of the considerations received from broker-dealers in exchange for brokerage commissions. One adviser noted that:

A number of brokers and dealers maintain highly competent research staffs of their own. In order to make the results of their research available to the funds, portfolio transactions of the funds are directed to such firms. There is no agreement in regard to obtaining such information or in the direction of such portfolio transactions, but a careful appraisal is made as to the worth of the information received and this is used as a factor in the allocation of such portfolio business.

Another important investment counseling firm states that—

the investment research work carried on by the investment departments of brokerage and investment banking houses does in the aggregate provide helpful and valuable background information which is utilized to the extent pertinent in the background for investment decisions. * * * There is no direct remuneration for such assistance other than commissions in the ordinary course of business.

Many other advisers stated that they receive regular or sporadic information from the research department of the larger broker-dealers, and a number indicated that—

this material is obtained with the understanding that such dealers will receive consideration when securities are purchased or sold by the fund.

(3) Daily quotation and wire services for portfolio valuation, transmission of orders, etc.

Thirty-one of the eighty-three respondents included in table VIII-70 allocate some portion of their brokerage business to broker-dealers who supply twice-a-day prices necessary to value the portfolios of mutual funds. This service is frequently associated with the provision of direct telephone and wire services, which are separately mentioned by nine respondents. One adviser reports a business relationship with two brokers—

who furnish wire services to the fund in connection with the twice daily pricing of the fund's shares. The fund allocates brokerage business in the amount of approximately $300 per month to each of these brokers as compensation for such services.

Another investment adviser notes that a local security dealer—

furnish[es] benefits to the investment company in the form of a daily list of quotations at the close of the market which are used by the investment company in determining the offering price (net asset value). When available, this firm's direct telephone line to New York is also used to furnish daily closing quotes to the New York Times and Quote Bureau of NASD. Although not based in any understanding, * * * [this firm] does participate in commissions paid in connection with the purchase and sale of portfolio securities.

Another important adviser mentions—

arrangements with various brokers through which bid and asked prices of the company's shares are distributed twice daily throughout the Nation, for the information of dealers and their customers and for transmission to newspapers incidental to the publication of such prices for the information of shareholders and the general public. In some instances, these brokers may also transmit orders or inquiries.

For small investment company groups, where the volume of brokerage business is small, this type of service is frequently a predominant basis for brokerage allocations. For example, in the case of one fund it is reported that—

commission business of this relatively small fund has been directed thus far largely to a dealer furnishing price data to the fund twice daily.

(4) Efficient and low-cost executions

The mutual fund industry has developed a highly standardized phraseology which is extensively used in both company prospectuses and in replies to the advisers' questionnaire to describe the bases of brokerage allocations to dealers in mutual fund shares. Typically it is stated that—

it will be the practice of the fund where possible, while endeavoring to obtain the most favorable prices in the execution of orders, to place a part of the fund's portfolio transactions with dealers who are active in the distribution of the fund's shares, or permit them to participate in commissions thereon, using their relative sales of shares of the fund as a factor in the allocation.

Minor variations are encoundered in the qualifying phrase which indicates that brokerage allocations to dealers "is conditioned upon a proper execution of the buy-and-sell order," and must be consistent with the location of "best executions," "prompt and efficient executions at best prices," or "best markets as to price and availability."

A number of companies go beyond these general qualifications, indicating that they study closely broker suitability in the light of the proposed purchase. The management of one of the largest funds observes, for example, that:

In placing orders for the purchase or sale of portfolio securities, careful consideration is given to the ability of an investment dealer to execute an order, and membership or nonmembership on a recognized stock exchange is taken into account. As a result, brokerage commissions placed with several dealers [are] on a give-up basis.

