Goldman, Sachs & Co.
New York, NY

March 29, 1968

Mr. Orval L. DuBois, Secretary
Securities and Exchange Commission
500 North Capitol Street
Washington, D.C. 20549

Dear Mr. DuBois:

Goldman, Sachs & Co, hereby responds to S. E. C. Release No. 8239, dated January 26, 1968, inviting comments from interested parties on proposed Rule 10b-10, and on the five point proposal issued by the New York Stock Exchange. Since many areas of our industry are touched by the issues raised, we propose to offer our comments from the viewpoint of their potential effects upon the marketing of securities, which is one of our particular fields of specialization.

At the outset, let us make clear our position on 10b-10; the underlying spirit of the Rule assumes that the give-up system is inherently wrong, because it lends itself to fraudulent practices and to the abdication of fiduciary responsibilities. We believe that the system serves an essential purpose in today's market place, and that the adoption of the New York Stock Exchange proposals will immeasurably strengthen our industry, and make it a more effective instrument for public participation in our economic growth.

Goldman, Sachs & Co. is one of the leading institutional brokerage firms on Wall Street. Our specialty, for purposes of this discussion, is the marketing of large blocks of securities through normal market channels, principally the major stock exchanges. The dynamic growth of this business is reflected in the 6,685 blocks of 10,000 shares or more traded on the New York Stock Exchange in 1967, representing 6.7% of total share volume; the comparable 1966 figures were 3,642 blocks and 4.5% of total volume. Among the many reasons for the dramatic growth in large block activity, in our judgment, is the increasing specialization and professionalism of firms providing institutional service. This is the means by which our industry has sought to meet the needs of institutional managers for:

1. better and timelier research ideas;

2. improvements in the methods for making substantial portfolio changes quickly and efficiently.

A fund manager requires these services in order that he may discharge the <u>most</u> important of his fiduciary responsibilities; to maximize the return on the funds placed at his disposal (with due consideration for the risks involved) for the benefit of his shareholders. Further, he needs a considerable amount of flexibility to take advantage of market conditions and to compensate those who are helpful to him in achieving his goals. These twin pillars of institutional performance, <u>effective research and execution</u>, each have great weight in their impact on portfolio values.

In recent years there has emerged, on the one hand, a group of firms whose primary emphasis has been upon the production and dissemination of quality institutional research and, on the other hand, a group of firms with broad institutional contacts, well-staffed trading departments and an emphasis upon securities marketing. Obviously, several firms perform both functions in a creditable manner, but the trend toward specialization is well established. Furthermore, some firms have become known for quality research covering a broad range of securities, while individual researchers at other firms have developed a following because of their expertise in specific areas, e.g., airlines, steels, oils, etc. Consequently, the fund manager receives ideas and recommendations from a wide range of sources. When he becomes interested in a specific recommendation, he will often check with several firms to broaden his perspective or to seek out contrary opinions. To the degree that these contacts assist the fund manager in reaching his decision, he must have the means at his command to compensate for them, in order to retain access to those external sources of research which can be so beneficial to his shareholders.

When, as is often the case, a recommendation is made by a firm which does not possess the required facilities for handling block transactions, the manager usually turns to one of a handful of firms such as Goldman, Sachs & Co., for specialized assistance in executing the order. Utilizing a well established marketing network of institutional contacts to uncover potential buying or selling interest, the broker attempts to bring about a transaction at the best possible price, without disrupting the market. This is extremely important when one considers that, since block transactions frequently involve tens of thousands of shares, fractional price differentials can mean important savings to the fund's shareholders. In addition, the major block trading firms have developed the technique of "block positioning" whereby the firm will, for its own account, buy or sell stock when institutional interest is insufficient to complete the trade. This service brings a new dimension of liquidity and stability to the market, enabling the fund manager to carry out his portfolio transactions in a more timely and efficient manner. Block positioning often entails considerable risk, particularly during market declines such as we currently are witnessing. For this reason, if for no other, this transfer of market risk from the fund shareholders to the block

trading firm is a graphic illustration of how the public interest is served by innovations in securities marketing undertaken competitively.

Section 10 of the Securities Act of 1934 deals primarily with questions of fraud. Rule 10b-10, as proposed, assumes that all give-ups per se, except those which reduce fees owed by the investment company, are fraudulent and must be abolished. But the foregoing discussion of the give-up system and its role in compensating for essential services that accrue to the benefit of shareholders does, in our opinion, effectively refute this assumption and thereby casts doubt upon the validity of such a narrow approach to the issue.

Furthermore, the implementation of Rule 10b-10 would place a considerable burden upon fund managers in their quest for optimum performance of invested funds. One alternative to compensating for research by give-up, owing to one's inability to predetermine who will have the best research ideas in the future, is for the research firm to bill the fund for its services. The fund might then direct the executing broker to give up to the research firm, which would reduce its bill by the amount of the give-up. This alternative can hardly be considered an improvement over the present system. It is unwieldy, inefficient and would result in substantial bookkeeping and administrative costs to the shareholders.

If, on the other hand, fund managers were forced to reward research firms which were not capable of handling large orders by allocating directly to them portions of portfolio transactions for execution, the effect upon the central market place could be disastrous. Such a practice would probably result in more blocks coming directly to the Floor, where the thinness of the auction market would make it very difficult for the block to be absorbed by the specialist and the "book" without substantially affecting the price. Conversely, such blocks might be fed piecemeal into the market, causing buyers to stand aside until the end of the liquidation was in sight. The "overhanging" block, frequently mentioned by news media as a reason for weakness in a particular stock, is often disruptive, invariably costly and would very likely proliferate under 10b-10. By dividing a large order among a number of brokers, the fund manager would pay the same total commission as if the block had been executed in a single stroke, and would risk a decline in the market value of the holdings as his intentions became known. Further, such price fluctuations can be detrimental to the interests of the corporation whose shares are involved, and to its public shareholders.

In summary, therefore, we believe that Rule 10b-10 would not, of itself, accomplish the Commission's objectives and would give rise to new and equally serious problems. The five point proposal advanced by the New York Stock Exchange is more in the nature of a basic reform which seeks to curb certain abuses and alleviate certain difficulties which now characterize the present system, while recognizing its overall effectiveness. Indeed, the volume discount

proposal, when set forth more specifically, should do much to ensure that fund shareholders will participate more directly in the economies of size made possible by the employment of their pooled capital. This is a significant contribution to the dialogue on fiduciary responsibility, which is at the root of 10b-10.

Taken as a whole, the New York Stock Exchange program seeks to modernize the securities business by recognizing the special position of institutional investors today, and by meeting their needs within the framework of a strong, dynamic central securities market well equipped to discharge its responsibilities to all segments of the industry and, more importantly, to the general public.

Very truly yours,

GOLDMAN, SACHS & CO.