Higgins Associates
Boston, Massachusetts

February 28, 1968

Securities and Exchange Commission
Washington, D.C.

Re: Rule 10b-10 and mutual fund legislation

Gentlemen:

This letter is in answer to your invitation to comment on your proposed Rule 10b-10. I am also taking this opportunity to make statements concerning other pending legislation relating to the mutual fund industry.

PERSONAL BACKGROUND:

Higgins-Associates was started by the writer in 1961. Previous to that, I spent three and one-half years with the First National Bank of Boston as a management trainee. I hold a B.A., and an M.S. in Business and Public Relations.

OPERATION:

The business has been operated with no outside source of working capital, and no employees with the exception of several part-time salesmen who last year generated 12% of my net commissions. Our sales last year were just short of $1,000,000; all mutual fund business. This year, I have hired a secretary, and have registered five C.L.U.'s, to keep pace with the gravitation of the two industries. Our sales last year were derived from individuals and institutions, pension and profit-sharing plans, in about equal proportions. For the last three years, I have spent less than 10% of my time actually prospecting for new customers. My time is spent working with existing customers on their new money, and handling unsolicited referrals from the same source.

FINANCIAL:

The firm's profits can be measured by my personal income. My gross income last year was $45,781, $15,286 of which came from give-ups. Operating expenses came to $7,706, for a net profit to me of $38,075.

EFFECT OF PROPOSED LEGISLATION:

I have readjusted all transactions in 1967 to reflect the effect of the proposed reduction in dealer commissions and the elimination of give-ups. My net profit before taxes under those circumstances would have been $16,084. Operating expenses last year were artificially low due to the fact that there were virtually no secretarial expenses and no office rent. Our rent-free arrangement will terminate this year and now we do have a secretary. Very reasonable estimates for these new expenses fall into the $6,000 range, leaving a projected income to me of $10,000, or under, before taxes. The effect of give-ups in my case far exceeds that of reduced sales charges, which would lower my income by the relatively small amount of roughly $6,700.

COMMENT ON EFFECTS:

Our operations are representative in the extreme. No firm could exist more cheaply, nor have less opportunity to reduce expenses commensurate with drastically lower gross income. Our average dealer commissions are already very close to what you recommend, due, of course, to volume transactions. We currently offer extra ordinary services to our customers, including the 1,700 employees covered by the corporate retirement plans, and an increasing number of these people are depending upon these services. We have ideas which will expand these services, filling what we believe are real needs. If by some chance we find it practical to remain in business under new legislation, these services probably would have to be eliminated as one of our few available economy measures. It is within this weighted context that I comment upon your proposals.

PROPOSED RULE 10b-10

I have studied carefully the proposed Rule and published comments relating to it. Obviously, I do not have the resources to conduct a study which, by well documented statistics, could be of practical value to you. My only offering is the subjective commentary of a salesman/owner who deals with the small investor, banks, officers of small and medium sized corporations, and who has prospected many of the major corporations. This is an encompassing cross-section which has provided me with an interesting range of experience.

The Report put out by the N.A.S.D. in April of 1967 uses a sample group of b/d's which I hope you have accepted as being reasonably representative. My own figures appear to help verify the contention that the category including b/d's which market mutual funds exclusively, will, as a practical matter, disappear from the scene if give-ups are totally eliminated. This will reduce competition, of that there is no question. To what degree it will, no one should presume to guess without further study. What I can predict with certainty, is that the public will no longer have available the small firm whose representatives must perform service in depth on a very personal basis to compete with his counterpart at a large member firm. In order to overcome the type sales resistance which is eliminated by the appellation "Member, New York Stock Exchange, " we have to get out of our chairs and into the customers living room and promise and produce assistance which we contend is unavailable elsewhere. Like small town lawyers, we enter far more deeply into the lives of our customers than our competition. Consequently, we are in a better position to deal in the realities of a customer's circumstances, thus having an opportunity to do a better job. Only the new representative of a large member firm, who will take on any size account to help him get started, will begin to perform such services. Frankly, much of our new business comes from those people whose representatives have had to abandon them as they up-grade their clientele.

I have found that this competition-inspired approach can be brought into the board room of a major corporation, an air carrier, where I represented myself in an effort to have included mutual funds as an elective in a proposed, employee savings plan. If my proposal is accepted, 10,000 families will be purchasing mutual funds at a 1% sales charge, and, if give-ups exist, will allow me to afford them at least a measure of the treatment, as individuals, which my experience tells me is not commonly made available by those who will survive in the brokerage business if we are fiscally excised. (I should state now, if parenthetically, that my comments about the large member firms, although critical in this context, do not imply condemnation of their present size or dominance in major segments of the investment business. I applaud their commensurate contribution to our economy. My point is to hold out for consideration of segments of public need which, because of the very nature of the small specialized firm and not necessarily its excellence, we can serve in depth with greater efficiency.)

In my opinion, the compensation represented by the give-up system is essential to the conduct of my business as I know it. If I am a personal success in my efforts, my treatment of my customers and the demands I make on my salesmen as they relate to their customers will be of a much higher quality than if I could find some way to scratch out a living by selling more customers at less profit per capita. If my situation can logically be magnified by a factor of hundreds, I really cannot see how the public will benefit, even if costs to investors are reduced to the extent you propose. There will be created a margin for error and sins of omission, the extent of which, again, is guesswork.