Concern for proper execution and best prices is of particular importance to specialty funds that do not buy and sell to any substantial extent on the major exchanges. In the case of one such fund, for example:

Orders for purchase and sale of securities * * * are placed primarily with those dealers who specialize in making a market in the securities that are recommended. This is particularly true of the over-the-counter market. In the case of * * * [this fund] up to 75 percent of investments is concentrated in life insurance shares. There are a few firms which specialize in such securities and the bulk of purchases for this fund is with these dealers.

Several companies, concentrated mainly in the smaller size classes, that sell their own shares through independent dealers report that prime emphasis in their brokerage allocations is best execution and price, with dealer sales of investment company shares of little or no relevance. An illustration of this was given in the previous subsection.

(5) Other factors

In the case of 7 of the 83 groups, it was acknowledged that affiliations influenced the flow of brokerage. The provision of sales promotion material, sales advice, and other sales aids were explicitly noted as factors influencing brokerage allocations in six cases. One group allocated brokerage on a rotating basis using local brokerage firms, and one company reported the use of brokerage to compensate for the receipt of a publication. Eight groups put an unknown number of services under the general category "other services."

Although general and introductory, this brief discussion of the factors influencing brokerage allocations of investment adviser groups is still indicative of the importance of dealer sales of investment company shares in influencing the allocation of brokerage commissions, and of the usefulness of brokerage commissions as a means of purchasing a wide range of services. We turn now to a fuller consideration of the relationship between dealer sales of shares and brokerage commissions.

B. DEALER COMPENSATION BY MEANS OF BROKERAGE COMMISSIONS

The discussion in this subsection is confined mainly to those investment adviser groups that sold a substantial proportion of their own shares through independent dealers during 1960. A "substantial" proportion of shares is used here to refer to 20 percent or more of the total sold during that year. Of the 151 groups included in this study, at least 69, or 45.7 percent, fell into this category. Information was unavailable (in several cases because the system was newly organized) for 7 groups, 6 were not selling shares in 1960, 24 managed no-load funds, and the remaining 45 sold more than 80 percent of their shares directly or through an affiliated organization to investors.

Table VIII–71 describes the overlap by number between the largest dealers and the largest brokers, for the 69 groups selling a substantial volume of their shares through independent dealers. Specifically, this table shows the percentage of the 20 largest dealers in open-end company shares who were among the 20 largest recipients of net brokerage commissions, for each of these 69 adviser groups. It may be seen from this table that one-half or more of the 20 largest dealers in mutual fund shares were also among the 20 largest brokers in the case of 19, or 27.5 percent, of the 69 groups; that 40 percent or more of the largest dealers were among the 20 largest brokers in the case of 34, or 49.3 percent, of the groups; and that for only 13, or 18.8 percent, of the groups fewer than 10 percent of the largest dealers were among the 20 largest brokers. The modal percentage class is "40 and under 50," with 15 groups (21.8 percent) having this degree of overlap. It can also be seen in table VIII–71 that there is a tendency for the percentage of overlap of large dealers and brokers to increase with increases in size of open-end company assets managed by the adviser group.

The extent of overlap of large dealers and brokers is affected by the existence of a sizable number of specialist dealers in mutual fund shares who appear among the 20 largest dealers but who are not in a position to engage in normal portfolio business or otherwise to receive brokerage commissions. In order to eliminate the influence of dealers who cannot receive brokerage on portfolio transactions, table VIII–72 shows the percentage of dealers among the largest 20 who are member firms of the New York Stock Exchange and who are also among the 20 largest brokers for each of 59 open-end company groups whoes shares they sell.[55] It can be readily observed that the degree of overlap is significantly higher than that shown in the preceding table—in the case of 42 of the 59 groups, or 71.2 percent, half or more of the New York Stock Exchange firms that are among the 20 largest dealers are also to be found among the 20 largest brokers.

