CAPITAL
GROUP®

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VIA ELECTRONIC SUBMISSION

March 12, 2018

The Honorable Jay Clayton
Chairman
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Standards of conduct for investment advisers and broker-dealers

Dear Chairman Clayton:

We appreciate the opportunity to comment on the standards of conduct for investment advisers and broker-dealers. The Capital Group Companies is one of the oldest and largest asset managers in the United States. Through our investment management subsidiaries, we actively manage assets in various collective investment vehicles and institutional client separate accounts globally. The vast majority of these assets consist of the American Funds family of mutual funds, which are U.S. regulated investment companies distributed through financial intermediaries and held by individuals and institutions across different types of accounts.

We strongly support efforts by the U.S. Securities and Exchange Commission to adopt a uniform standard of conduct for investment advisers and broker-dealers. As discussed further below, we believe both advisers and broker-dealers should be subject to the same legal standard, requiring them to act in the best interest of their clients. We also believe that the standard of conduct adopted by the Commission should preserve choice for investors in how to best structure the relationship with their financial professional. Some clients may prefer transaction based advice, through a brokerage relationship while others may prefer an ongoing advisory relationship.

1. The uniform fiduciary standard should preserve choice for investors

In developing a uniform fiduciary standard, the Commission should develop principles based rules that provide investors with the flexibility to structure the relationship with their financial adviser in a manner that best facilitates their investment objectives and service needs. These principles should allow firms to tailor policies and procedures to address their own business models.

In particular, the Commission should structure the rule to preserve brokerage options, under which the adviser is compensated in a commission structure at the time of the transaction. For long-term investors, commissions are a cost efficient way of paying for ongoing investment advice. Buy-and-hold investors in commission based programs generally pay less for investment advice and may receive different services than investors in fee-based arrangements. We believe that a standard that favors fee-based advisory programs would disenfranchise smaller investors who need additional services and are ineligible for these programs, leaving them without access to personalized, human investment advice. It would also cost longer-term buy and hold investors more over time.

The compensation structure for mutual funds that are sold with a commission – typically denominated as A shares – is fairly consistent across the mutual fund industry. Registered representatives are typically compensated for mutual fund-related investment services through receipt of a commission and an ongoing service fee paid pursuant to the mutual fund's plan of distribution under Rule 12b-1 (a "12b-1 fee"). Ordinarily, the applicable commission is reduced based on the size of the investment – the average commission paid on an American Funds A-share investment in 2017 was 2.22%. A service fee under Rule 12b-1cannot exceed 0.25% of the balance of the investment. This combination of upfront payment at the time of an investment plus a modest ongoing fee aligns with the cost of providing investment advice. That is, the bulk of the work is done at the time of the initial investment, with ongoing monitoring based on life changes and subsequent developments.

We recognize that these payment streams create potential conflicts of interest. But one of the more striking aspects of our conversations with financial advisers is how many have shared that they will earn more if they move from a commission-based model to a fee-based model. In our experience, financial advisers who recommend mutual fund investments in commissionable share classes are foregoing revenue they could earn if they establish a fee-based relationship. They are recommending a commissionable share class because they believe in a buy-and-hold strategy and feel that the commission-based model and the benefits offered by investing with a professionally managed mutual fund family are more cost efficient given the servicing needs of buy-and-hold investors.

Many of the features of the Class A share that raise conflicts of interest considerations are also beneficial to investors. Traditional mutual funds typically pay smaller commissions and ongoing service or 12b-1 fees for fixed income funds relative to equity funds. The difference in pricing between fixed income and equity is a marketplace development that strikes a balance between reasonable compensation to the broker-dealer and successful investor outcomes.

Similarly, mutual fund families often eliminate commissions on exchanges between funds within the fund family ("rights of exchange") and provide reduced commissions based on prior investments with the fund family ("rights of accumulation"). Our experience is that rights of exchange and accumulation are widely utilized by financial advisers for the benefit of investors. A uniform standard should provide advisers with the option to select a financial arrangement that is in the best interests of their clients, which in many cases may be commissionable A shares. We recognize that these rights may encourage advisers to keep clients invested in a single fund family. This information should be evaluated by the adviser and disclosed to the client if determined to be in their best interest.

In addition, commissions can provide an incentive for investors to stay the course during periods of market volatility. Taking a longer-term view helps protect investors from selling at inopportune times and ultimately puts them in a better position to meet their investment objectives. Our analysis demonstrates that abrupt moves can be costly. Research indicates that it is not only impossible to predict short-term market moves, but that retreating from stocks at the wrong time can significantly damage long-term returns. For example, the S&P 500 had an average annual return of 7.7% from 1997 to 2016. But an investor who missed just the best 40 days during that span would have suffered a 2.4% annual loss. In fact, the average holding period for a commissionable investment in the American Funds is much longer than the average holding period for a fee-based investment in the American Funds.[1]

Additionally, we have worked with the SEC to develop a new model for commissionable advice – one that is largely free of conflicts of interest.[2] The clean shares model allows broker-dealers to apply their own commission schedule to mutual fund share classes that do not include distribution fees. We believe that clean shares are an appropriate option for firms to utilize for a commission based option. However, clean shares are a new and innovative concept and tens of millions of investors currently hold Class A shares and benefit from their rights of exchange and accumulation. It is therefore critical that any uniform standard of care accommodate A shares.

