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July 20, 2015

Filed Electronically

Office of Regulations and Interpretations
Employee Benefits Security Administration
Room N-5655
U.S. Department of Labor
200 Constitution Avenue N.W.
Washington, DC 20210

Office of Exemption Determinations
Employee Benefits Security Administration
Attn: D-11712
U.S. Department of Labor
200 Constitution Avenue N.W.
Washington, DC 20210

Re: **RIN 1210-AB32; Conflicts of Interest Rule**
ZRIN 1210-ZA25; Proposed Class Exemption

Dear Sir or Madam:

The Capital Group Companies is pleased to provide comments on the Department of Labor's proposed conflicts of interest rule and best interest contract exemption. Our detailed comments are attached; listed below is a summary.

1. Best interest contract exemption. At Capital, we support a fiduciary or best interest standard of conduct for all financial advisors. We are, however, concerned that the proposed rules could make it harder for investors to pay for investment advice through commissions and other traditional forms of broker-dealer compensation. Unless changes are made to strike a better balance between mitigating perceived conflicts of interest and preserving commissionable compensation, we believe that many small balance investors who currently pay for advice largely through commissions will lose access to personalized, human investment advice.

2. Grandfathering. There is no grandfather rule in the proposal for existing investments, including mutual fund investments where the shareholder previously paid a commission. An advisor cannot even make a hold recommendation during a market downturn, without complying with all of the proposal's requirements. Without an appropriately drawn grandfather rule, millions of existing advisory relationships will be disturbed unnecessarily.

3. Phase-in. As proposed, advisors would need to comply with the new rules within eight months of the date the final rules are published. The rules, however, would upend the market for personalized investment advice and impact millions of Americans. It is simply not practicable to shift the advisory paradigm so quickly and we urge the Department to phase-in the new requirements.

There are a handful of other issues, which we discuss in some detail below. We appreciate the opportunity to comment and would be happy to meet with the Department if it would be helpful.

Respectfully submitted,

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The Capital Group Companies is one of the oldest and largest asset managers in the nation. We, through our investment advisory subsidiaries, manage assets in various collective investment vehicles and separate accounts. The vast majority of these assets consist of the American Funds family of mutual funds, which are widely held in retirement plans and IRAs. We are one of the five largest investment managers in participant-directed retirement plans and we manage nearly $500 billion in IRA assets for more than 10 million investors.[1]

Capital is the leading low cost active investment manager. Through the decades, and in many challenging environments, Capital's active management has produced superior outcomes for investors.[2]

At Capital, we believe in the value of professional investment advice. There is a stark contrast between market returns and the returns realized by investors. Because of untimely buying and selling, the average investor captures only a fraction of market gains. However, investors who work with an investment advisor representative or a registered representative of a broker-dealer (collectively, a "financial advisor") are more diversified and do better by staying invested in market downturns and avoiding the traps of market timing.[3]

The Department's proposed conflicts of interest rule could, however, make it harder for investors to receive professional investment advice. The proposal would for the first time clearly treat broker-dealers and their registered representatives who provide investment recommendations to IRA owners as "fiduciaries." Most significantly, the broader definition would trigger application of the prohibited transaction rules of the Internal Revenue Code. These rules flatly bar the types of compensation that registered representatives and their home offices typically receive for services -- commissions, ongoing service payments from mutual funds and revenue sharing. The Department's proposal includes an exemption that would allow broker-dealers to continue to provide advice and receive these forms of compensation but only with substantial new conditions.

At Capital, we support codification of a fiduciary or best interest standard of care for registered representatives of broker-dealers. We believe that a best interest standard is

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[1] Pensions & Investments, DC Money Managers (2013); IRA assets and accounts are as of December 31, 2014.

[2] Rekenthaler, "Improving the Odds in Active Management," Morningstar (October 16, 2014); Rekenthaler, "American Funds Keeps Rolling," Morningstar (January 30, 2014); Yang, "In an Industry of Sprinters, American Funds Demonstrates Endurance," Morningstar (July 25, 2013); see also "Capital Idea: The Active Advantage Can Help Investors Pursue Better Outcomes", American Funds Distributors, Inc.,, (April 2014), available at www.americanfunds.com/advisor/pdf/shareholder/mfcpwp-028_capidea913.pdf**,** for a thorough analysis of the investment results for the equity-focused American Funds against their benchmark indices and other metrics.

[3] "Dalbar's 21st Annual Quantitative Analysis of Investor Behavior", DALBAR, 2015; Kinnel, "Mind the Gap: Why Investors Lag Funds," Morningstar (February 4, 2013); see also Baden, "In Past Decade, American Funds Created Most Wealth," U.S. News (March 9, 2010).

consistent with the way in which the vast majority of registered representatives provide investment advice to their clients today. Registered representatives who provide personalized investment advice are not mere salesman but rather valued financial advisors. Perhaps the most important role that financial advisors play is to serve as a buffer between a client's investment strategy and his or her emotions -- particularly during market downturns when the urge to leave the market and "lock in losses" is the greatest. But financial advisors also help their clients save more than they would otherwise and customize portfolios to investors' risk tolerance. Many advisors also guide their clients in the development of a sustainable retirement income strategy and assist with financial changes following life events such as marriage or divorce, birth of a child or death of a spouse or partner.

