Board Memorandum

THE New York Stock Exchange

September 19, 1973

Summary Memorandum

NONMEMBER ACCESS DISCOUNT -- MANAGED INSTITUTIONAL ACCOUNTS

The Issue

To consider the Exchange's options following SEC rejection of two Exchange attempts to deal with the question of the nonmember access discount for managed institutional accounts?

Background

The Exchange has given considerable attention to this issue in recent months. A chronology is attached as Exhibit A. The Board has twice sought to resolve the issue without success.

The first attempt to deal with the question was an interpretation published in Educational Circular 415 on June 1, 1973, following receipt of word that the SEC would not object to its issuance pending further study and opportunity for public comment. The circular defined "affiliated person" as the term applies to both the 80% test for membership and the nonmember discount. The interpretation spelled out a number of situations in which an institutional account managed with discretion would be deemed to be an affiliated person. A copy of the circular is attached as Exhibit B.

On September 13, 1973, the SEC published conclusions based on public comment and on its own study. The Commission rejected the interpretation in Educational Circular

415 and directed the Exchange to withdraw it promptly. A copy of the SEC letter is attached as Exhibit C.

The second attempt to resolve the issue was made in July when the Board approved a proposed amendment to Rule 385 which governs the nonmember discount. The proposed amendment would have retained the existing definition of "affiliated person" for purposes of membership eligibility, while making the definition more stringent for purposes of access. The net effect would have been to bar nonmember brokers from receiving the discount for their managed institutional accounts, even though those same accounts would be considered as public business for purposes of membership eligibility.

The SEC rejected the proposed amendment in a letter dated August 29, 1973, attached at Exhibit D.

Options

The Exchange appears to have a choice of three broad optional courses:

1. Take No Action. The Exchange could choose to drop the question. This would mean that nonmember brokers would be able to obtain a discount of up to 40% on their managed institutional accounts.

There is no basis for determining the amount of commission income which will flow to nonmember brokers through the discount. To date, fewer than thirty insurance companies and investment advisors have become eligible to receive the discount through

qualification of broker subsidiaries. However, others may have been awaiting the outcome of the SEC consideration of the Exchange's proposal to amend Rule 385 and the interpretation published in Circular 415.

Our argument in favor of taking no action is the SEC announcement of its intention to end fixed minimum commissions by April, 1975. The end of fixed minimum commissions would make this question academic, because the discount is applicable to fixed rates only.

2. Amend Rule 318. The Exchange could propose an amendment to Rule 318 which would change the definition of "affiliated person" for purposes of both membership and access. This would meet the SEC criticism -- expressed in the Commission's rejection of the proposed amendment to Rule 385 -- that there is no justification in not having the same requirements for both members and nonmembers. Although informal discussion indicates that the SEC would not be receptive to such an amendment, the Exchange might wish to press for it over SEC objections. A similar proposal was circulated to the membership for comment last June.

3. Seek a Legislative Solution – The Exchange could recommend that Congress adopt legislation to prohibit any broker-dealer from making transactions for any managed institutional account. Legislation which would accomplish this by April, 1976 has been passed by the Senate and is also included in H. R. 5050, the Moss Bill. One argument in favor of such a legislative remedy is that is would continue in effect with or

without fixed minimum commissions. Thus, it would offer a more permanent solution to the broad question of whether investment managers should have access to the Exchange to effect trades for their investment management clients.

Department of Regulatory Development

Exhibit A - Background of Nonmember Discount for Managed Institutional Accounts
Exhibit B - Educational Circular No. 415
Exhibit C - SEC Letter (September 13, 1973)
Exhibit D - SEC Letter (August 29, 1973)

EXHIBIT A

Background of Nonmember Discount for
Managed Institutional Accounts

Membership Rules

Until 1970, Exchange membership rules provided that control of each member organization had to be in the hands of its managers, either through their being the only general partners in a member firm or holding all the voting stock in a member corporation. In 1970, the membership rules were changed to allow a member corporation to issue its securities to the public. One of the new membership requirements then adopted was the so-called "parent" rule, which required that the parent of any member organization, as well as the member organization itself, had to have as its primary purpose the transaction of business as a broker or dealer in securities, receiving at least 50% of its gross income from those sources. The effect of this requirement was that an organization whose primary activity was the investment management of securities accounts could not itself become a member organization of the Exchange and could not have a member organization as a subsidiary. However, membership was open directly or through ownership of a subsidiary to any organization which managed accounts as a secondary activity and had the securities business as a primary activity.

On February 1, 1973, the Exchange's membership rules were again amended, this time to meet the requirements of SEC Rule 19b-2. The "parent" rule was replaced by the requirement that at least 80% of the business of each member organization must be for the account of public customers, with no more than 20% done for "affiliated persons". As required under SEC Rule 19b-2, the definition of "affiliated person" excluded managed accounts, with the result that managed accounts are now deemed to be public

business. The "primary purpose" rule was retained for member organizations but was rescinded for their parents.