Table VIII–73 affords a more complete picture of the extent to which the New York Stock Exchange firms who are among the 20 largest dealers for the 59 adviser groups participate in brokerage business. Columns 2 and 3 of this table show that only 289 (54.6 percent) of the 529 New York Stock Exchange firms who are among the largest 20 dealers for these 59 groups are also among the largest 20 brokers; however, columns 4 and 5 of the table indicate that an additional 157 of these firms receive brokerage commissions that are not sufficiently large to put them into the first 20. Four hundred and forty-six, or 84.3 percent, of the 529 New York Stock Exchange dealers are recipients of some net brokerage commissions from these 59 groups.

It may also be noted from tables VIII–72 and VIII–73 that there is a positive relationship between the size of the investment adviser group and the number of dealers who also appear as recipients of net brokerage commissions.

[55] Sixty-nine less 5 groups none of whose dealers are members of the New York Stock Exchange and 5 others whose brokerage business is done almost exclusively by a closely affiliated broker.

TABLE VIII-71.—*Percentage of the 20 largest dealers who were also among the 20 largest brokers,*[1] *by size of open-end company assets managed, 69 investment adviser groups, 1960*

Percentage of dealers	Open-end company assets in millions of dollars															
	600 and over		300 and under 600		150 and under 300		50 and under 150		10 and under 50		1 and under 10		0 and under 1		Total number	Cumulative percentage
	Number	Percent	Number	Percent	Number	Percent	Number	Percent	Number	Percent	Number	Percent	Number	Percent		
100	0	--------	0	--------	0	--------	0	--------	0	--------	0	--------	1	10.0	1	1.4
90 and under 100	0	--------	0	--------	0	--------	0	--------	0	--------	0	--------	0	--------	0	1.4
80 and under 90	0	--------	0	--------	0	--------	0	--------	0	--------	0	--------	0	--------	0	1.4
70 and under 80	1	33.3	0	--------	1	12.5	0	--------	0	--------	0	--------	0	--------	2	4.3
60 and under 70	0	--------	1	11.1	2	25.0	0	--------	0	--------	3	20.0	1	10.0	7	14.5
50 and under 60	0	--------	2	22.2	1	12.5	3	42.9	0	--------	0	--------	3	30.0	9	27.5
40 and under 50	1	33.3	2	22.2	2	25.0	2	28.6	4	23.5	4	26.7	0	--------	15	49.3
30 and under 40	1	33.3	1	11.1	0	--------	0	--------	2	11.8	2	13.3	0	--------	6	58.0
20 and under 30	0	--------	2	22.2	1	12.5	0	--------	3	17.6	1	6.7	0	--------	8	69.6
10 and under 20	0	--------	1	11.1	0	--------	1	14.3	4	23.5	2	13.3	2	20.0	8	81.2
1 and under 10	0	--------	0	--------	1	12.5	1	14.3	1	5.9	2	13.3	0	--------	6	89.9
0	0	--------	0	--------	0	--------	0	--------	3	17.6	1	6.7	3	30.0	7	100.0
Total	3	100.0	9	100.0	8	100.0	7	100.0	17	100.0	15	100.0	10	100.0	69	100.0

[1] For those groups with fewer than 20 dealers and/or 20 brokers, the total number listed was used as the basis for the percentage calculation.

TABLE VIII–72.—*Percentage of New York Stock Exchange firms among the 20 largest dealers who were also among the 20 largest brokers,*[1] *by size of open-end company assets managed, 59 investment adviser groups, 1960*