We believe the existing transition rules under the Department of Labor's (DOL) fiduciary rule accomplish this goal. Advisers are subject to the DOL's "Impartial Conduct Standards" which require them to act in the best interests of clients. We believe that the Impartial Conduct Standards have provided an appropriate framework for advisers to develop policies and procedures designed to provide appropriate recommendations to their clients.

2. The uniform fiduciary standard should be based on the principles outlined in the Department of Labor's Impartial Conduct Standards

We believe the Commission should consider implementing a standard based on the four elements of the DOL's Impartial Conduct Standards, as described below.

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[1] The average holding period over the last three years for commissionable shares (A shares) was 9.3 years while the average holding period for advisory shares (F shares) was 5.3 years.

[2] Capital Group Companies, Inc. (pub. avail. Jan. 6, 2017).

a. Duty of loyalty

The uniform standard should require broker dealers to act in the best interest of the client when making an investment recommendation. This standard can be reconciled with commission based compensation. The DOL's Impartial Conduct Standards and Transition Guidance make clear that commission based compensation may be appropriate so long as the firm has developed policies and procedures to identify material conflicts of interest and take steps to mitigate and disclose those conflicts. As noted by the DOL "...even if a fiduciary adviser recommends proprietary products or investments that generate commissions or other payments that vary with the investment recommended, the adviser can meet the impartial conduct standards by ensuring that the recommendations are prudent; the investment advice is based upon the customer's financial interests, rather than the adviser's competing financial interests in the transaction; the communications are free from material misrepresentations; and the associated fees and charges are reasonable. Of course, to the extent the adviser limits recommendations to proprietary products or receives compensation that varies with the product recommended, the adviser should be candid about the compensation and the limits on investments."[3]

Policies to monitor conflicts would include an assessment of the client's investment horizon and service needs in developing a fee structure that is in the client's best interest. For example, as noted above, commissionable A shares may be more beneficial to a long-term investor with a lower effective commission rates due to rights of accumulation. Firms would also need to develop procedures to supervise the activities of financial advisers to monitor whether a recommendation is in the best interest of the client. Broker-dealer firms already have extensive experience in supervising compensation arrangements with clients and have developed procedures to select the most appropriate program. This approach is consistent with both the Investment Adviser's Act of 1940 and Section 913 of the Dodd-Frank Act.

[3] Department of Labor's Conflict of Interest FAQs (Transition Period), May 2017.

b. Duty of care

Recommendations made by a broker-dealer should reflect diligence, reasonable care, skill and prudence. This would be consistent with the duty of care applicable to investment advisers under the DOL's Impartial Conduct Standards. We further note that the information required under FINRA's suitability rule[4] provides a foundation for the types of information that should be required in assessing a client's investment strategy.

c. Reasonable compensation

As discussed above, it is important that a uniform standard of care provide flexibility for investors to choose an economic relationship with a financial adviser that meets their needs. The rule should not favor fee based compensation over transaction based compensation; rather, it should allow for both forms of compensation, so long as the compensation is reasonable in light of the services provided to the investor.

We do not believe a fiduciary standard mandates level compensation payments to financial advisers. The uniform standard should address differential compensation by requiring firms to adopt policies and procedures to reduce conflicts associated with differential compensation. These policies should require ongoing monitoring of adviser practices in light of the products they recommend to clients. In addition, to the extent an adviser recommends proprietary products or receives compensation that varies with the product recommended, the conflicts should be disclosed to the investor.

d. Prohibition on false and misleading statements and disclosure of conflicts

Consistent with the federal securities laws, the uniform standard should prohibit a financial adviser from making false and misleading statements in connection with an investment recommendation. As part of this obligation an adviser would be required to accurately describe the transaction, compensation received as a result of the transaction and any

[4] FINRA Rule 2111(a)

associated conflict, including any benefit to the adviser making the recommendation or the adviser's firm.

3. The Commission should clarify that low fees are one component in developing an appropriate investment recommendation

We believe low fees are a critical component to help investors achieve their long-term goals. However, other factors such as long-term investment results and downside protection should also be considered when evaluating an investment. As part of its rulemaking in this area the Commission should emphasize that the costs associated with an investment are only one factor that should be considered in developing an appropriate recommendation. Overemphasizing costs could lead investors to favor passive products when actively managed portfolios would be a better fit for the investor's goals. For example, some investors may desire a strategy that pursues lower volatility by active security selection or investors may wish to avoid the heavy allocation to technology if invested in passive broad market indexes if in or approaching retirement. Clarifying this concept will help facilitate choice and avoid the perception that passive investment products should in all cases be favored over low-cost actively managed mutual funds.

4. The Commission should proceed with rulemaking in this area

The Commission should proceed with rulemaking now so that states do not feel the need to develop their own regulations. Having a federal fiduciary standard endorsed by the SEC will significantly reduce complexity and improve compliance. In addition, a federal standard will better serve investors and be easier to for them to understand than a multitude of inconsistent regulations.

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We appreciate your consideration of this important issue. If you have any questions, please feel free to contact either of us.

Sincerely,

Timothy D. Armour

Chairman and Chief Executive Officer
The Capital Group Companies, Inc.

Paul F. Roye

Senior Vice President
Capital Research and Management Company

cc: The Hon. Robert J. Jackson Jr.
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