Example: Under the amended membership rule, if a member organization manages the account of a pension fund through holding investment discretion over the fund's portfolio transactions, the dollar value of the trades effected for the pension fund are considered public business and count toward the minimum 80% required to be done for public customers. On the other hand, if the same member organization trades for its own account, it is considered to be trading for an "affiliated person", and the value of those transactions is counted toward the maximum 20% permitted for "affiliated persons".

Access Rules

The Exchange adopted a 40% access discount for qualified nonmembers in March, 1972 as part of its then-new commission rate schedule. The discount was made available to nonmember brokers meeting the Exchange's "primary purpose" and "parent" test requiring that at least 50% of their gross income and the gross income of any parent had to be derived from activities as a broker or dealer in securities. In effect, the 40% access discount was available only to nonmember brokers which could meet Exchange membership requirements. Organizations whose primary activity was the management of securities accounts could not qualify, either directly or through a subsidiary, for the 40% discount. The discount was to continue in effect for one year, unless extended by the Board.

In January, 1973, the 195-page SEC announcement of the adoption of SEC Rule 19b-2 stated that all securities exchanges which had access rules should amend them to the extent necessary to eliminate any "parent" test and to limit the access discount to trades effected for public customers. For practical purposes, this establishes a 100% public business test for the 40% discount compared to an 80% public business test for membership eligibility. In March, 1973, the Board extended the 40% access discount and gave preliminary approval to Constitutional amendments to carry out the SEC directives. The membership approved these amendments on April 19, 1973 effective June 4, 1973. The interval between the approval and effective dates permitted new agreements to be signed between the Exchange and qualifying nonmember brokers.

An important effect of the amended Exchange access provisions is to allow brokers whose primary activity (or whose parent's primary activity) is the management of institutional securities accounts to receive the 40% discount on transactions effected for their managed institutional accounts. This is possible because the definition of "affiliated person" for purposes of both the 40% discount and membership qualification exclude managed accounts.

Example: Under the amended access rule, if a nonmember broker--like the member organization in the previous example -- trades for the account of a pension fund which it (or its parent) manages with investment discretion, the pension fund is considered a public customer. The nonmember broker is therefore eligible for the 40%

access discount on transactions for the pension fund. However, the nonmember broker's own account is considered an "affiliated person", and the nonmember is not eligible for the 40% access discount on those transactions.

Proposal to Amend Rule 318

At its meeting on June 7, 1973 the Board of Directors determined to circulate to the membership a proposed amendment of Rule 318. This was done in Educational Circular 419, attached as Exhibit A-1. Comments on the proposed amendment were received from five member organizations. All five supported the proposed amendment. However, informal discussions with the SEC indicated that the amendment to Rule 318 might not be acceptable to the Commission. Accordingly, the proposed amendment was dropped in favor of an attempt to redefine "affiliated person" solely for the purpose of nonmember access only by an amendment to Rule 385.

This proposed amendment left the definition of affiliated person untouched for purposes of membership qualification -- i.e., 80% of the value of Exchange transactions must be for public customers and not more than 20% may be for affiliated persons. At the same time, the definition for purposes of the nonmember discount was to be amended so that institutional accounts managed by a nonmember, with or without written discretion, were to be considered as affiliated persons, and their trades would therefore be ineligible for the 40% discount. The language in the proposed amendment closely followed the language in S. 470, which has been passed by the Senate. The proposal was

widely publicized both to the Exchange membership and to nonmember brokers. It was this proposed amendment that the SEC rejected on August 29.

Exhibit A-1--Educational Circular No. 419

M. F. Educational Circular No. 419 EXHIBIT A-1

N E W Y O R K S T O C K E X C H A N G E, I N C.

M E M O R A N D U M

June 8, 1973

TO: Member Organizations and Individual Members
Not Associated with Member Organizations

FROM: Department of Regulatory Development

SUBJECT: Managed Institutional Accounts – Proposed Amendment of Rule 318

Introduction

The Board of Directors of the Exchange seeks the comments of the Exchange membership on a proposed amendment of the definition of "affiliated person" in Rule 318 to include managed institutional accounts in that definition. The proposed amendment would affect both Exchange members and nonmember brokers qualified to receive the access discount of up to 40% from the fixed minimum commission.

Background

On February 1, 1973 the Exchange amended its Constitution and Rule provisions for membership in response to the adoption of SEC Rule 19b-2. The so-called "parent test" was rescinded, and a new "principal purpose" requirement was added. Under the new requirement the use of Exchange membership solely for the purpose of recapturing commissions is prohibited. This is done by requiring that the principal purpose of each member and member organization of the Exchange must be the conduct of a public securities business. This requirement is deemed to be met if at least 80% of the value of securities transactions effected by or through a member or member organization on exchanges is for public customers and not more than 20% is for "affiliated persons". On April 19, 1973 the provisions of the Exchange's 40% access discount for nonmember brokers were also amended. Agreements filed by nonmember brokers under the new access provisions became effective on June 4, 1973.

Both the membership provisions and the access provisions refer to securities transactions effected for "affiliated persons". In the case of membership, it is part of the 80% test described above. In the case of access, the discount may be extended to nonmember brokers only on transactions for other than "affiliated persons".