Percentage of dealers	Open-end company assets (in millions of dollars)															
	600 and over		300 and under 600		150 and under 300		50 and under 150		10 and under 50		1 and under 10		0 and under 1		Total number	Cumulative percentage
	Number	Percent	Number	Percent	Number	Percent	Number	Percent	Number	Percent	Number	Percent	Number	Percent		
100	0	--------	0	--------	1	14.3	0	--------	0	--------	1	7.1	0	--------	2	3.4
90 and under 100	0	--------	0	--------	1	14.3	0	--------	0	--------	0	--------	0	--------	1	5.1
80 and under 90	1	33.3	2	22.2	1	14.3	1	14.3	0	--------	0	--------	0	--------	5	13.6
70 and under 80	0	--------	1	11.1	1	14.3	1	14.3	1	7.1	3	21.4	0	--------	7	25.4
60 and under 70	1	33.3	1	11.1	0	--------	0	--------	2	14.3	2	14.3	1	20.0	7	37.3
50 and under 60	1	33.3	3	33.3	3	42.9	3	42.9	7	50.0	2	14.3	1	20.0	20	71.2
40 and under 50	0	--------	1	11.1	0	--------	0	--------	1	7.1	1	7.1	1	20.0	4	78.0
30 and under 40	0	--------	0	--------	0	--------	1	14.3	0	--------	2	14.3	1	20.0	4	84.7
20 and under 30	0	--------	1	11 1	0	--------	1	14.3	0	--------	1	7.1	0	--------	3	89.8
10 and under 20	0	--------	0	--------	0	--------	0	--------	1	7.1	1	7.1	0	--------	2	93.2
1 and under 10	0	--------	0	--------	0	--------	0	--------	0	--------	0	--------	0	--------	0	93.2
0	0	--------	0	--------	0	--------	0	--------	2	14.3	1	7.1	1	20.0	4	100.0
Total	3	100.0	9	100.0	7	100.0	7	100.0	14	100.0	14	100.0	5	100.0	59	100.0

[1] For those groups with fewer than 20 dealers and/or 20 brokers, the total number listed was used as the basis for the percentage calculation.

TABLE VIII-73.—*Number and percentage of New York Stock Exchange firms among the 20 largest dealers who received some brokerage commissions, by size of open-end company assets managed, 59 investment adviser groups, 1960*

Open-end company assets (in millions)	Number of New York Stock Exchange firms among 20 largest dealers (1)	Number of firms in col. (1) also among 20 largest brokers (2)	Col. (2) as percentage of col. (1) (3)	Number of firms in col (1) receiving some brokerage commissions (4)	Col. (4) as percentage of col. (1) (5)
0 and under $1	26	10	38.5	13	50.0
$1 and under $10	98	45	45.9	52	53.1
$10 and under $50	94	43	45.9	73	77.7
$50 and under $150	75	41	54.7	74	98.7
$150 and under $300	84	59	70.2	83	98.8
$300 and under $600	111	64	57.7	110	99.1
$600 and over	41	27	65.9	41	100.0
Total	529	289	54.6	446	84.3

TABLE VIII-74.—*Percentage of net brokerage commissions of the 20 largest brokers accounted for by the 20 largest dealers, for 69 investment adviser groups, 1960*

Percentage of net brokerage commissions	Number of groups	Cumulative percentage of groups	Percentage of net brokerage commissions	Number of groups	Cumulative percentage of groups
100	6	8.7	30 and under 40	7	69.6
90 and under 100	4	14.5	20 and under 30	5	76.8
80 and under 90	7	24.6	10 and under 20	4	82.6
70 and under 80	3	29.0	1 and under 10	4	88.4
60 and under 70	4	34.8	0	8	100.0
50 and under 60	11	50.7			
40 and under 50	6	59.4	Total	69	100.0

Table VIII-74 describes the percentage of the net brokerage commissions of the 20 largest brokers accounted for by the 20 largest dealers in their mutual fund shares, for each of the 69 adviser groups selling in volume through independent dealers. It may be seen that in the case of 35 (50.7 percent) of the 69 groups included here the 20 largest dealers accounted for 50 percent or more of the net brokerage commissions of the 20 largest brokers; and in 17 instances (24.6 percent) those dealers accounted for 80 percent or more of such brokerage commissions. In 16 cases (23.2 percent) the largest dealers accounted for less than 20 percent of the net brokerage commissions received by the 20 largest brokers.

