

The Capital Group Companies, Inc.

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February 13, 2012

VIA ELECTRONIC SUBMISSION

Ms. Elizabeth M. Murphy Secretary U.S. Securities and Exchange Commission 100 F. Street, N.W. Washington, D.C. 20549

Mr. Robert E. Feldman Executive Secretary Federal Deposit Insurance Corporation 550 17th Street, N.W. Washington, D.C. 20429

Mr. David A. Stawick Secretary Commodity Futures Trading Commission Three Lafayette Centre 1155 21st Street, N.W. Washington, D.C. 20581 Ms. Jennifer J. Johnson Secretary Board of Governors of the Federal Reserve 20th Street and Constitution Avenue, N.W. Washington, D.C. 20551

Mr. John G. Walsh Acting Comptroller of the Currency Office of the Comptroller of the Currency 250 E Street, S.W. Washington, D.C. 20219

RE: Prohibitions and Restrictions on Proprietary Trading and Certain Interests In, and Relationships With, Hedge Funds and Private Equity Funds

Ladies and Gentlemen:

The Capital Group Companies, Inc. appreciates the opportunity to comment on the proposed rule issued by the regulatory agencies referenced above (the "Agencies") to implement Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), commonly known as the "Volcker Rule" (the "Proposed Rule").

The Capital Group Companies, Inc. is the parent company to a number of investment management subsidiaries, including Capital Research and Management Company, investment adviser to the American Funds family of mutual funds and Capital Guardian Trust Company, investment adviser to a number of institutional funds and client accounts (collectively, the "Capital Group"). Capital Group manages over \$1 trillion in assets for individual mutual funds, large and small defined contribution and defined benefit plans, foundations, endowments and other institutional clients that together represent over 50 million customer accounts.

As investment managers, Capital Group transacts on a daily basis with banks, broker-dealers and other market makers and relies on these counterparties in order to invest mutual fund shareholder and client funds and to execute our investment strategies for the funds and accounts we manage.

We understand and respect the reasoning behind the Proposed Rule and appreciate the great effort the Agencies have gone through to propose a rule that meets the objectives of Section 619 of the Dodd-Frank Act, while at the same time allows banking entities the ability to operate and manage their businesses and continue to provide "client-oriented financial services." In this spirit, Capital Group respectfully offers the following general observations and suggestions regarding the Proposed Rule.

1. The importance of market making and liquidity

a. Importance to the economy

Efficient, competitive and active financial markets are important because they allow companies and borrowers of all sizes to access new credit, refinance existing credit and raise the capital needed to sustain their operations. The ability of companies large and small to access credit is vital for a growing economy, including the creation of new jobs. If investors believe that there will not be support or market makers for a particular security they will charge a higher rate of interest in order to be compensated for the lack of liquidity and borrowers' access to capital will be restricted, especially during periods of market dislocation. The issuers most affected are likely to be smaller and/or private companies and borrowers.

b. An efficient, liquid market is vital to buyers and sellers

As asset managers, institutional investors must continually invest contributions received from investors and cash received from interest payments and maturing securities. Asset managers must also be able to efficiently adjust portfolios in response to expected changes in market conditions. Both of these functions would be difficult, if not impossible, if counterparties such as banking entities could not hold or create an inventory of securities to accommodate client purchases and sales.

Market makers provide a necessary source of liquidity to institutional investment managers who must be able to sell securities to meet investor withdrawals. The Capital Group manages nearly a trillion dollars in mutual fund assets that are subject to daily redemptions. During certain periods between 2008 and 2010, market volatility caused anxious mutual fund investors to redeem or exchange their assets to cash. This in turn required fund managers to build liquidity by raising cash in their portfolios to ensure they could meet those redemptions and exchanges. For certain fixed-income sectors, banking entities acting as principal were important in providing the market liquidity for fund managers to raise this cash in a way that did not distress prices further.

c. Market making dampens price volatility and aids in valuation

Liquidity and volatility go hand-in-hand. A lack of liquidity can cause price volatility and volatility, as described above, can cause investors to pull out of the market creating a vicious cycle. Entities willing to participate in markets to help meet liquidity demands can help reduce the excess volatility and pro-cyclicality of market price movements during periods of uncertainty.