On June 1, 1973 in Educational Circular No. 415 Exchange members and nonmember brokers qualified to receive the access discount were informed that the Board of Directors of the Exchange would consider amending the definition of "affiliated person" in Rule 318 with respect to accounts in which investment discretion is exercised. The Board has tentatively approved such an amendment. The purpose of this circular is to afford members and member organizations an opportunity to study the proposed amendment and comment on it before any formal action is taken by the Board.

The amendment itself would be in the form of the deletion of one phrase and the addition of new language to Rule 318, which contains the conditions for Exchange membership. The text of the amendment is attached. The amendment would also have the effect of amending Rule 385, which governs eligibility for the access discount, because Rule 318 is incorporated into Rule 385 by reference.

Proposed Amendment

The definition of "affiliated person" in Rule 318 includes the following:

> "any person directly or indirectly controlling, controlled by or under common control with the member or member organization*, whether by contractual arrangement or otherwise, provided that the right to exercise investment discretion with respect to an account, without more, shall not constitute control;"

This definition has been interpreted in Educational Circular No. 415, dated June 1, 1973.

The proposed amendment would delete the provision that investment discretion, without more, is not deemed to be control, and would add a new provision to the effect that controlled or managed accounts of institutions are "affiliated persons". The language of the proposed amendment is designed to include all controlled or managed institutional accounts, whether or not investment discretion is conferred by a written agreement.

The proposed amendment is limited to managed institutional accounts. No change is proposed in the definition of "affiliated person" with respect to managed individual accounts.

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* In applying the definition to a nonmember broker for the purpose of the access discount in Rule 385, the term "member or member organization" is deemed to refer to the nonmember broker.

Effect on Membership Rules

The effect of the proposed amendment on Exchange member organizations would be that pension and profit sharing funds, foundations, trusts and other institutional accounts managed or controlled by them would become "affiliated persons", and the total value of securities purchased and sold for their account would count toward the maximum 20% of the value of securities transactions on exchanges which may be effected for "affiliated persons". Under the existing rule, it is possible for these transactions to count toward the minimum 80% required to be done for public customers, assuming there are no other circumstances (such as those described in Educational Circular No. 415) which the Exchange would interpret to constitute a control relationship.

Example: For an example of how the amendment would affect a member organization, assume that during a given six month period a member organization does $50 million value of purchases and sales on exchanges, of which $5 million is for the member organization's own investment account and $10 million is for the accounts of institutions under investment discretion. Assume further that the investment discretion is not subject to any other circumstances which the Exchange would interpret to constitute a control relationship. The position of the member organization under existing Rule 318 would be:

	Dollars (millions)	%
Total value of purchases and sales for public customers (including managed institutional accounts)	$45	90%
Total value of purchases and sales for "affiliated persons"	$ 5	10%
Total	$50	100%

The member organization would be in compliance with the present Rule 318 because more than 80% of the total value of purchases and sales would be for the accounts of public customers. The position of the same member organization under the proposed amendment of Rule 318 would be:

Total value of purchases and sales for public customers	$35	70%
Total value of purchases and sales for "affiliated persons" (including managed institutional accounts)	$ 15	30%
Total	$50	100%

The member organization would not be in compliance with the proposed amendment of the Rule because only 70% of the total value of purchases and sales would be for public customers.

Effect on Access Discount

The effect of the proposed amendment on nonmember brokers qualified to receive the access discount under Rule 385 would be that trades for pension and profit sharing funds, foundations, trusts and other institutional accounts managed or controlled by them would not be eligible for the discount. Under the existing Rule, these trades are eligible for the discount, assuming there are no other circumstances which the Exchange would interpret to constitute a control relationship.

Example: For an example of how the proposed amendment would affect a nonmember broker qualified to receive the access discount of up to 40%, assume the same circumstances as for the member organization in the previous example. Under existing Rule 318, which is incorporated by reference into Rule 385, the position of the nonmember broker would be as follows:

	Dollars (millions)
Total value of purchases and sales eligible for access discount (including managed institutional accounts)	$45
Total value of purchases and sales not eligible for access discount	$ 5
Total	$50

The position of the same nonmember broker under the proposed amendment to Rule 318 would be as follows:

Total value of purchases and sales eligible for access discount		$35
Total value of purchases and sales not eligible for access discount (including managed institutional accounts)		$ 15
	Total	$ 50

Submission of Comments

Comments on the proposed amendment of Rule 318 should be submitted to Mr. Richard A. Greves, New York Stock Exchange, Inc., Department of Regulatory Development, 55 Water Street, New York, New York 10041. Comments should be received by July 9, 1973.

