Ms. Vanessa Countryman  
Acting Secretary  
U.S. Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-1090

Re: Fund of Funds Arrangements (File No. S7-27-18)

Dear Ms. Countryman:

We appreciate the opportunity to provide comment to the Securities and Exchange Commission (the “Commission”) on the Commission’s above-referenced proposal regarding fund of fund arrangements (the “Proposal”). The Capital Group Companies is one of the oldest 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 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. As part of the American Funds, we manage approximately $175 billion in proprietary fund of funds assets in reliance on Section 12(d)(1)(G) of the Investment Company Act of 1940 (the “Act”). Further, approximately $25 billion of the funds we manage are underlying investments to fund of funds managed by insurance company affiliates that act as underlying investment options for variable annuity and variable life contracts.

While we support the Commission’s efforts to streamline and enhance the regulatory framework applicable to fund of funds arrangements, certain modifications to the Proposal are necessary in order to achieve the Commission’s goal of not disrupting the value that advisors provide to investors.

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through fund of funds structures. In particular, we believe that limiting redemptions of an underlying fund to 3% of that fund’s assets will have a chilling effect on the use of these structures. This result would cause harm to both the acquired fund which would be deprived of the significant scale provided by fund of fund arrangements as well as to the fund of fund which will effectively lose access to attractive investment opportunities. Further, forcing funds of funds that today rely on Section 12(d)(1)(G) into the framework proposed by the Proposal simply because they invest in other securities in reliance on Rule 12d1-2 is not consistent with the objectives of the Proposal. The Proposal states that the Commission is putting forth the Proposal “in order to create a more consistent and efficient regulatory framework for fund of funds arrangements” and that “a comprehensive, streamlined framework would reduce confusion and subject fund of funds arrangements to a tailored set of conditions that would enhance investor protection, while also providing funds with investment flexibility to meet their investment objectives in an efficient manner.” Given existing limitations and constraints, the fund of funds segment of the industry has not experienced abuses. We believe that the Proposal would remove investment flexibility and severely limit investment options that have served end investors well.

1. Comments regarding the 3% redemption limit

The Proposal attempts to address concerns that an acquiring fund could threaten large-scale redemptions as a means of exercising undue influence over an acquired fund by prohibiting an acquiring fund that acquires more than 3% of an acquired fund’s outstanding shares from redeeming or submitting for redemption more than 3% of an acquired fund’s total outstanding shares in any 30-day period. Interestingly, the Proposal would not apply this 3% redemption limit to acquiring funds that invest in funds that are listed on an exchange. The proposed 3% redemption limit is far too restrictive and will have a chilling effect on acquiring funds use of mutual funds in their allocations. We believe that this restriction will effectively codify the limits set forth in Sections 12(d)(1)(A) and (B) as the maximum investment in unrelated acquired funds. This is in stark contrast to the fund of funds landscape created by exemptive relief granted by the Commission that has worked to provide investors with a variety of investment options. The proposed redemption limit and exclusions would also create an unfair advantage for ETFs and closed-end funds and sub-advised structures where the fund of funds sponsor utilizes its proprietary funds with third-party management through sub-
advisory relationships (rather than using the sub-advisor’s funds) in reliance on 12(d)(1)(G). The proposed redemption limit will also likely have unintended consequences under newly adopted liquidity risk management programs.

a. Investment considerations

While the Proposal suggests that it is broad enough to provide investment flexibility, we believe that the 3% redemption limitation will have the exact opposite effect. First, fund of funds managers will be less likely to include more than 3% of an acquired fund in their allocations and may opt to invest in other underlying options (e.g. ETFs, closed-end funds). Second, this will likely have an effect on the performance of a fund of funds. If a fund of funds manager needs to consider keeping acquired funds under 3% of that fund, then it may not be creating the manager’s ideal allocation that will best serve investors. Third, the redemption limit will create a bias toward using larger funds that can provide a more meaningful allocation to the fund of funds model at the expense of smaller funds. This is at odds with a recent focus by Commission staff on fostering competition and advancing regulatory policies that do not disadvantage small and mid-size funds and their managers.2