Liquidity provided by market makers also plays an important valuation role. The value of equity and fixed-income instruments is determined by the balance of a buyer's bid and a seller's offering price for a security. Without both sides of the bid and offer investors are challenged to determine a representative value for the asset to mark on their books. This is particularly important for mutual funds who must value their shares accurately on a daily basis in order to

fairly price both shareholder purchases and redemptions. Accordingly, entities making markets in what might otherwise be illiquid securities not only helps to dampen volatility, but also aids in price discovery and valuation requirements.

2. Proprietary trading presumption and market maker exemptions

a. Market making involves taking principal risk

The Proposed Rule generally presumes that all trades executed by banking entities on a principal basis for a trading account are prohibited, proprietary trades. We believe this is too broad a presumption because much of market making necessarily involves taking on principal risk. For example, in the fixed-income markets, we estimate that between 60%-70% of investment grade and high-yield corporate bond trades, and up to 90% of emerging market trades we execute involve our counterparty taking on some amount of risk by taking securities onto their books for future sale or shorting securities to accommodate the client. In other words, it is a minority of trades in which our counterparty transacts with us knowing they already have an offsetting trade on the other side. Nonetheless, under the Proposed Rule these transactions would be presumed to be proprietary trades rather than the client-oriented activity we would consider them to be.

Principal risk-taking is more pronounced in the fixed-income than the equity markets. This is due to fewer overall participants comprised largely of institutional investors, but many more individual instruments (CUSIPs and tranches) for each particular issuer. For example, many companies have one or two classes of shares, such as common and preferred stock. However, those same companies' debt structures may include tradable bank loans, senior secured bonds, subordinated and unsecured bonds, mezzanine bonds and hybrid securities to name but a few. In addition, within each of these debt structures there may be multiple securities with different maturities and possibly different structures. Given the limited number of market participants and very large number of issues, it is rare that a market maker is able to perfectly offset a trade with the same security. Consequently, because each debt structure and tranche has its own risk characteristics, by standing in the middle of these trades counterparties without the perfect hedge are taking on risk.

b. Proprietary trading presumption will generate "false positives"

We appreciate the difficulty in trying to determine parameters for identifying a proprietary trade versus a market making transaction. However, we are concerned that the Proposed Rule as currently written does not necessarily prevent proprietary trading and will discourage market making. For example, as part of the assumption that all trades executed on a principal basis for a trading account are prohibited, proprietary trades, the Proposed Rule presumes that a trading account includes those accounts for which a position was bought and held for 60 days or less. However, applying a single holding period to all trades does not take into account the nature of trading in different types of securities. Larger cap stocks and benchmark investment grade corporate bonds for instance, may naturally re-trade in shorter periods of time, but smaller cap stocks, bonds with smaller issue sizes and high-yield corporate bonds may tend to re-trade over longer periods. One could argue that there is a similar or greater likelihood that someone would attempt to profit from the latter trades than the former, but the 60-day presumption works the other way. We believe crafting the presumption based on a single, standard and arbitrary time period will produce an inordinate number of "false positive" proprietary trades and lead to unnecessary administrative work to rebut the presumption.

As described below, we believe there may be better ways to achieve the objectives of the Proposed Rule without creating a presumption using a set time period. However, if the Agencies feel compelled to utilize a stated time period we suggest that the presumption mechanism be reversed to become a safe harbor, so that any position that is re-traded within a certain period of time is presumed not to be a proprietary trade. Further, if the Agencies desire to have one time period for all markets, we would suggest 90 days is a more reasonable time period based on our observation of dealer inventory management. We believe this will cut down on unnecessary compliance and monitoring burden for both banking entities and the Agencies.

c. Simpler balance sheet alternatives

In order to rebut the 60-day presumption just discussed and otherwise use the market making exemptions provided under the Proposed Rule, banking entities must work through a complex set of six principles and seven separate criteria for permitted market making activities. The criteria include extensive commentary and quantitative metrics from the Agencies. And yet, despite all of the factors one must consider, there is very little guidance as to how to apply the framework. Further, we believe it is impractical for a trader, trading desk or banking entity as a whole to apply and/or document all of these considerations in an efficient, real-time, day-to-day basis. We are concerned that when banking entities balance the risks versus rewards in having to go through this process they will choose not to make markets in many securities.