We understand the Department's concern that commissions and related payments made in connection with certain investments could in theory encourage registered representatives to recommend those investments over other investments. In principle, we have no objection to enhanced regulation of these potential conflicts of interest but it is important to strike the right balance between mitigating potential conflicts of interest and preserving the beneficial aspects of commission-based compensation. Unless the right balance is struck, some investors will be forced into fee-based advisory relationships that may cost more than current commissionable arrangements. Others -- largely smaller balance investors who are not eligible for fee-based advisory programs -- will lose access to personalized, human investment advice.

Some have suggested that computerized investment advice solutions (sometimes referred to as "roboadvice") could fill the gap and provide low cost advice to small balance investors. But these programs are new and largely untested through market cycles. In particular, it is far from clear that investors in such programs will stay invested through market corrections. Notably, many of these programs recognize the value of a human advisor and shift away from computerized advice alone as investable asset levels rise.[4] That is, it is only the small balance investors who are relegated to computerized advice; the larger balance investors get the benefit of a traditional financial advisor, including a broader range of financial planning services and the personal relationship that keeps savers invested through market cycles. It is also far from clear that these programs are cost-efficient for small balance investors.[5] This is not to suggest that computerized advice is worthless; it may well be that computerized advice will prove to be a valuable contribution to the advice marketplace. But our point is that it is misplaced to think these nascent programs are currently viable fee-based alternatives to personalized, human advice.

The importance of access to professional investment advice cannot be overstated. A recent economic analysis commissioned by Capital found that, in the absence of a workable best interest contract exemption, investors could lose as much as $80 billion over 10 years solely as a result of selling out of the market during downturns because they did not have access to

[4] Two prominent computer-based advisors introduce access to a human advisor when assets under advisement reach $100,000 and $500,000, respectively.

[5] Based on a survey of publicly disclosed advisory fee schedules for computer-based advisors, fees for a full-service investor with a balance equal to our average IRA balance -- $42,000 -- range from 0.25% to 0.95% of assets.

a broker-dealer registered representative.[6] And the value of advice is much greater because that figure does not capture the other lost benefits conferred by financial advisors, such as foregone employer matching contributions or reduced savings, which are less easily quantified.

Unfortunately, it is clear from our conversations with financial intermediaries that the proposed best interest contract exemption does not hit the mark. Unless changes are made, it is simply going to be much easier for financial advisors to do business on a fee basis; that is, pursuant to an arrangement in which the advisor's compensation is charged separately and does not vary based on the investment recommendation provided. Virtually all of our financial intermediaries do business in both a fee-based capacity and a brokerage capacity, and the majority of registered representatives are also investment advisor representatives.[7] Without changes, we foresee a dramatic acceleration of the existing trend away from commission-based advice to fee-based advice.

We discuss below a number of changes to the proposed exemption that would preserve the broker-dealer business model while addressing concerns about conflicts of interest. We then focus on the need for a grandfather rule for existing mutual fund investments and phasing in the requirements of the best interest exemption. We also respond to the Department's requests for comments on how to operationalize a streamlined exemption for low fee, high quality investments and conclude with comments on several other issues.

The focus of our comments is IRA investors. While the new rule would have a significant impact on participant-directed retirement plans, commissions and other forms of differential compensation are less prevalent in retirement plans and the greatest impact of a new rule will be on IRA investors.

1. The final regulation should include a workable exemption for commissionable investments.

There are good reasons for investors to choose to pay for investment advice through commissions. Commissionable investments are buy-and-hold investments. One of the less appreciated facts about commissions is that they discourage frequent trading and market timing. In fact, the average holding period for a commissionable investment in the American Funds is nearly twice as long as the average holding period for a fee-based investment in the American Funds.[8]

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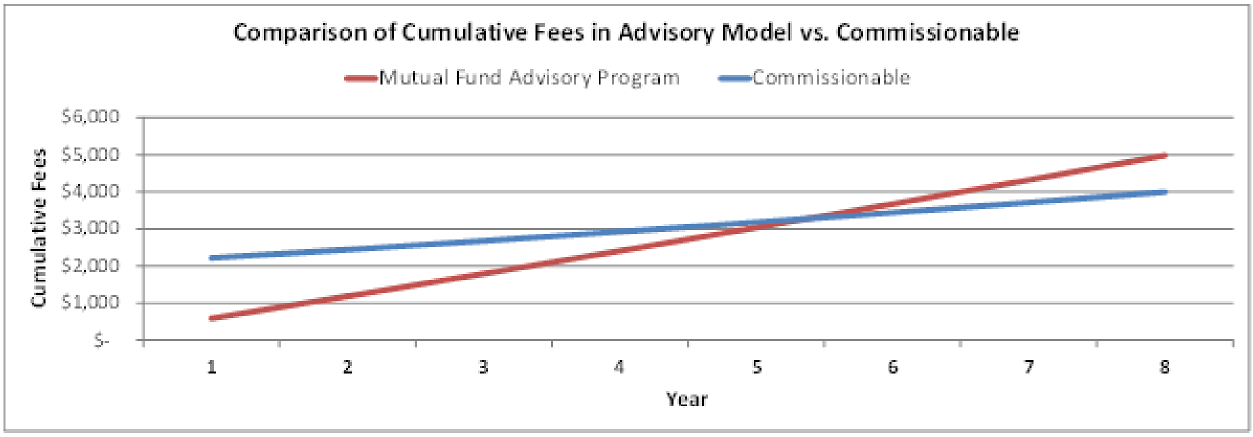
[6] Litan & Singer, "Good Intentions Gone Wrong: The Yet-To-Be Recognized Costs of the Department of Labor's Proposed Fiduciary Rule" (July 2015).