David D. Huntoon
Assistant Vice President

PROPOSED AMENDMENT OF RULE 318

New language underlined – Deleted language in brackets [ ]

The following terms shall have the following meanings for the purposes of subsection (k) of Article IX, Section 7 of the Constitution and this Rule:

The term "affiliated person" shall include:

(1) any person directly or indirectly controlling, controlled by or under common control with the member or member organization, whether by contractual arrangement or otherwise, [provided that the right to exercise investment discretion with respect to an account; without more, shall not constitute control];

(2) any principal officer, stockholder or partner of such member or member organization, or any person in whose account such person has a direct or material indirect beneficial interest;

(3) any investment company of which the member or member organization, or any person controlling, controlled by or under common control with the member or member organization, is an investment advisor within the meaning of the Investment Company Act of 1940; [and]

(4) any securities account of any institution which account is controlled or managed by the member or member organization or by any person controlling, controlled by or under common control with the member or member organization, whether through ownership of voting securities, by any agreement or understanding pursuant to which investment discretion is exercised, or otherwise; and

(5) the member or member organization to the extent he or it trades for his or its own account, excluding from such trades, however, such transactions effected by such member or member organization as are enumerated under (A) through (H) below;

(A) any transaction by a registered specialist in a security in which he is so registered;

(B) any transaction for the account of an odd-lot dealer in a security in which he is so registered;

(C) any transaction by a block positioner acting as such, except where an affiliated person is a party to the transaction. For the purpose hereof a block

positioner shall mean a member organization which engages, either regularly or on an intermittent basis, in a course of business of acquiring positions to facilitate the handling of customers' orders;

(D) any transaction effected in conformity with a plan designed to eliminate floor trading activities which are not beneficial to the market, which plan has been adopted by the Exchange and declared effective by the Securities and Exchange Commission;

(E) any stabilizing transaction effected in compliance with Rule 10b-7 under the Securities Exchange Act of 1934 to facilitate a distribution of such security in which the member organization effecting such transaction is participating;

(F) any bona fide arbitrage transaction, including hedging between an equity security and a security entitling the holder to acquire such equity security, or any risk arbitrage transaction in connection with a merger, acquisition, tender offer or similar transaction involving a recapitalization;

(G) any transaction made with the prior approval of a Floor Official to permit the member effecting such transaction to contribute to the maintenance of a fair and orderly market, or any purchase or sale to reverse any such transaction; or

(H) any transaction to offset a transaction made in error.

A person shall be presumed to control another person, for purposes of this Rule, if such person has a right to participate to the extent of more than 25% in the profits of such other person or owns beneficially, directly or indirectly, more than 25% of the outstanding voting securities of such person.

The principal officers of a member organization include the president, executive vice president, treasurer, secretary or any other person performing a similar function for an incorporated or unincorporated organization. A principal stockholder or partner of a member organization is any natural person actively engaged in the business of the member organization and beneficially owning, directly or indirectly, more than 5% of the outstanding voting securities of the member organization or having the right to participate to the extent of more than 5% in the profits of the member organization.

The term "investment company" shall have the meaning given that term by Section 3 of the Investment Company Act of 1940.

The term "subsidiary" when used with respect to a member organization shall include any approved corporate affiliate, corporate subsidiary or associated partnership provided for in Rule 321, 322 or 324.

The term “institution” shall mean any bank, savings and loan association, pension or other employee benefit fund, charitable foundation, educational or religious institution (including its investment or endowment fund), investment company (including its advisor) or insurance fund.

The term “pension and other employee benefit fund” shall mean any fund which is available for the payment either from principal or income, or both, to persons who are employees, or to members of the families, dependents, or beneficiaries of such persons, of one or more of the following benefits: Medical or hospital care, pension on retirement or death of employees, benefits under a profit-sharing-retirement plan, compensation for injuries or illness resulting from occupational activity or insurance to provide any of the foregoing, or unemployment benefits or life insurance, disability and sickness benefits, or accident benefits, or pooled vacation, holiday, severance or similar benefits, or defraying the cost of apprenticeship training programs.

The term “bank” shall mean any organization, whether incorporated or not, a substantial portion of the business of which consists of receiving deposits or exercising fiduciary powers similar to those permitted to national banks.

The term “insurance company” shall mean a company which is organized as an insurance company, whose primary and predominant business activity is the writing of insurance or the reinsuring of risks underwritten by insurance companies.

The term “savings and loan association” shall mean a savings and loan association, building and loan association, cooperative bank, homestead association, or similar institution.

M. F. Educational Circular No. 415 EXHIBIT B

N E W Y O R K S T O C K E X C H A N G E, I N C.

M E M O R A N D U M

June 1, 1973

TO: Managing Partner/Chief Executive Officer

SUBJECT: Definition of "Affiliated Person"

On February 1, 1973 the Exchange amended its Constitutional and Rule provisions for membership in response to the adoption of SEC Rule 19b-2. On April 19, 1973 the provisions for the Exchange's access discount of up to 40% for nonmember brokers were also amended. Agreements filed by nonmember brokers under the new access provisions will become effective on June 4, 1973.

Both the membership provisions and the access provisions refer to securities transactions effected for "affiliated persons". In the case of membership, at least 80% of the value of securities transactions effected by or through a member or member organization on exchanges must be for public customers and not more than 20% may be for "affiliated persons". In the case of access, the discount may be extended to nonmember brokers only on their agency transactions for their customers who are not "affiliated persons" of the nonmember brokers; the discount is not available on trades for their own accounts.