As an alternative to the provisions described above, we suggest using a balance sheet type metric that limits the amount of capital a trading desk can have at risk at any given time or requires a certain amount of capital to cover trades executed by a trading desk. Such a metric would be simpler to administer and would allow a firm or trading desk to more clearly determine its trading capacity. For example, some options to consider could include looking at a trading desk's balance sheet committed to trading (or VaR) and the level of clearly identifiable customer trades (*i.e.*, those trades that are not between banking entities or broker-dealers). Higher volume of customer trades should justify a higher use of a banking entity's balance sheet.

Another option would be to charge a trader or trading desk for positions held on their balance sheet beyond set time periods and to increase the charge at set intervals. The charge could be reserved and given back to the trading desk when the position was sold. Unlike the 60-day presumption discussed above, the use of time periods in this instance would allow traders to provide clients market making liquidity and at the same time provide a disincentive to a trader holding onto a position in the hope of making a profit. Again, we believe a balance sheet framework would be less complicated to implement and maintain. In addition, it would provide accountability and visibility and would encourage banking entities to continue to make markets.

We would also suggest that there be an exception for situations where a banking entity is the lead or co-manager of a new issue. This exception should extend the safe harbor for a longer period, possibly up to one year. As part of bringing a new issue to market, investors expect that the lead and co-managers will make a market and quote the security (*i.e.*, provide secondary market liquidity). Failure to do this will likely prevent investors from participating in new issues and result in much higher costs of capital, particularly for smaller issuers.

d. Market makers take on risk that they should be allowed to hedge

As managers or underwriters expected to make markets for new issues, banking entities must hold some amount of security inventory and may be forced to retain more inventory than they anticipated due to lack of initial demand. Banks should be allowed to hedge this commitment, as well as their overall counterparty exposure that comes from market making activity. This hedging may not be perfectly correlated. For instance, banking entities trying to hedge in the most efficient manner may aggregate different counterparty exposures or net similar offsetting risks in determining their hedging positions. We believe that banking entities should be allowed to hedge their risk in the most efficient manner and that the risk mitigating hedging exemption should be sufficiently flexible to permit this activity. In particular, imperfect hedges should still be regarded as legitimate, and firm-wide hedging strategies should be permitted provided they can be shown to support customer focused activity. If not, the consequence will be that market making will require more risk taking and hence more capital than necessary, banking entities will have less capacity to make markets, liquidity will be impaired and there will be less opportunity for borrowers, especially smaller ones to raise needed capital.

e. Market makers should be reasonably compensated

Proprietary trades should not be determined based on the fact that a banking entity makes a profit from a trade. While a banking entity could earn revenue through commissions or bid/ask spreads we do not believe these are good measures. For one, bid/ask spreads seen in the fixed-income markets are not always quantifiable or well-defined. For example, they can fluctuate widely within a trading day not necessarily due to the inherent risk of the security, but rather because of

small or odd lot trades, price discovery activity, a lack of availability to cover short trades or external factors not directly related to the security being traded. Note that explicitly quoted bid/ask spreads are valid only for indicated trade sizes that are modest enough to have negligible market impact; they cannot be used to gauge the market maker's expected profit on, or the expected market impact of, a significantly larger trade.

We also believe banking entities should not be denied profits made as a result of price appreciation if the appreciated security they are holding is the result of having provided a service to a client by taking on risk. Market makers frequently purchase a security from a customer anticipating that another customer will want to buy it. However, they may end up holding onto a position for longer than expected due to unforeseen market pressures or disappearance of customer demand. Of course, such a position can just as easily fall in value during that time. Banking entities should be adequately compensated for the risks and services described above and such compensation should not be limited to, or have constraints around, commissions or bid/ask spreads which, as noted above, are not an appropriate measure of expected profit in fixed-income markets.

3. All municipal securities should be considered government obligations

The Agencies specifically asked whether the definition of municipal securities should be expanded and whether Section 3(a)(29) of the Securities and Exchange Act of 1934 would be helpful in determining the scope of the exemption. We strongly support the exemption of all municipal securities, as defined by Section 3(a)(29), from the trading restrictions in the Proposed Rule. Following an already established definition for municipal securities will prevent confusion in the market. Furthermore, we believe using the same definition and thereby including all municipal securities promotes and protects the country's financial stability by maintaining needed liquidity in the market. At the same time, we do not believe municipal securities in the exemption by itself should not adversely affect the safety and soundness of banking entities.