Sixty-four companies specified in their prospectuses the brokerage volume allocated to the dealers in their shares. Of these 64, 9 indicated that all brokerage went to their dealers, 25 (39.1 percent) reported 75 percent or more allocated to dealers, 46 (71.9 percent) reported 50 percent or more given to dealers, and 57 (89.1 percent) indicated that 25 percent or more of their brokerage business had been allocated to dealers in their shares.

A substantial number of companies report the use of various types of rules of thumb in allocating their brokerage to dealers (and sometimes also to others). The most frequently mentioned rule is that used by the management of one major system, which attempts to allocate its brokerage so that commissions roughly approximate 1 percent of the gross amount of its shares sold by various broker-dealers over a period of years. Another fund uses the same formula on a monthly basis for sales beyond a certain substantial level ($50,000), to be paid in brokerage commissions where available, or otherwise by the adviser-underwriter in some other manner. Another major adviser also reports that—

the aggregate proportion of the company's commission business identified with the distribution of bid and asked prices for its shares, and in the area of statistical information is quite small. Thereafter, qualified broker-dealers participate in the amount available to a point where such commissions approximate 1 percent of the dollar amount of their sale of the company's shares.

Other companies report various approximate gross allocations between sellers of investment company shares and those performing other functions. Thus, in the reply of one adviser it is stated that:

In connection with purchases and sales of previous securities, as a practice, purchases and sales are allocated approximately 50 percent for information regarding portfolio companies, and 50 percent for new sales of the fund's shares. In this regard, a reciprocal business given to dealers who sell the shares is such that it should approximate the dollars of the fund sold by a given dealer.

Two major funds reportedly allocated more than 85 percent of total brokerage commissions to dealers selling their shares in 1960, with the remainder going to those providing statistical or other services to the companies. Another important company reports that—

For purposes of internal control, and the practical and efficient handling of routine, but without any strict adherence to formula either in percentage or amount, customarily, about two-thirds of brokerage commissions are tentatively and very roughly allocated to dealers who sell the company's shares as well as provide other services. About one-third of such brokerage as arises from normal portfolio transactions is tentatively allocated to brokers who may provide factual information of use to the company or its managing agent, or may provide wires or other miscellaneous services, or may be friends of long standing intimately familiar with how the company likes to have its transactions handled. However, this one-third to two-third relationship is not fixed and varies significantly from time to time, based upon the amount of brokerage available and other factors too varied in nature to be readily classified.

In order to determine more precisely the relationship between sales of open-end company shares and brokerage commissions received for portfolio transactions of mutual funds, an attempt was made to show this relationship in the form of simple linear regression equations. For this purpose our sample was restricted to the sales of mutual fund shares by New York Stock Exchange firms among the 20 largest dealers of each of the 59 adviser groups which had one or more such dealers,[56] and the net brokerage commissions of these same dealers where they were also among the 20 largest brokers for each of the adviser groups.

For the entire sample of 59 groups, the effect of a 1-percent change in sales of mutual fund shares during 1960 by New York Stock Exchange firms among the 20 largest dealers for an adviser group, on the percentage of the net brokerage commissions of stock exchange firms who were also among the 20 largest brokers received by these firms, was found to be expressed by the linear regression

$$(1)\quad Y_t = .015 + .866X_t, \text{ with } \bar{R}^2 = .49$$

This is to say that a 1-percent increase in sales of open-end company

[56] See above for a discussion of this sample.

shares by a New York Stock Exchange firm among the 20 largest dealers in the shares of that company tended to increase the net brokerage commissions directed to that dealer by 0.866 percent. The adjusted coefficient of determination $\bar{R}^2$ of 0.49 indicates that variations in the percentage of broker-dealer sales of mutual fund shares among the 20 largest dealers explains only about one-half of the total variation in the percentage of net brokerage commissions received by these dealers who were also among the 20 largest brokers, for the sample of broker-dealers and adviser groups analyzed here.