Several questions have arisen with respect to the definition of "affiliated person" in connection with securities accounts of institutions over which investment discretion is exercised. The purpose of this circular is to notify member organizations and nonmember brokers eligible for the access discount that the Board of Directors of the Exchange is considering the amendment of that definition and to assist in the interpretation of the existing definition.

The portion of the definition of "affiliated person" which is the subject of this memorandum is as follows:

"The term 'affiliated person' shall include:

(1) any person directly or indirectly controlling, controlled by or under common control with the member or member organization,*

* In applying the definition to a nonmember broker for the purpose of the access discount in Rule 385, the term "member or member organization" is deemed to refer to the nonmember broker.

whether by contractual arrangement or otherwise, provided that the right to exercise investment discretion with respect to an account, without more, shall not constitute control;"

Possible Amendment of Definition

The Board of Directors of the Exchange will consider at its June meeting amendments to Rule 318. These amendments may include a redefinition of "affiliated person" which could result in certain accounts which are not now "affiliated persons" becoming "affiliated persons" through redefinition. Any proposed amendment to Rule 318 will be circulated to the Exchange membership for comment before being formally submitted to the SEC as required under the '34 Act.

If Rule 318 is amended to redefine "affiliated person", the effect on Exchange members may be that the total value of securities purchases and sales on exchanges for certain accounts will be considered to be effected for "affiliated persons" and count toward the 20% allowable maximum instead of being included within the value of transactions required to be done for public customers.

The effect on nonmember brokers of such an amendment might be to make trades for certain accounts ineligible for the access discount. This means that on trades for such accounts a nonmember broker would not be able to receive a discount, but would have to pay the full nonmember commission.

Interpretation of Rule 318

Under the existing definition of "affiliated person", the Exchange has determined that for an account not to be considered to be in a control relationship with the person holding the investment discretion, the conferring of such discretion must be based on competitive merit and may not be the result of or incidental to other circumstances or relationships. Among other circumstances and relationships which are considered to constitute such a control relationship for the purposes of Rule 318 are:

(1) Investment discretion is given pursuant to a contract or agreement which can be cancelled only on notice of more than 30 days.

(2) Investment discretion is given pursuant to a contract or agreement which provides for a penalty upon termination.

(3) Investment discretion cannot be cancelled without the incurrence of substantial expense or hardship.

(4) Investment discretion is part of a more extensive relationship which includes providing other services to a

substantial degree, including, but not limited to, commercial banking, insurance and investment banking.

(5) The account is a so-called "separate account" managed by an insurance company which exercises investment discretion and under applicable law the securities in the account are the property of the insurance company.

The following examples may serve to illustrate this interpretation:

(1) The portfolio of a pension or profit sharing trust is managed by an investment manager which has discretion over the account. The discretion may be cancelled at any time on receipt by the investment manager from the trust of written notice without the payment of any penalty of any sort. Neither the investment manager nor the trust have any other relationship which might constitute control. The trust is not considered to be controlled by the investment manager, and is not an "affiliated person" of the investment manager.

(2) The circumstances are the same as in (1) above, except that the investment discretion is given by a contract which may be cancelled only on notice which must be given at least 90 days prior to the effective date of cancellation. The trust is considered to be controlled by the investment manager and is an "affiliated person" of the investment manager.

(3) A pension or profit sharing trust is managed by an insurance company as a "separate account" and the insurance company has investment discretion over the account. The agreement between the trust and the insurance company provides that investment discretion may be cancelled upon 30 days written notice, but that in the event of such cancellation a substantial cash penalty must be paid. The trust is considered to be controlled by the insurance company and is an "affiliated person" of the insurance company, even though under applicable law the securities in the "separate account" are not considered to be the property of the insurance company.

(4) A charitable trust is managed by an investment manager which exercises investment discretion over the trust account. The discretion may be cancelled at any time by the trustees (who have no other relationship with the investment manager) upon written notice, without penalty.

However, the investment manager also provides office space, clerical support, telephones and other services which are necessary to the trust. In order to cancel the investment discretion, the trustees would have to find other quarters and arrange for clerical, telephone and other essential services. The trust is considered to be controlled by the investment manager, and is an "affiliated person" of the manager.

(5) A pension or profit sharing trust established by the X corporation is managed by an investment manager which holds investment discretion over the trust account. The discretion may be cancelled forthwith at any time by the trustees without penalty. The parent of the investment advisor is a bank holding company which has as another of its subsidiaries the principal commercial bank servicing the X corporation. The trustees of the trust are officers and/or employees of the X corporation. Under these circumstances, the trust will be considered to be in a control relationship with the investment manager and an "affiliated person" of the manager.

(6) A pension or profit sharing trust established by the X corporation is managed by an investment manager which holds investment discretion over the trust account. The discretion may be cancelled forthwith at any time by the trustees without penalty. The investment manager is also an investment banker and has traditionally been a managing underwriter of securities issued by X corporation. The trustees of the trust are officers and/or employees of X corporation. Under these circumstances, the trust will be considered to be controlled by the investment manager and an "affiliated person" of the manager.