[7] Virtually all of the financial intermediary firms that distribute the American Funds have both a commissionable brokerage business and a fee-based advisory business. Every single firm among the top 30 sellers of American Funds held on our books offers both brokerage and fee-based solutions. More generally, based on Discovery Data as of June 20, 2015, half of all registered representatives of broker-dealers are also representatives of investment advisor representatives.

[8] The average holding period over the last three years for commissionable shares (A shares) was 8.9 years while the average holding period for advisory shares (F shares) was 4.1 years.

For long-term investors, commissions are a cost efficient way of paying for ongoing investment advice. Buy-and-hold investors generally pay less for investment advice than investors in fee-based arrangements. The exact point at which a buy-and-hold investor pays less than a comparable fee-based arrangement depends on a variety of factors, including the cost of the fee-based program and investment returns, but there is no question that compensating a financial advisor for investment advice through commissions is a reasonable choice for many.[9]



This is not to suggest that fee-based arrangements are problematic or that commissionable investments are always preferable, but it is to say that the manner in which investors pay for advice should be a matter of investor choice.

The compensation structure for mutual funds that are sold with a commission -- typically denominated as A-shares -- is tightly regulated by FINRA and fairly standardized across the mutual fund industry.[10] 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 2014 was 2.28%. The annual payments from a fund for service under Rule 12b-1cannot exceed 0.25% of the balance of the investment.[11] This combination of upfront payment at the time of an investment plus a modest ongoing fee aligns with the cost of providing investment advice.

[9] The chart assumes a one-time investment equal to our average full-service IRA account balance -- $42,000 -- in two different programs. The first is a mutual fund advisory program which charges the investor an annual advisory fee of 1.10% of assets. The second is a commissionable program in which the investor is charged a 5.0% up-front commission. Mutual fund expenses for both programs were assumed to be equal to an annual management fee of 0.30%; however, mutual fund expenses for the commissionable program also include a 12b-1 fee of 0.25%. Other mutual fund expenses were excluded from the calculation. An annual 5% rate of return was assumed for both programs.

[10] See FINRA's NASD Conduct Rule 2830(d); see also U.S. Securities and Exchange Commission "Mutual Fund Fees and Expenses" available at www.sec.gov/answers/mffees.htm.

[11] FINRA rules distinguish between a payment for distribution and a payment for ongoing service. Any payment in excess of 0.25% is included in calculating maximum allowable sales loads.

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 could create potential conflicts of interest. But one of the more striking aspects of our conversations with financial advisors 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 advisors 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 is more cost efficient given the servicing needs of buy-and-hold investors. Without a workable exemption, the Department's proposal could make it difficult for advisors to act in the best interests of their clients.

The core challenge in crafting a workable exemption is mitigating the potential conflicts of interest created by commissionable compensation -- incentive to churn and differential advisor compensation -- without tipping the scale too far in favor of fee-based advisory arrangements. The proposed exemption attempts to strike the appropriate balance by imposing a best interest standard of conduct, creating a directly enforceable right of action against advisors who do not act in the best interests of their clients, requiring conflicts of interest mitigation practices and mandating fee disclosure.

In basic outline, we think the exemption is headed in the right direction. The fundamental contours of the proposed exemption are reasonable. However, the devil is in the details and the proposed exemption contains elements that are confusing, inflexible and unduly burdensome. We discuss below changes to the proposed exemption that are necessary to make the exemption workable, preserve access to advice for smaller balance investors and ensure that buy-and-hold investors can pay for advice through commissionable investments.

a. **The written contract requirements of the best interest contract should not include the proposed warranties.**

As the name suggests, the best interest contract exemption requires that an advisor enter into a written contract with the IRA owner or, in a rollover, the participant. The contract must affirmatively state that the advisor will act in the client's best interest, put the client's interests first and not make misleading statements. The contract must also affirmatively warrant that the advisor will comply with all state and federal laws, adopt appropriate conflicts of interest mitigation policies, identify material conflicts of interests and adopt compensation policies that eliminate any compensation practices that "would tend to encourage individual [advisors] to make recommendations " that are not in the best interest of investors.

Under the proposal, an investor would have a direct private right of action against an advisor who violates either the basic provisions of the contract or the required warranties. The Department has, however, largely mirrored the existing enforcement mechanisms that apply to registered representatives under FINRA rules.[12] That is, the written contract may require

[12] See FINRA Rule 2268(d)(3), prohibiting member firms from including provisions in arbitration agreements limiting the ability of a party to join a class action lawsuit.

arbitration to resolve disputes but must not limit an investor's ability to join a class action lawsuit.