In order to test the differences in this relationship by size of open-end company assets managed, the 59 groups were divided into 3 size classes. The largest size class comprised 19 adviser groups all managing open-end company assets of $150 million or more. The intermediate size class included 21 adviser groups supervising between $10 and $50 million of open-end company assets. The smallest size class included 19 adviser groups each supervising less than $10 million of open-end company assets. The regression equations expressing the relationship between percentage changes in mutual fund share sales and net brokerage commissions received by New York Stock Exchange member firms for these three size classes, proceeding from the largest asset size class down, are as follows:

$$(2)\quad Y_t = -.003 + 1.040X_t, \text{ with } \bar{R}^2 = .42$$

$$(3)\quad Y_t = .021 + .827X_t, \text{ with } \bar{R}^2 = .42$$

$$(4)\quad Y_t = .022 + .859X_t, \text{ with } \bar{R}^2 = .55$$

We can see from these equations that the response of the receipt of brokerage commissions to dealer sales of mutual fund shares is strongest for the largest firms, with a 1-percent increase in dealer sales tending to elicit an almost identical percentage increase (1.04) in brokerage business in equation (2). The relationship is only slightly less strong in the two smaller size classes, with response coefficients of 0.827 and 0.859 respectively. For all three classes the $\bar{R}^2$ values indicate that dealer sales of mutual fund shares are only a partial explanation of variations in brokerage business as between New York Stock Exchange firms who sell mutual fund shares.

It was seen above that only 289 (54.6 percent) of the 529 NewYork Stock Exchange dealers who were among the 20 largest dealers for the 59 adviser groups included in our regression analysis were among the 20 largest brokers for these groups in 1960. This in itself is strong evidence that the system of rewards and benefits is not a simple one. Usually the few most important New York Stock Exchange dealers in mutual fund shares appear among the 20 largest brokers, but even here the relationship is not entirely dependable, and as we move down the scale to less important dealers, the relationship becomes increasingly erratic. This lack of consistency is due in part to variations in other benefits received from broker-dealers, including investment advice, valuation and wire services, efficient execution, and the economy and secrecy advantages in the use of primary brokers. Other factors that weaken the relationship between dealer sales and brokerage receipts are the influence of longer term affiliations and business relationships between broker-dealers and investment company groups, and the fact that many mutual fund groups do not yet feel a firm obligation to reward mutual fund dealers with brokerage business at some fixed rate. Moreover, when we get to the smaller groups, brokerage commissions may not be available in sufficient volume to permit more than rewards for the performance of essential services (such as twice daily asset valuations).

This last point helps to explain the stronger relationship between dealer sales and brokerage commissions among the larger firms. The latter are "surplus" firms; i.e., firms with sufficient portfolio business to acquire more than basic execution and informational services from brokers. These surpluses provide an extra margin for rewarding dealers selling group investment company shares.[57] In general the brokerage allocations of smaller groups are less dealer oriented than in the case of larger groups. This is due in part to the lesser availability of surplus brokerage, but it results also from the greater frequency of direct selling among smaller groups and the greater importance of broker affiliations as a force influencing the flow of brokerage.

C. INDIRECT PARTICIPATIONS

Frequently allocations of brokerage commissions to dealers are implemented by instructions to other brokers to "give up" part of their brokerage commissions to designated dealers in mutual fund shares. Thus, of the 1,143 dealers who were among the 20 largest for the 69 groups selling a substantial proportion of their shares through independent dealers, 365, or 31.9 percent, received some or all of their commissions from the group in the form of indirect participations.

The use of giveups is positively related to the asset size of the adviser group. The average number of dealers among the 20 largest receiving giveups is approximately 10 for the first 4 size classes, drops to 4 for the groups in the $10–$50 million class, to below 1 in the $1–$10 million class, and falls to zero in the smallest size class. This is as we would expect, since the number of dealers tends to increase sharply with larger asset size, the surplus brokerage available for dealer rewards tends to be larger, and the pressure for centralization of active brokerage work in the interest of efficiency increases with the growth in volume of portfolio business.