(7) A pension or profit sharing trust established by the X corporation is managed by an insurance company as a "separate account" and the insurance company holds investment discretion over the trust account. The discretion may be cancelled forthwith at any time by the trustees without penalty. The account of the trust is operated as a "separate account" by the insurance company. The insurance company provides substantial insurance coverage to X corporation. The trustees of the trust are officers and/or employees of X corporation. Under these circumstances, the trust will be considered to be controlled by the insurance company and an "affiliated person" of the

insurance company, even though under applicable state law the securities in the "separate account" are not considered to be the property of the insurance company.

(8) A pension or profit sharing trust is managed by an insurance company which holds investment discretion over the trust account. The discretion may be cancelled forthwith at any time by the trustees without penalty. The trust account is operated as a "separate account" by the insurance company. Under applicable law the securities held in the "separate account" are considered the property of the insurance company which operates the "separate account". Under these circumstances, the "separate account" is considered to be an "affiliated person" of the insurance company.

Questions concerning this circular should be directed to Rudolph J. Schreiber at (212) 623-5226 or William S. Belcher at (212) 623-4815.

David D. Huntoon

EXHIBIT C

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

SEP 13 1973

The New York Stock Exchange
Eleven Wall Street
New York, New York 10005

Attention: David D. Huntoon

Re: Proposed Interpretation of the Term "Affiliated Person"

Gentlemen:

This is in further response to your letter of May 31, 1973 enclosing for our concurrence a "significant interpretation" of the term "affiliated person", as that term is used in Securities Exchange Act Rule 19b-2 and NYSE Rule 318. While our letter of June 1, 1973 indicated that we had no objection to your issuance of the proposed interpretation as of that date, pending our consideration of its appropriateness, it also indicated that, because of the importance of this interpretation, we would solicit public comments thereon. We further stated that it might be necessary to revise the proposed interpretation as a result of our conclusions after further consideration of the interpretation and any comments received. We have received comments from thirteen persons and organizations representing various sectors of the investment community expressing diverse views regarding the appropriateness of the interpretation. Our conclusions, based on our consideration of the comments received and our view of the purposes of Rule 19b-2, as expressed in Securities Exchange Act Release No. 9950 (January 16, 1973), are set forth below.

The proposed interpretation delineates certain circumstances under which the term "affiliated person" would include an institutional account over which a money manager exercises investment discretion. Rule 19b-2, clause (b) provides, in part, than an "affiliated person" of a member shall include:

> "(1) any person directly or indirectly controlling, controlled by or under common control with such member, whether by contractual arrangement or otherwise, provided that the right to exercise investment discretion with

> respect to an account, without more, shall not constitute control;. . ."

Thus, under clause (b)(1), in order to find that a person is an "affiliated person" for purposes of Rule 19b-2 a finding of "control" must be made. NYSE Rule 318 contains identical language.

The NYSE's proposed interpretation would find the existence of "control" in all cases where, in addition to having investment discretion, a money manager, by contract or by furnishing additional services, has decreased the likelihood that his customer will dispense with his services in favor of those of another money manager on the basis of competitive merit alone. While in certain respects the NYSE's interpretation is consistent with the "competitive merit" considerations which we enunciated in Release No. 9950, at pages 152 and 153, the rigid approach implicit in the interpretation would deprive the term "control" of the flexibility which we intended it to have by giving rise to an irrebuttable presumption of control without regard to whether, in a particular case, control is actually present.

The terms "affiliated person" and "control" were assigned by the Commission "their traditional legal meanings", as indicated in Release No. 9950 at footnote 434 on page 152, and the NYSE should utilize those traditional meanings in applying Rule 19b-2 and its Rule 318. While it may be difficult for securities exchanges to probe the relationships between customers and their money managers and other factual circumstances having a bearing on the question of control, denial of membership on an exchange is a serious matter and must be based on a careful review of all relevant facts and the particular circumstances of each case. At page 8 of Release No. 9950 we stated that Rule 19b-2 "requires" exchanges "to make exchange membership available to any person or entity, assuming minimum standards of financial responsibility and competency are met" and assuming the availability of a seat, "provided only that each member demonstrate his commitment to compete for the public's exchange securities business" [emphasis supplied]. This does not mean that each member must prove that persons for whom the member effected at least 80 percent of the value of its exchange securities transactions during the preceding six months were not affiliates of the member. Rather, disclosure of the identity of a member's affiliates (if any) and a showing that the required volume of transactions was for persons other than those affiliates satisfactorily demonstrates the requisite commitment of the public's business. A determination that a broker-dealer is not engaged in a "public securities business" as defined in Rule 19b-2 and Rule 318 must be bottomed on findings more substantial and more carefully tailored to particular situations that those envisaged by the NYSE's proposed interpretation. All exchanges should carefully formulate questions to be put to their memberships and to applicants for membership designed to uncover the identities of affiliates and the amount of business done for the accounts of those affiliates. The exchanges' power under their rules to compel disclosures which will reveal control relationships cannot be questioned. The burden of proof that a broker-dealer's claimed "public" business is in fact a "private" business because of a control relationship with its customer, however, must rest with the securities exchange which denies membership.