I agree that the way that this compensation reaches us borders on the ludicrous; that we do not participate in any way in the executions which produce it; that the distribution is inequitable; and that some of the results are abusive. Still, the money provided us by give-ups is essential in the conduct of our business. Unless there is an underlying desire on the part of the Commission to decimate the number of firms, knowing full well that practically all of the attrition will be among the smaller firms, a new look at the benefits of the give-up may be in order rather than a single minded attack on its source. The only negative factor, abuse, if you will, of the result of give-up money other than its disproportionate distribution, is that of the firm or the salesmen homing in on one-fund, or a group of funds. This tendency will continue to persist under any circumstances for many existing and to-be-contrived reasons if give-ups are eliminated. Even if the wholesaler element disappears entirely, new direct services such as greatly increased advertising for the dealer and of course outright acquisitions, will take plan and would lock in firms more strongly than do give-ups now. Your problem would be having to chip away at the creation of the new sales efforts of an imaginative industry, which, by its characteristics should remain perpetually vital.

THE EXCHANGE PROPOSAL:

By supporting the Exchange Proposal in part, I admit to the same fault I lay with the Commission. In this case, I would be forced to allow an attrition in activity among the regional exchanges. Nevertheless, the Exchange proposal to limit the amount of reciprocal, which could be extended to include its receipt on the part of those taking no part in the execution of orders, would be in recognition of the fact that manufactured circumstances of all types, especially among the wealthiest firms, will continue the existing practice in different form easily circumventing regulations supposed to effect the contrary. The "business has to be placed somewhere" approach would create an invitation to subterfuge to be countered only by regulations forbidding funds to do no business with those who sell their shares; an incredible situation from any point of view you wish to take. The limit on a percentage of what we may again call give-ups, which can be disbursed to pay for research on sales, will replace your proposal which, instead of evening off the 2% I receive and the 8% a major receives, will have the effect of giving 10% to the major for his mutual fund sales. If a mutual fund were allowed to use 50% or 75% of its brokerage for purposes of helping its sources of distribution deal effectively and profitably with the public, and to pay from this source for investment ideas it otherwise would have to buy outright or generate from within at greater expense, there would still be an amount left to effectively defray management expense, even if a limited reduction in charges for volume transactions on the Exchange is put into effect.

I believe that under such circumstances the public will be best served as the result of continuing competition. Firms like mine can stay in business and originate beneficial ideas for our prospect and customers as we compete with our more prestigious neighbors for the investment dollar.

REDUCTION IN SALES CHARGES:

In the past five years, competition from both inside and outside our industry has wrought methods which reduce acquisition costs for volume purchases, and more are on the way. The figures I have set forth earlier help support the statement that I have applied all those methods available. As an aside, I might say that I have helped press for these, and still am doing so. In May of 1963 I wrote to Mr. Carr of the Commission relative to performing services for individuals under our corporate accounts at no charge. Most of our requests were turned down. In 1964, I circulated another proposal among the elders of my industry regarding a request for an interpretation of 22d which would allow a reduction in sales charges for employees voluntarily purchasing mutual funds under a 401 employee savings plan. I was advised not to communicate with the Commission since the N.A.S.D. had recently failed to secure a favorable ruling on the same matter. My proposal would have reduced a sales charge 7% for 7,000 people. Whether or not these requests should have been accepted is not my point. It is simply indicative of the trends intense competition will produce, if given time.

The fact that the economies I have brought to my institutional accounts were enjoyed by retirement plan participants does not impress those concerned with commission levels paid by the small individual investor. I can address myself to this less subjectively than other areas discussed in this letter since the peculiarities of my operation would preclude any disasters to me by the lowering of the highest charge paid and the dealer commission with it. However, those organizations who depend totally on attracting and holding men, probably could not exist under your proposed commission reduction. They possibly could live with a maximum 5% or 5 1/2% dealer discount, but I am not familiar with the profit margins of that type of operation. The result of the proposed commission reductions would again be most harmful to the public. If the industry cannot profit by reaching the small investor, he will be ignored, which is not good unless you believe for some reason that this is desirable, or that this investor will seek out his own medium. Harsh as it may sound to say, the small investor is small for a reason, and usually, the same reason renders invalid any argument that he will effectively work for himself.

REINVESTMENT OF DIVIDENDS AT NET ASSET VALUE:

My comments on this can be brief. Approximately 2% of my compensation is derived from this source. Over 2% of our time is spent in one form or another, handling dormant accounts where dividends are being reinvested, and the number is growing. More and more of our customers including my largest ($1.5 million market value) are in plan accounts where dividends are being reinvested at net asset value. This appears to be an area where competition is working out the details.

CONCLUSION:

I freely admit that the not-so-obscure message of this letter is "Keep Higgins in business". As I have studied the situation this past week to learn as much as two hours a day will teach a mutual fund salesman about the economics of an intricate situation, I have come to believe strongly in the reasons I have found which lend support to my personal position. These reasons may have more universal application and negative aspects than the Commission believes, or perhaps less than I believe. What is obvious to me is that studies examining both your proposals and those of the Exchange as they ultimately would affect the public, which includes the 50,000 hard core mutual fund salesmen, must be undertaken in greater depth than they have been to the present. I am truly concerned as to who, and in what manner, my customers, and those of hundreds of thousands of other small firms, will be handled if we are taken out of the picture. They have come with us, and have stayed with us, for a reason, some of which are due to the positive factors related to our size and methods of operation.

Neither my industry, nor the Commission should take the apathy of a public, at present front-minded with more evident burdens and pleasures, as license to continue or undertake courses and procedures without separately and together examining the probable and possible long term effects of their actions.

Very truly yours,

Edwin M. Higgins