In table VIII–75 we can see that giveup transactions account for a considerable proportion of the brokerage commissions paid to dealers. In 6 cases, or 8.7 percent of the total, indirect participations accounted for 50 percent or more of total net brokerage commissions paid to the 20 largest dealers; in 21 cases, 30.4 percent of the total, giveups accounted for 20 percent of large dealer commissions. Thirty-six, or 52.2 percent, of the groups had no giveup payments made to any of the 20 largest dealers in their shares.

The present importance of giveup transactions in the structure of rewards to dealers offered by management groups of mutual funds is a result of a combination of factors. First, there is the underlying desire to stimulate growth by adding to dealer incentives to sell shares. Second, it is frequently found expedient for best prices and efficient

[57] The fact that surplus brokerage commissions available for rewarding dealers in mutual fund shares tends to be a function of size means that effective sales rewards tend to be somewhat larger for larger groups. This is a small factor but one making for a higher level of concentration of assets in the mutual fund industry than would otherwise prevail.

execution to neglect certain dealers in investment company shares who are not members of principal exchanges or who do not specialize in the securities being bought and sold by the adviser group. Indirect participations afford a means of compensating these dealers for their services in selling investment company shares.[58]

Third, it is often considered in the interest of economy to the trading department of the mutual fund group and desired secrecy of transactions being undertaken by the group, to channel brokerage business in concentrated amounts through one or a few principal brokers. Arrangements with such principal brokers generally include an understanding that giveups to designated dealers will absorb the largest portion of total brokerage commissions available for disposition by the adviser group.[59] Thus, according to the management of one major fund:

TABLE VIII-75.—*Ratio of the amount of give-ups received to total net brokerage commissions received by the 20 largest dealers, for each of 69 adviser groups, 1960*

Ratio of the amount of give-ups to total net brokerage commissions (percent)	Number of groups	Cumulative percentage of groups	Ratio of the amount of give-ups to total net brokerage commissions (percent)	Number of groups	Cumulative percentage of groups
100	1	1.4	30 and under 40	3	17.4
90 and under 100	0	1.4	20 and under 30	9	30.4
80 and under 90	1	2.9	10 and under 20	6	39.1
70 and under 80	2	5.8	1 and under 10	6	47.8
60 and under 70	1	7.2	0	36	100.0
50 and under 60	1	8.7			
40 and under 50	3	13.0	Total	69	100.0

A great many dealers and brokers are helpful to the company either through distribution of shares, investment research, or other services. While they would all like to execute orders for the company, the time lost in placing orders with a large number of firms would place a severe handicap on the facilities of the trading department. In addition, the use of a large number of firms would make it more difficult for the company to maintain its desired secrecy as to its transactions. Time-consuming delays would exact stiff penalties when the volume of transactions is heavy.

For these reasons, the company's orders for listed securities are executed through a limited number of member firms, both for the members' own accounts and for the accounts of their correspondents. In addition, some of these member firms execute other orders, a portion of the commissions on which are credited by them to give-up accounts. Funds accumulated in the give-up accounts are then paid out to other member firms as directed by the company.

This type of view and arrangement is also illustrated by the following statement from the return of another major system:

* * * It should be noted that all purchase and sale orders for New York Stock Exchange securities for any of the investment companies for whom * * * [this company] acts as investment adviser are placed with * * * [a] New York Stock Exchange firm * * * [which] allocates the individual purchase and sale orders among various brokers so as to comply with overall allocations directed by * * * [the adviser]. The allocation among the brokers is designated to compensate

[58] On most, but not all exchanges, including the New York Stock Exchange, member firms are forbidden by the rules of the exchange to give up any part of their commissions to nonmembers. Where this is the case, the range of use of giveups is limited for the securities bought and sold on the exchanges subject to such restrictions, unless these rules are violated directly or indirectly. Nonmembers may still be rewarded by means of indirect participations in business on unrestricted exchanges and by direct and indirect participations in over-the-counter business. Some companies also note that, "Inasmuch as broker-dealers that are members of national securities exchanges receive virtually all of the commission business incidental to the purchase and sale of listed securities in the usual manner, it is a policy generally to allocate commissions or concessions on any new issues or secondary distributions to nonmember firms to the extent this can properly be done."