An additional disagreement we have with the NYSE's interpretation stems from its premise that a money manager's "control" over an "account" can be determined without also determining that a money manager is in a control relationship with the persons who own the account or are charged with its care. It is difficult to conceive of a money management relationship which by itself so separates an account from the persons whose account it is or those charged with its care that control over the account could be said to have passed to the money manager. We believe that such a situation generally could exist only where other factors clearly establish a money manager's control relationship with those persons sufficient to enable the money manager to direct their allocation of money management for the account. Those ultimately responsible for an account are legally entitled, and, indeed, are obliged, to make such disposition of the funds constituting the account as they deem appropriate. No money management agreement, whatever its terms may be, can deprive such ultimately responsible persons of that right or relieve them of that duty. At page 153 of Release No. 9950 we noted that whether an adviser "with mere discretionary authority over an account" was a broker, an insurance company or a bank, he was "subject to discharge by whoever is ultimately in control of the account." We also noted that if the element of competition for the account's business was present and the money manager had no authority in the selection or retention of a money manager, that account "should not be considered a captive or 'controlled' advisory account." In the words of Release No. 9950, at page 152, it is the receipt of business "because of an identity of interest between the broker and his 'customer'" that requires the business to be characterized as private, rather than public. In this context, the person owning or ultimately responsible for the account, not the account itself, is the customer.

A transaction executed by a broker-dealer subsidiary of an insurance company, for example, for an account of its parent -- consisting of the parent's assets invested for its sole benefit -- is clearly executed for an affiliated person and does not qualify as public securities business. A transaction executed for a corporation's pension fund account managed by that insurance company parent, however, should qualify as public business absent other circumstances evidencing a control relationship between the insurance company and the trustees of the pension fund or the corporation (in the event the pension fund's trustees are deemed affiliates of the corporation). As we stated in Release No. 9950 at pages 155 and 156:

> "Where the insurance company, or its subsidiary, is simply managing and investing pension fund assets without any other indicia of control, as is typically the case with a separate account, we would consider transactions executed on an exchange for the

> account by the insurer's affiliated member to be public business. . . ."

The NYSE's interpretation would make ready and inexpensive mobility of an account the definitive test of whether a control relationship exists between the money manager and the person owning or charged with custody of that account. Mobility of a managed account is, of course, an evidentiary factor to be considered in determining whether a control relationship exists between a money manager and his customer, but the customer must be allowed sufficient latitude to exchange easy mobility of the account for economical packages of money management, brokerage and other services. Contractual impediments to mobility (e.g., notice periods prior to cancellation, liquidated damages, termination or increase in price of other services) do not by themselves, except in extreme cases, demonstrate either conclusively or presumptively that a control relationship between the parties exists.

Similarly, the coupling of investment discretion over a customer's account with commercial banking, insurance or investment banking services does not prove the existence of a control relationship, although it may be evidence of it, particularly where it can be demonstrated that a mix of services provided to the customer at a particular price was not obtainable from any other source. For example, the fact that a bank may provide various banking services to a corporation in addition to managing its employees' profit-sharing plan is not a sufficient basis for concluding that a control relationship exists between them. Moreover, the fact that an insurance company may write group life insurance for a corporation in addition to managing its employees' pension fund would be unlikely to affect the corporation's desire to seek the best available performance, consistent with the most economical cost of management, for its pension fund.

Certainly state law to the effect that "separate accounts" of an insurance company are to be deemed property of that insurance company has little, if anything, to do with whether the persons beneficially interested in or ultimately responsible for such accounts are in a control relationship with the insurance company. While many states have adopted statutes under which separate accounts legally are deemed to be the property of insurance companies (for purposes quite different from those governing qualification for exchange membership), such laws do not change the practical nature of these separate accounts whereby all gains and losses, as well as income, inure to the benefit of the account holder. Furthermore, these state statutes typically provide that the assets of separate accounts may not be used to satisfy the obligations of the insurance company. Even more significantly, the technical ownership of the funds by the insurer does not, as a practical matter, restrict their mobility. Thus, such laws cannot be said to constitute a realistic index of control sufficient to overcome our view that for purposes of Rule 19b-2 separate accounts of insurance companies are essentially public business. To assert the existence of affiliation under such circumstances would appear to contravene the conclusion articulated in Release No. 9950 that separate accounts of insurance companies would be considered to be "public" business, absent a showing of other indicia of control. As

stated by the Supreme Court in Rochester Telephone Corp. v. United States, 307 U.S. 125, 145 (1939): "…control cannot be determined by artificial tests but is an issue of fact to be determined by the special circumstances of each case."