We agree that investors should have a direct means of recourse against an advisor that relies on the best interest contract exemption and fails to live up to the best interest, impartiality and honesty standards. However, the contractual warranty requirement includes elements that invite the plaintiffs' bar to find opportunities to sue advisors that rely on the exemption. As proposed, the warranty provisions of the best interest contract would be contract features. Thus, for example, if a registered representative or his or her home office violated state law, the representative and the home office would have breached the contract and would be subject to class action liability for breach of the best interest contract exemption. It seems patently unfair to transform an unrelated state or federal law violation into a class action.

Similarly, the inclusion of a warranty on conflicts of interest mitigation policies, including a requirement to eliminate compensation practices that would "tend" to incent certain recommendations, would be a windfall to the trial bar. The exemption makes no effort to reconcile a best interest standard with commission-based compensation, even though it allows broker-dealer firms to receive compensation that varies based on the investment recommendation that is made. We believe that broker-dealers and their registered representatives will be subject to lawsuits alleging that they failed to act in their client's best interest solely because they recommended a fund that pays commissions or ongoing service fees -- the very activity the exemption is intended to facilitate. The exemption will be of little value if advisors are subject to liability solely because they availed themselves of the exemption. To prove a breach of the best interest standard, an investor should have to claim more than that the advisor had a conflict of interest; the investor should have to claim that the investment was an imprudent one at the time of the recommendation.

We appreciate that the proposal makes the warranties a contractual provision but does not make compliance with the warranties a condition of the prohibited transaction exemption. Thus, a breaching advisor would be subject to litigation risk but not prohibited transaction excise tax liability. In effect, the proposal delegates enforcement for the warranty requirements to the trial bar rather than the Internal Revenue Service. On balance, we believe that any privately enforceable contractual remedy must be tailored to the best interest standard and should not extend to the ambiguous and complex warranties. The IRS should enforce the warranty requirements, which apply at the firm level rather than the individual investor level.

b. The exemption's conflicts of interest mitigation requirements are too inflexible and would disrupt the existing broker-dealer compensation system.

Another issue is the level of specificity suggested by the proposal with respect to required conflicts of interest mitigation policies. We agree that broker-dealers should have policies to mitigate as well as disclose potential conflicts of interest. But the proposed best interest contract exemption appears to go far beyond any conflicts of interest policy we have encountered. It would require enormous changes in the ways in which individual advisors are compensated and would fundamentally disrupt the broker-dealer business model.

As mentioned above, the proposal requires that broker-dealer firms eliminate any compensation practices that "would tend to encourage individual [advisors] to make recommendations" that are not in the best interest of investors. The preamble to the best interest contract exemption provides additional color by describing a series of compensation practices that would not run afoul of this prohibition. With only one exception -- where differential compensation is justified based on neutral factors such as the difference in time and analysis for an investment -- all of the examples involve compensation methods that are used to avoid prohibited transactions today, for example, use of an independent third-party computer model to provide advice, asset-based fees and fee offsets. Significantly, it is clear that firms could not continue paying advisors a portion of the revenue they bring to the firm -- the traditional payout grid. We appreciate the many statements in the preamble that the proposal is meant to be flexible and should not be viewed as dictating compensation structures. But the fact of the matter is that the proposal clearly reflects a belief that prohibited transaction relief should only be granted to the extent individual advisors can no longer receive traditional forms of broker-dealer compensation. This distinction -- differentiating between the compensation that can be received by the firm from the compensation that can be received by the registered representative -- belies the notion that the exemption preserves the broker-dealer business model.

Put simply, this is an enormous intrusion into the manner in which brokerage firms compensate their advisors. In a principles-based exemption, firms should have flexibility to manage conflicts of interest without intervention in the way in which broker-dealer firms compensate their individual advisors. FINRA has already provided the template for such an approach and we urge the Department to accommodate a more principles-based, flexible approach to conflicts mitigation along those lines.[13]

c. The best interest contract exemption should include workable point-of-sale disclosure requirements.

As a general matter, we support appropriate disclosure for mutual fund investments at the point of sale. However, we support the comments of others in the industry who have pointed out that the exemption's proposed disclosure requirements are unduly burdensome, commercially unworkable, and far too much for investors to process.

Like others, we believe it makes little sense to create an entirely new disclosure regime under the best interest contract exemption. Instead, we believe that it makes sense for the Department to leverage the existing disclosure requirements of ERISA sections 404(a)(5) and 408(b)(2). Financial intermediaries recently established systems to meet these requirements and it appears that such systems could be extended to IRAs at a lower cost than creating an entirely new structure.

d. The exemption should apply to participant-directed retirement plans.

In addition, assuming that the exemption is made workable, we urge the Department to reconsider the scope of the exemption. Registered representatives of broker-dealers are the primary source of investment advice for smaller balance individual investors. This is similarly true of small business retirement plans. Yet the best interest contract standard is not available to participant-directed retirement plans. Without an exemption, we believe that fewer small business retirement plans will be started and that many plans will lose their

[13] FINRA, Report on Conflicts of Interest (October 2013).

advisors. For this reason, it is important the final best interest contract exemption apply to participant-directed retirement plans.

e. The exemption should be carefully revised to address technical drafting issues.