b. Unintended impacts on shareholders

Shareholders of an acquiring fund may be subject to undue risk because of the redemption limit. Where an acquiring fund is invested in an acquired fund in excess of 3% of the acquired fund’s assets, the acquiring fund will be prohibited from redeeming its holdings in that fund while other holders of such acquired fund (regardless of the size of such other holders position in the acquired fund) will be able to redeem their positions without limitation. This creates a situation where the acquiring fund’s position in the acquired fund grows as a result of other holders redemptions, thereby causing the acquired fund to have to redeem over a longer time frame. The general concept behind mutual fund investing is that the funds provide a diversified portfolio that is redeemable daily. The idea that one holder will be subject to limits on the amount it can redeem in a time of uncertainty or stress for the acquired fund (i.e. a star portfolio manager departure or increasingly worsening investment results),

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while other holders are free to redeem seems to fly in the face of this general concept. In the Proposals own economic analysis, it estimates that it could take up to 10 months for an acquiring fund that fully unwinds its investment in an acquired fund, if that fund holds 25% of the outstanding shares of the acquired fund. The average mutual fund investor would clearly not expect her investment adviser to be limited in this way when making an investment decision for the acquiring fund in which she invests.

c. Advantage for ETFs, closed-end funds and sub-advisory structures

The 3% redemption limit would not apply to ETFs and closed-end funds since they can be sold in the secondary market. The redemption limit would similarly not apply to a sub-advisory structure where the fund of funds manager employs sub-advisors to provide management in proprietary funds that are acquired funds and relies on Section 12(d)(1)(G) to form its funds of funds. We believe that this advantage will cause fund of funds managers to choose these types of investments as acquired vehicles to a far greater extent in order to avoid the 3% redemption limit. In either of these situations it is the type of vehicle that determines the investment allocations rather than the investment decision that is in the best interest of the end investor of the fund of funds. We do not believe that the form of the investment vehicle should impact these decisions because of a regulatory impediment implemented on one type of vehicle.

d. Liquidity Risk Management Program impacts

Prohibiting an acquiring fund from redeeming more than 3% of an acquired fund’s shares within any 30 day period could cause increase liquidity risk for the acquiring fund and its shareholders. Under the provisions of the Commission’s Rule 22e-4, holdings of an acquired fund’s shares in excess of 3% may be required to be classified as Illiquid Investments, as they cannot be sold or disposed of within seven calendar days. If the 3% redemption limit is adopted as proposed, the industry would need clarification on the impacts to liquidity classifications of these otherwise Highly Liquid Investments.

3 See the Proposal at footnote 28.
We propose that acquiring funds may consider the holding size that they would reasonably anticipate trading in determining liquidity classifications of their holdings in acquired funds. In many cases, an acquiring fund may find that its reasonably anticipated trading size is less than 3%, in which case we feel it would be reasonable to classify the entire holding in the acquired fund as a Highly Liquid Investment. However, the industry would also need clarification as to how an acquired fund’s shares should be classified in a time of stress for the acquired fund where the acquiring fund’s investment adviser has determined to remove the acquired fund from its allocation. It is not clear in this type of situation that an adviser could rely on a reasonably anticipated trading size analysis.

e. Proposed alternative solutions

We believe that the 3% redemption limit will cause meaningful harm to investors in fund of funds structures. The Commission states that it is proposing this limit to address concerns about undue influence of an acquiring fund over an acquired fund, but offers no suggestion that there has been any abuse in the current fund of funds ecosystem created through a variety of exemptive relief and no-action guidance. We suggest that the Commission eliminate the 3% redemption limit from the Proposal and take an approach that is consistent with current exemptive relief.