In light of the foregoing, it appears that none of the hypothetical cases submitted by the NYSE set forth facts sufficient to support a predetermined finding of control by a money manager over the persons owning or charged with custody of a pension fund or trust. Thus, it does not appear that the NYSE's proposed interpretation is in accord with the intent of Rule 19b-2 and the interpretation therefore should be promptly withdrawn. While the Commission encourages the NYSE to publish new hypothetical situations which illustrate cases in which the NYSE believes that facts will require it to find that a control relationship exists, such hypotheticals should be drawn with the principles set forth above in mind. Such hypotheticals, of course, as significant interpretations, should be submitted to the Commission for its review prior to their circulation.

The Commission, in promulgating Rule 19b-2, of course, stressed the experimental nature of its policymaking endeavors, thus leaving open the possibility that changes in the rule might be appropriate after necessary experience with the rule has been obtained. The interpretations you have furnished would effect significant changes in the concept of the term "affiliated person" bringing the scope of that term closer to the formulation utilized by two Congressional subcommittees in drafting new legislation. As you know, we have advised the Congress that its approach -- which would preclude any exchange member from executing transactions for any institutional account the member manages -- reflects a valid legislative resolution of the issues involved. As a matter of administrative policymaking, however, we did not believe we should adopt that approach without first obtaining some practical experience with a somewhat more gradual formulation.

The Commission has no further comment at this time.

Sincerely yours,

Ray Garrett, Jr.
Chairman

EXHIBIT D

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

AUG 29, 1973

Mr. James J. Needham, Chairman
The New York Stock Exchange, Inc.
Eleven Wall Street
New York, New York 10005

Dear Mr. Needham:

This is in response to your letter of July 13, 1973, which submitted, pursuant to Securities Exchange Act Rule 17a-8, proposed amendments to Exchange Rule 385 concerning the availability of the Exchange's non-member assess discount. The proposed revisions would add a new subsection (c) to the Rule, amending the present definition of the term "affiliated person," and would impose a primary purpose test requiring that a qualified non-member be primarily engaged in the transaction of business as a broker or dealer in securities.

On March 1, 1973 the Exchange submitted amendments to Exchange Rule 385 in response to Securities Exchange Act Release No. 9950 (January 16, 1973), which required elimination of the "parent test" restriction of non-member access and limited the discount to agency transactions for persons other than "affiliated persons." Rule 385, as then amended, adopted the same test of affiliation as was used in Securities Exchange Act Rule 19b-2 and Exchange Rule 318 dealing with membership. Thus, the discount was made available to brokerage affiliates of institutional money managers on trades executed for discretionary accounts of the customers of such money managers, since the exercise of investment discretion alone over an account was not deemed to constitute control over the customer owning or charged with custody of that account.

The current proposed amendment would broaden the definition of the term "affiliated person" of a non-member to include institutional accounts for which a non-member makes investment decisions and thus would create a more stringent test of affiliation for non-members than for members. It is the Commission's current view that non-member access should be limited only to the extent necessary to prevent receipt of a commission discount by any person other than a broker acting as such for an account other than his own or one with which he has a substantial identity of interest. Non-member brokers seeking to utilize exchange facilities should not be subjected to more rigorous criteria for access purposes than those established for brokers enjoying membership, unless some regulatory justification exists requiring different treatment.

The proposed amendment, by defining the term “affiliated person” to include managed institutional accounts of non-members, implies that a money management relationship between a non-member broker and an institutional customer creates such an identity of

interest that transactions for the account of that customer should be deemed ineligible for the discount. Such an identity of interest was not found to exist where an exchange member has investment discretion over and acts as money manager for an institutional customer's account and no basis has been presented for distinguishing between members and non-members in this regard.

Your submission suggests that non-member access should not be used to execute transactions for managed institutional accounts. The Commission does not believe that the availability of the access discount should be so limited. It is true, however, as Release No. 9950 points out (at page 183, note 519), that access "was never intended to enable any individual customer to obtain a commission rate advantage". To the extent a non-member money manager credits any of the access discount it receives on transactions for a customer against advisory fees owed by that customer, such customer does receive a commission rate advantage. While such an arrangement appears inconsistent with the original objectives of non-member access, the Commission believes it would be unfair to restrict the use of such an arrangement by non-members while permitting its use by exchange members.

You also point out that the language of the two bills pending in Congress which deal with the uses of exchange membership, S.470 and H.R. 5050, do not treat managed institutional accounts as "public business". This apparently leads you to conclude that non-members who execute transactions for such accounts should not receive the discount. In Release No. 9950 the Commission set forth at length the reasoning underlying its administrative determination to treat managed institutional accounts as "public business" and that investment discretion, without more, would not be deemed to create a control relationship between the money manager and his customer. The Commission is not aware of any reason why this conclusion should not also be applicable to non-member access.

For the foregoing reasons, it does not appear that the Exchange has provided a regulatory justification for the proposed dissimilar treatment of transactions executed on the Exchange for institutional accounts managed by members and non-members. We therefore request that the proposed amendment adding subsection (c) be withdrawn.

As we indicated in our letter of June 20, 1973, we have no objection to the imposition of a primary purpose test as a qualification for the non-member discount.

The Commission has no further comment at this time.

Sincerely yours,

Ray Garrett, Jr.
Chairman