We also support the comments of others pointing out the myriad technical issues that arise under the best interest contract exemption. The exemption should, for example, be revised to clarify that (i) services incidental to a rollover are covered; (ii) the best interest contract must be entered into before the first investment, rather than the first recommendation; and (iii) the exemption applies to recommendations to hire an investment advisor or investment manager.

2. The final regulation should grandfather existing mutual fund investments.

The proposal indicates that the final rule's compliance date will be eight months after the final rule is published. Presumably this means that the new rule will apply to investment advice provided after the compliance date. The proposal does not provide any exception, carveout or other grandfather provision that would allow existing investors in commissionable mutual funds to continue to receive advice from their broker's registered representative. Instead, every investment relationship involving an ERISA plan or an IRA would have to comply with the new rule within eight months of its release.

For commission-based relationships, the lack of a grandfather provision would mean that the advisor and the investor have three options: (i) shift to a fee-based advisory relationship; (ii) execute a best interest contract that meets the requirements of the new proposed prohibited transaction exemption; or (iii) end the advisory relationship. Unfortunately, for smaller-balance investors, we fear that the last option -- converting advised investors to self-directed investors or simply ending any relationship with the client -- is the most likely outcome.

Fee-based advisory arrangements are simply not viable for many smaller balance investors. The current minimum investment requirements for participation in an advisory program that charges asset-based fees are simply too high for many investors.[14] And hard dollar fees, such as per hour fees or project-based fees, are both uncommon and prohibitively expensive for smaller balance investors. It is possible (even likely) that over time new business models for providing advice to smaller balance investors will arise but the current landscape does not easily accommodate these savers.

Moreover, even if a particular investor has access to reasonably priced fee-based advice, the investor may need to sell his or her current investments prior to moving into the advisory relationship, for example, because the existing investments in a transaction-based account are designed to make differential payments to the investor's financial advisor. Thus, even for those investors with practical access to fee-based advice, the outcome could be the selling of existing funds to convert to cash prior to re-investment in advisory programs and enormous investment churn.

[14] The minimum investment requirements for fee-based advisory programs depend on the type of program and the firm. There is significant variation in minimums but mutual fund fee-based programs generally have minimums that exceed the $42,000 average size of the IRAs we manage and service.

Further, a mass migration of commissionable relationships to the best interest contract exemption is simply not practicable within the eight-month time frame contemplated by the proposal. There are more than eight million IRAs that are invested in American Funds mutual funds that pay a 12b-1 fee. All of these investors would have to affirmatively execute a best interest contract in order to stay invested. Even if the exemption is substantially improved, financial intermediaries will need to develop new agreements, conflicts of interest policies, disclosure systems and websites. Further, these intermediaries will need to train their financial advisors and determine how much investment discretion to delegate to individual advisors. It may be that broker-dealer home offices choose to retain greater control, for example, through investment select lists, under a best interest standard of care. It is difficult to imagine that such a shift could be accommodated in an eight-month window. Given the risk of turmoil and dislocation, we believe that the final rule begs for a grandfather rule that will allow for a more organic transition.

The closest thing to a grandfather rule in the existing proposal is a provision allowing for the receipt of compensation after the compliance date for prior investment advice. But that rule does not allow the advisor to provide any advice thereafter, even a recommendation to stay invested during a market correction -- the very time in which shareholders most need to be encouraged to stay the course. We are doubtful as a practical matter that broker-dealer home offices will be comfortable that advisors who are receiving ongoing compensation will not provide ongoing advice. The only practical approach to ensuring compliance is to end the compensation. Thus, the net effect is that all existing advisory relationships will need to be revisited or restructured.

We urge the Department to include a real grandfather rule for legacy mutual fund investments -- one that allows for ongoing advice, including recommendations to stay invested. There are sound policy arguments for a grandfather rule. First, as an economic matter, the commission paid in connection with the sale of a mutual fund is compensation for the transaction as well as a prepayment for ongoing investment advice, for example, investment reviews, reallocation decisions, etc. The investor pays a commission equal to a percentage of the initial investment and then the mutual fund typically pays the advisor an annual amount equal to up to 0.25% of the value of the account. These payments entitle the shareholder to ongoing service. Without a grandfather rule, millions of shareholders will forfeit their pre-paid right to ongoing advice at very modest cost.

Consider, for example, a shareholder who paid his advisor a commission in connection with a $100,000 rollover into an A share mutual fund. His advisor receives an annual payment from the fund equal to 0.25% of the amount invested for ongoing advice. Assume the rule is finalized as proposed and the investor and advisor are forced to restructure their relationship. If the best interest contract exemption is not attractive and the investor and his advisor choose to move to a fee-based arrangement, the investor will lose the benefit of his prepayment for future advice and he will be forced to sell his current mutual fund investments before the new rule's compliance date because its ongoing payments would otherwise result in a prohibited third-party payment to a fiduciary.