[59] The member companies of one of the largest mutual fund groups state that "Most of the purchases and sales are executed through certain member firms of the New York Stock Exchange which are designated as 'primary' brokers. * * * All of these primary brokers agree to 'give up' a percentage of their commissions to other member firms of the stock exchange as designated by the investment company."

those brokers and dealers who have furnished particularly efficient and extensive services to the investment company and to * * * [the adviser] and to stimulate other brokers or dealers to increase the services they extend to these companies, particularly with respect to research information and assistance and other related services over and above the bare brokerage function. * * *

Based upon its experiences and its studies of all possible methods * * * [it is believed] that this system provides the most efficient way of handling its New York Stock Exchange business. This system greatly simplifies and expedites the execution of orders, shields the identity of the investment company doing the buying or selling until the transactions are completed to a greater degree than might otherwise be possible and gives the investment company the great advantage of removal from the pressures of Wall Street while protecting and preserving for the investment company all of the advantages of continuous and instant communication with all vital components of that financial center. All of these advantages and benefits are enjoyed by the investment company at no extra cost to it since the brokerage cost on each such purchase and sale transaction consists only of the standard New York Stock Exchange commission. For its services as described above * * * [the clearing broker] is compensated by various of the brokers or dealers so designated by * * * [the adviser, which brokers also contribute to the expense of a direct telephone line between clearing broker and adviser].

Fourth, and finally, the structure of brokerage fee rates charged mutual funds on their portfolio transactions has contributed to the use of indirect participations. Although subject to a sliding scale according to size of purchase, brokerage commission rates fixed by the organized exchanges are geared to relatively small transactions which are assumed to require associated services; they appear to make inadequate adjustment for large transactions which require little besides a relatively mechanical execution. The result is that for the larger institutional investors, including mutual funds, it is understood that a smaller or larger fraction of brokerage commissions, depending on transaction size, problems, and associated services, is more or less at the disposal of the investor. The management of one major system reported that:

The percentage of the total commission to be retained by the give-up broker member of the New York Stock Exchange for his own services and the percentage to be paid to others are subject to negotiation but are presently 40 percent and 60 percent, respectively. The percentage retained by the give-up broker is considered high enough to assure the best possible service and to command the special attention required for maximum efficiency.

Other companies also suggest 40 and 60 as the usual execution-give-up ratio.

To a considerable extent the present importance of brokerage payments, and particularly give-ups, to dealers in investment company shares, can be regarded as a consequence of a relatively inflexible structure of prices for brokerage services that makes surplus brokerage available for disposition to others by sizable investment companies. It would clearly be in the interests of shareholders of mutual funds to pay competitive prices for brokerage services that would allow adequate compensation to the executing broker and would leave what was formerly surplus brokerage to the free use of the fund. In the absence of price competition in this area shareholder interests would dictate forward integration into the brokerage business by the mutual fund or a subsidiary of the fund,[60] or, at a minimum, the full use of brokerage surpluses to acquire services of value to fund shareholders.

[60] Management groups, of course, frequently channel investment company brokerage business to companies in which they have an ownership interest. It would be possible for mutual fund shareholders to share indirectly in the benefits of this brokerage business if adviser-brokers reduced their management fees in proportion to brokerage commissions derived from the fund.

It may also be noted that forward integration into the brokerage business by mutual funds themselves would apparently be contrary to the present rules of the New York Stock Exchange.