As the manager of approximately $25 billion of fund assets that act as acquired funds for various insurance company acquiring funds, we are party to fund participation agreements with those firms. We have enjoyed good relationships with these firms and have not encountered any instance where a firm has attempted to influence our management with the threat of redemption or intentionally breached our fund participation agreement. We believe that the Commission should consider mandating a fund participation agreement as the instrument to control any concern of undue influence. The acquiring fund’s manager and the acquired funds’ manager would be required to enter into a fund participation agreement prior to investing in an acquired fund’s assets in excess of the limits set forth in Section 12(d)(1)(A). The Commission could outline the required conditions to be addressed in the fund participation agreement, including a representation that the acquiring fund will conduct its investment program in good faith and undertake not to exert undue influence over an acquired fund. Further practical conditions could also be required, including advance notice of any anticipated large redemption of an acquired fund so that the acquired fund can prepare for an
orderly liquidation of securities to meet the redemption (e.g. 10 days’ notice for any redemption in excess of 3% to the extent reasonably practicable).

Requiring the execution of a fund participation agreement would give the acquired fund the ability to assess the potential benefits and risks of allowing an acquiring fund to invest in excess of 3% of its assets. The acquired fund’s advisor could then make an informed decision as to whether to proceed with the relationship with the acquiring fund prior to the acquiring fund having the ability to invest in excess of 3% of the acquired fund’s assets.

2. Proposed rescission of Rule 12d1-2

We do not believe that the rescission of Rule 12d1-2 is consistent with the objectives of the Proposal. For all of the reasons articulated in the Proposal regarding the fiduciary duties of a common manager of an acquiring fund and an acquired fund to both funds and therefore not requiring the safeguards of the Proposal, there is no fathomable reason to treat an acquiring fund that invests in acquired funds in the same group of funds and other securities differently than an acquiring fund that invests only in the same acquired funds. The same fiduciary obligations exist with respect to the acquiring and acquired funds obviating the need for further safeguards provided by the rule. The introduction of other securities in the fund of funds structure does not change this. For example, the Proposal would impose the 3% redemption limit on an acquiring fund that invests in the same underlying funds as another acquiring fund that relies on Section 12(d)(1)(G) (that is not subject to the 3% redemption limit) simply because it invests in a single other security.

Given that the introduction of other securities in a proprietary fund of funds structure does not introduce further risks for which the Proposal is seeking to address, we propose that the Commission retain Rule 12d1-2, but amend it in the following two ways: (1) eliminate section (a)(1) of the rule and (2) add a provision that allows acquiring funds relying on Section 12(d)(1)(G) to invest in financial instruments that may not be “securities”. Eliminating section (a)(1) of Rule 12d1-2 would limit fund of funds relying on 12(d)(1)(G) to those that invest solely in acquired funds that are part of the same group of funds. This would create a more ‘pure’ form of 12(d)(1)(G) and move other acquiring funds into reliance on the provisions of the Proposal. Allowing acquiring funds to invest in financial
instruments that may not be securities is consistent with the way many funds of funds operate today, the exemptions those funds rely on and the Northern Lights no-action letter.\footnote{See Northern Lights Fund Trust, SEC Staff No-Action Letter (June 29, 2015).} Further, allowing for investment in these types of instruments does not create any of the conflicts the Commission is seeking to address in the Proposal.

3. Comments regarding three-tier structures

The Proposal asks for comment on whether it should permit acquired funds relying on Section 12(d)(1)(G) to invest in a third-tier “central fund” in order to centralize the portfolio management of floating rate or other instruments. First and foremost, we applaud the Commission for recognizing the ongoing importance of allowing acquired funds to invest in money funds in reliance on Rule 12d1-1. We believe that the Commission has the opportunity to expand this concept to other types of central funds in order to allow fund families the opportunity to more efficiently invest in different asset classes. For example, an investment manager could manage a portfolio of TBAs, high yield securities or emerging markets securities in a single fund that in turn could be easily accessed by multiple funds or client accounts managed by the same investment manager or an affiliate. This would allow the investment manager to take advantage of investment, trading and operational efficiencies provided by this structure, such as the ability to trade and settle in fewer and larger blocks which may also result in better execution. At the same time, it allows the other funds and client accounts managed by the investment manager or its affiliates to access a more broadly diversified set of securities in the specific asset class.