Second, even in the absence of an upfront commission, the lack of a grandfather rule could mean increased costs for millions of savers. As discussed above, the ongoing cost of service in A share mutual funds is a mere 0.25%. Fee-based arrangements generally cost much more. Without a grandfather rule, it is likely that the new rule will result in a substantial immediate increase in the cost of investment advice for many savers.

Consider, by way of another example, an investor who rolled from an ERISA plan where she was invested in American Funds. She rolls $50,000 to an IRA and invests in the same funds. Under the American Funds rollover policy, no commission is paid and instead the sole compensation the advisor receives is an annual payment from the funds equal to 0.25% of the amount invested in the funds. Assume the client is eligible for a fee-based advisory arrangement with the investor's current financial advisor. The cost of the arrangement is 1.00% annually. The investor's cost of advice could increase fourfold as a consequence of attempting to comply with the new rule.

Third, from a public policy perspective, allowing advisors to receive an asset-based fee from existing mutual fund brokerage accounts does not raise the types of conflicts of interest issues underlying the fiduciary proposal. Ongoing compensation of one-quarter of one percent (0.25%), typically for fairly small balance investors is very modest, for example, $125 per year on a $50,000 investment. Such a small amount should not raise the conflicts of interest concerns driving the Department's proposal. A financial advisor is not going to recommend that a client stay invested in a mutual fund to receive what is a very modest revenue stream.

We believe that a grandfather rule could be appropriately crafted so that it does not swallow the general rule or lock investors into inappropriate investments. First, the grandfather rule need not cover existing relationships; it could be limited to existing investments. That is, all new purchases could be covered by the new rules. Second, grandfathered investments could be subject to the best interest standard, which the Department's proposal makes broadly applicable under a number of different prohibited transaction exemptions. Under a best interest standard, an advisor could only recommend that a client stay invested in a grandfathered investment to the extent it is in the best interests of the client. Third, we believe that a grandfather rule could be limited to payments made out of investment assets. In other words, a grandfather rule could prohibit less transparent forms of compensation, such as revenue sharing. Under this approach, the maximum amount that a financial advisor could receive annually with respect to legacy A share mutual fund investments would be 0.25% of the investor's investment -- the amount permitted under FINRA's NASD Rule 2830(d). Such a grandfather rule would be incredibly valuable in minimizing disruption from the new rule while accomplishing the Department's goal of shifting to a new model of financial advice.

Two other considerations are worth mentioning. The Department may want to consider extending the grandfather to investment exchanges as long as an exchange did not trigger a new commission or otherwise increase the advisor's compensation. In this regard, mutual fund families typically provide rights of exchange within the fund family that allow investors to exchange mutual fund investments without paying a new commission or otherwise changing the advisor's compensation. Such an approach would accommodate rebalancing programs while ensuring that advisors did not have inappropriate incentives to recommend exchanges. Further, the Department may want to consider extending the grandfather to periodic payment programs that were established before the effective date of the new rules. It would be a shame if previously established financial plans are disrupted by the new rules.

We believe a grandfather rule along these lines would provide the investor access to ongoing investment advice for a very low fee -- generally 0.25% of assets. It would reduce investment churn, which would be particularly egregious given the buy-and-hold nature of many commissionable mutual fund investments. Most importantly, without an appropriately drawn grandfather rule, we believe that millions of existing investment relationships will be disturbed. Some investors who previously pre-paid for ongoing advice will have the worst of both worlds -- a pre-payment followed by higher ongoing fees, for example, 1% of assets, as they are shifted into advisory relationships. Other investors will be orphaned and will effectively become self-directed accounts with no advisor to guide them through market and life changes.

To the extent the Department has concerns about the availability of this exemption in participant-directed retirement plans, for example, because plans have new participants and a long duration, the exemption could be limited to IRA investors.

It is also worth noting that the Department's proposal is out-of-step with the approach the Financial Services Authority (FSA) took in the Retail Distribution Review (RDR), when the U.K. moved to ban commissionable compensation for retail investment advice. The RDR includes detailed guidance on the treatment of legacy assets, including the circumstances in which advisors receiving "trail commissions" can continue to provide ongoing advice. That guidance includes a grandfather rule that allows for recommendations to hold.[15] It also allows for fund exchanges in limited circumstances and grandfathers systematic investment programs. Thus, even in a more stringent regime that fully bans commissionable compensation, the U.K. regulators provided a grandfather rule.

Finally, we believe that this grandfather rule will be effectively limited in both duration and scope. Financial advisors will shift larger accounts from commissionable investments to fee-based programs, which offer a different suite of services and will represent the investment advisory business model of the future. Moreover, investors who are making ongoing contributions will be motivated to aggregate all of their investments in one account -- they will not want grandfathered and non-grandfathered accounts. The significance of the grandfather rule will be to facilitate an orderly transition to the new regime. It will avoid disruption for millions of investors, including retired and elderly investors who may find a forced transition in their advisory relationship challenging. It will also avoid the orphaning of millions of existing smaller balance investors.