As others have commented, the municipal securities market is unique and operates much differently than other fixed-income markets. The municipal market when compared to the equity and corporate bond market has thousands of more individual CUSIPs, the average issue size is much smaller (over the last four years the average size has been approximately \$30 million), about half of municipal market participants are retail investors and municipal securities tend to trade in smaller lots.

As a result of these unique features most individual municipal issues do not trade frequently or widely, making this market already challenging from a liquidity and price discovery standpoint. Consequently, investors rely heavily on banking and other entities to be market makers. For example, we estimate that at least 50% of our municipal bond trades involve our counterparty taking on principal risk. Restricting dealer risk-taking in a large portion of the municipal market may cause current participants to abandon the market, worsening liquidity and increasing price volatility. Further, we believe (and experience has shown) that the nature of the market itself has not and will not make it a natural candidate for excessive risk taking. Therefore, we believe expanding the definition of government obligations and municipal securities to match Section 3(a)(29) to include all municipal securities will not jeopardize the safety and soundness of banking entities.

4. Asset-backed commercial paper should be exempt

As currently written, the securitization vehicle exemption in the Proposed Rule does not include asset-backed commercial paper programs ("ABCP"). We believe ABCP should be exempted because it does not pose the risks the Proposed Rule was meant to combat. On the contrary, ABCP provides an essential source of short-term funding for businesses, and liquidity and shortterm investment options used by many investors today. We urge the Agencies to either clarify the securitization vehicle exemption so that it clearly includes ABCP or create a separate exemption in the Proposed Rule specifically for ABCP.

5. U.S. residents must continue to be able to invest in foreign securities

As global investment managers, we are significant investors in non-U.S. securities, a large percentage of which are traded by non-U.S. counterparties. The Proposed Rule contains an exception to the prohibition on proprietary trading for non-U.S. banks that solely trade outside the U.S. ("foreign trading exception"). In order to qualify for this exception, though, a non-U.S. bank cannot transact with a U.S. resident.

The definition of U.S. resident in the Proposed Rule is broader than the existing definition of U.S. person in Regulation S of the Securities Act of 1933 ("Reg S"). For example, under the Proposed Rule, it appears that a discretionary fund or account advised by a U.S. investment manager would be considered a U.S. resident. Conversely, under Reg S there are circumstances where such an account would be considered a non-U.S. person. We believe creating a separate definition for U.S. resident would create confusion and disruption in the market, and inefficient market practices as counterparties built separate processes to determine whether they can rely on the foreign trading exception. These inefficiencies could cause some non-U.S. counterparties not to trade with global investment managers such as ourselves. This would have a deleterious impact and put U.S. investors at a severe disadvantage. Accordingly, we urge the Agencies to consider defining and interpreting a U.S. resident in the same manner as Reg S.

6. Implementation of the Proposed Rule

Given the significance of the Proposed Rule and the extent of the proposed changes, we urge the Agencies to consider including in the final rule an appropriate implementation or phase-in period. The phase-in period should be long enough to allow banking entities and others directly impacted by the rule to update their systems, internal processes and business models and to communicate to the global marketplace their intended approach to the rule. We also strongly suggest that the Agencies incorporate into the final rule an ongoing monitoring mechanism that would allow the Agencies to assess how the rule is working and make adjustments or issue clarification or guidance, as appropriate. Monitoring could include cross-firm comparisons, and the Agencies should consider publishing progress reports with aggregated information.

Finally, we urge the Agencies to adopt a clearly defined timetable, with consistent compliance dates and Agency oversight methods. We believe extended and consistent implementation schedules, as well as consistent monitoring and oversight mechanisms will give firms the confidence to proceed with implementation rather than simply scaling back market making activities. In other words, it will help avoid unnecessary market disruptions and volatility.

7. Conclusion

The Capital Group supports the underlying purpose of the Proposed Rule. However, we believe more consideration needs to be given to the essential services banking entities currently provide as market makers. We are concerned that certain aspects of the Proposed Rule will create undue market volatility, reduce liquidity – especially during periods of market dislocation when it is needed the most – and cause serious long-term disadvantages for institutional investors and markets, for companies and borrowers that require capital and hence for the economy as a whole.

Thank you for considering our comments. If you have any questions please feel free to contact the undersigned or Kristine Nishiyama at (213) 486-9200.

Sincerely,

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Paul G. Haaga, Jr. Chairman Capital Research and Management Company