In order to avoid the issues of complexity and layering of fees, we suggest that the Commission allow acquired funds to acquire central funds in excess of the limits set forth in Sections 12(d)(1)(A) and (B) so long as (1) the central fund is only available to funds within its same group of funds and other collective investment vehicles and accounts managed by the same advisor or affiliated advisors and (2) the central fund does not impose any type of commissions or fees (recognizing that the central fund may incur a small amount of other expenses to account for legitimate fund expenses, including, but not limited to custodial, audit, legal and board fees).
4. **Exclusion for the purposes of control**

The Proposal prohibits an acquiring fund and its advisory group from controlling, individually or in the aggregate, an acquired fund, except in certain circumstances. The Proposal notes that the Act creates a rebuttable presumption that any person who directly or indirectly beneficially owns more than 25% of the voting securities of a company controls the company and that one who does not own that amount does not control it. Of course, this is a presumption and may be rebutted based on the facts and circumstances in each situation.

The Proposal defines “advisory group” to mean an acquiring fund’s investment adviser or depositor, and any person controlling, controlled by, or under common control with such investment adviser or depositor. While technically within this definition, we would suggest that the Commission clarify that a feeder fund that invests in an acquired fund in reliance on Section 12(d)(1)(E) should not be included within the advisory group’s ownership calculation. While the investment adviser may control the allocation decisions within its fund of funds structures, it may not, on its own, divest the shares of an acquired fund from a feeder fund. In order to divest from shares of an acquired fund and invest in another fund, the independent board of the feeder fund would have to make a determination that such change was in the best interest of shareholders. This step in the process and the insertion of an independent board of directors takes the ability of the adviser to exert control over the acquired fund with respect to the shares held by the feeder fund away from the investment adviser. Further, feeder funds relying on Section 12(d)(1)(E) are already required to vote using either pass through voting or mirror voting pursuant to 12(d)(1)(E)(iii)(aa). The combination of these factors should put the Commission at ease that the ownership of an acquired fund by a feeder fund does not create the concerns the Commission has articulated with respect to fund of funds arrangements.

5. **Retaining current exemptive relief**

The Proposal suggests rescinding many of the exemptive orders the Staff has granted giving relief from Sections 12(d)(1)(A), (B), (C) and (G) of the Act. The Proposal further states that recipients of prior orders may make their views known in the context of the comment process and that those views will be given due consideration.
We received a fairly standard fund of funds exemptive order with one unique provision (the “Managed Risk Fund Provision”) that would be eliminated as a result of the implementation of the Proposal. We worked with the Staff for well over a year to craft conditions to ensure that our relief was consistent with prior relief and addressed issues that may have arisen with respect to complexity and layering of fees. We believe that our current relief remains consistent with the Proposal and should therefore not be rescinded.

The provision in question would allow an American Fund Insurance Series fund that invested in one other underlying fund in excess of the limits in Section 12(d)(1)(A) and derivatives to operate a managed risk strategy (a “Managed Risk Fund”) in reliance on 12(d)(1)(G) to be eligible as an acquired fund to an unrelated fund of funds, subject to the conditions set forth in the order. The exemptive relief was premised on the fact that the Managed Risk Fund operated much like a feeder fund that relied on the exemption set forth in Section 12(d)(1)(E). Among the conditions for this relief were that (1) the investment adviser to the Managed Risk Fund and the acquired fund would be the same, (2) the Managed Risk Fund may only invest in one acquired fund and (3) the Managed Risk Fund will comply with Section 12(d)(1)(E) other than its investment in derivatives to run the managed risk strategy. These conditions are consistent with the Proposals exception for three tier structures when the second tier is a feeder fund relying on Section 12(d)(1)(E).

We respectfully request that the Managed Risk Fund Provision of our order not be rescinded in connection with the implementation of any final rule resulting from the Proposal.

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We greatly appreciate the Commission’s efforts to streamline and enhance the regulatory framework for fund of funds arrangements; however, we believe that some of the provisions of the Proposal require modification for the robust fund of funds market to persist. We thank the Commission for its consideration of our above comments, which we believe align with the goals of proposed rule and are intended to make fund of funds arrangements as valuable as possible for investors. If you have any questions, please feel free to contact me at [redacted].

Sincerely,

Michael J. Triessl
Senior Vice President and Senior Counsel
Capital Research and Management Company

cc: The Hon. Jay Clayton
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