Although the focus of our comments is understandably on mutual funds, we also note that there are other types of existing investments for which advice was provided on a commissionable basis, for example, variable annuity contracts, where a grandfather rule seems entirely appropriate. Without such a rule, millions of investors in IRA annuities could incur surrender charges in connection with liquidations as they move to fee-based arrangements, not to mention the loss of potential retirement income and other benefits. We believe a grandfather rule structured along the lines described above would be appropriate for variable annuity contracts.

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[15] PS 12/3 *Distribution of retail investments: RDR Advisor Charging – treatment of legacy assets* (February 2012).

3. The final rule should phase-in the best interest contract requirements.

As discussed above, the Department of Labor's proposed effective date is extraordinary in its brevity for a change of this magnitude. It will likely result in enormous disruption without appropriate transition rules. We believe that one needed aspect of transition is a grandfather rule. Another is a phase in of the requirements of the new best interest contract exemption. Even if the best interest contract requirements of the final rule reflect the financial industry's concerns, we believe that eight months is simply too little time to allow investment advisors to begin utilizing the exemption by the effective date.

As a threshold, it is clear that it will take time to understand the final rules and determine how they impact various segments of the market. The Department provided 90 days for comments on the proposal and one can think of that time period as the bare minimum for understanding a new rule. We anticipate that the final rule will be even more challenging given the impacts of changes.

We also anticipate that financial intermediaries who elect to rely on the best interest contract exemption will not simply graft the exemption onto their existing investment philosophy and approach. It is unlikely that broker-dealer firms will allow their registered representatives to recommend the same universe of investments that they recommend today. Instead, we anticipate that they will seek to minimize perceived conflicts of interest and liability by narrowing the investments that are recommended, and types of compensation that are paid. At a minimum, given the increased liability associated with a best interest standard of care, we anticipate that home offices will exercise greater centralized control over the investments that their advisors may recommend, for example, by creating approved lists. But we expect even more significant changes. For example, a firm may choose to no longer accept revenue sharing payments. Others may choose to work with only a select group of mutual fund companies that each pay similar upfront commissions and ongoing service fees. As a result, compliance with the best interest contract exemption will be an enormous exercise that will involve fundamentally redefining a firm's approach to investing.

In addition, virtually every broker-dealer firm will need to restructure the manner in which individual registered representatives are compensated. Even if the final exemption provides much needed flexibility in terms of approaches to conflicts of interest mitigation, it is clear that firms will need to review all of their compensation policies to identify any practice that would "tend" to affect investment advice. This could affect much more than sales incentives and rewards. Any changes to compensation are challenging and we think it is simply unrealistic to expect the financial services industry to fundamentally restructure its compensation programs within eight months.

And there are of course the practical implications of a best interest contract exemption. Financial advisors will have to enter into written agreements with every single new investor. These contracts will need to be developed and financial advisors will need to be trained to understand those contracts. Further, broker-dealer firms will need to make massive investments in systems to be able to comply with the best interest contract exemption's point-of-sale and annual disclosure requirements, to say nothing of the website disclosure regime. While reliable estimates of the cost and time necessary to effect changes of this type are difficult, it is readily apparent that eight months is not practicable.

Put simply, the transition contemplated by the proposed regulation is impossible. Compliance within an eight-month window would be challenging -- even near impossible -- for new relationships. But the challenge increases exponentially for existing commissionable relationships, involving investors of all ages and levels of investment acumen, including investors who have not made a new investment in many years.

We are particularly sensitive to the consequences of a market correction or disruption. If history is any guide, there will be a material correction. It would be devastating if such a correction occurs during a period in which advisory relationships are in flux. Financial advisors are critical to minimizing the risks of market timing and panic selling and a failure to carefully navigate the transition to new rules governing investment advisory relationships could have long-term negative impacts on retirement adequacy.

For these reasons, we believe the contract, conflicts of interest and disclosure requirements of the best interest contract exemption should be phased in. It should be enough to begin by applying the best interest standard of care. These rules should be phased in over a lengthy period. Specifically, we believe that the contract, conflicts of interest and disclosure requirements of the best interest contract exemption should be phased-in over three to five years.

4. The final rule should clarify that wholesaling activity is not fiduciary investment advice and provide a seller's exemption for retail investors in situations in which it is readily apparent that a person is not providing impartial investment advice.

The Department's initial conflicts of interest rule proposal issued in 2010 included a rule indicating that selling activity was not fiduciary investment activity even if the selling included an investment recommendation. It is also well-settled in the case law that selling activity is not fiduciary activity. We appreciate the Department's concerns that retail investors are not able to effectively distinguish selling activity from fiduciary investment advice in certain circumstances, even when accompanied by robust disclosures reflecting that the salesman is not providing impartial investment advice. However, we believe that the elimination of the seller's exemption from the 2015 proposal sweeps in certain activities that should not be considered fiduciary investment advice.

Capital makes its investments, including the American Funds, available to retail investors through financial advisors -- either a registered investment advisor representative or a registered representative of a broker-dealer. For that reason, our distribution and sales efforts are targeted to professional investment advisors. Our sales representatives are often referred to as "wholesalers" because they only sell to professional financial intermediaries. We are concerned that under a literal reading of the proposed regulation, wholesalers could be considered investment advice fiduciaries and we urge the Department to clarify that these types of wholesalers are not fiduciaries.

The Department of Labor's fiduciary proposal treats certain investment-related recommendations given to a "plan, plan fiduciary, plan participant or beneficiary, IRA, or IRA owner" as fiduciary recommendations. Many of the investment advisors that our wholesalers market to will be plan fiduciaries -- in fact, if the proposal is finalized as proposed, virtually all of our financial intermediaries will be considered fiduciaries. Read literally, investment recommendations made to financial intermediaries who are fiduciaries could be considered fiduciary advice itself. There are arguments that this is either not intended or not covered because the recommendation is not "individualized to" or "specifically directed to" the advice recipient, namely the plan, participant or IRA owner. Similarly, it seems likely an untenable rule since it creates a "daisy chain" effect that could turn individuals far removed from a plan or IRA into fiduciaries. But we believe there is sufficient ambiguity that the final regulation should be clarified.

We believe the final rule should clarify that recommendations made to a third-party investment advisor -- whether acting in a 3(21) nondiscretionary or 3(38) discretionary capacity -- are carved out of the definition of fiduciary investment advice if the third-party advisor is either a registered representative of a broker-dealer or registered investment advisor representative. A simple approach that focuses on whether advice is provided to a professional investment advisor, not the plan or IRA owner, strikes a better balance between cost and benefit than a sophisticated advisor rule.

We also believe that there is a category of selling activity to retail investors that may fall within the technical definition of fiduciary investment advice but that should be carved out of the definition. Consider an American Funds associate who meets with a small plan along with a third-party financial advisor and tries to sell the American Funds Target Date Retirement Series to the plan. Under the Department's proposal, the associate and the associate's employer, Capital Group, would be considered an investment advice fiduciary if he or she recommends the American Funds Target Date Retirement Series. Such an analysis is nonsensical. While we can appreciate the Department's concerns about the ability of retail investors to distinguish between selling activity and investment advice as well as questions about the efficacy of disclosure, the proposed rule throws out the baby with the bathwater by failing to include any seller's exemption. There are undeniably circumstances where it is obvious that a person is engaging in selling activity.

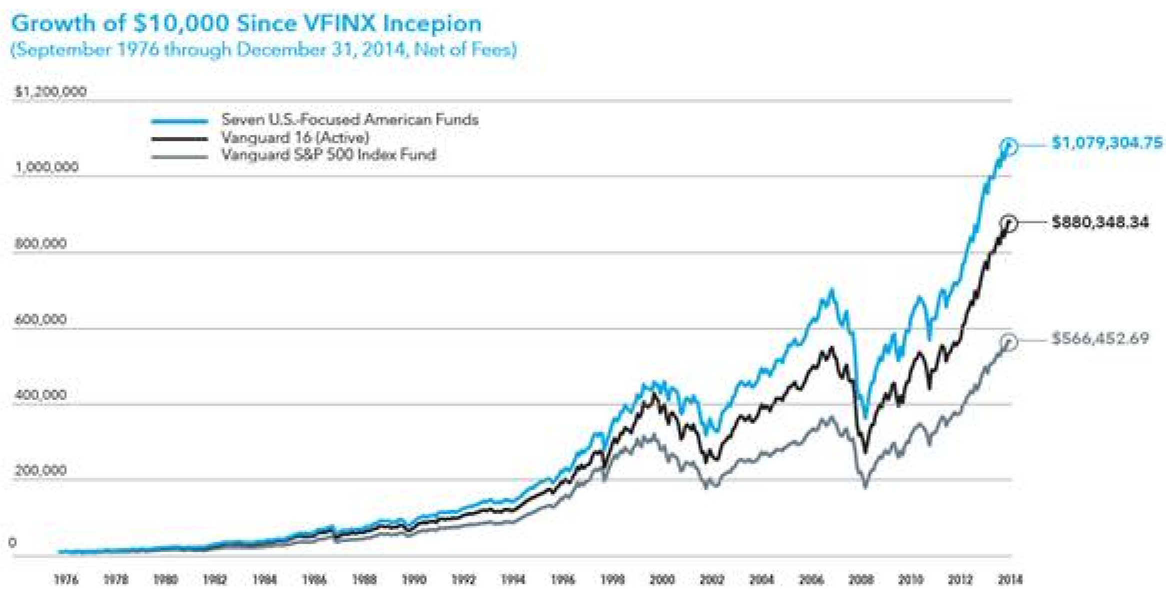
We believe that the final rule should include an exception for selling conversations where it is readily apparent that the financial professional is not providing impartial investment advice. In particular, we believe that a seller's exception can be crafted that excludes selling conversations in which the only investments that can be recommended are managed by an affiliate of the employee's employer and the investor is not paying a fee for investment advice, that is to say, the only indirect compensation is revenue from the investment. Such an exception could be accompanied by required disclosure, for example, disclosure that the individual is not providing impartial investment advice and can only recommend proprietary investment products. In this context, concerns about the efficacy of disclosure are misplaced.

5. The final regulations should <u>not</u> include a streamlined exemption for high quality, low fee investments.

The proposed fiduciary regulation includes an extensive discussion of a possible "low fee, high quality" streamlined exemption for mutual funds that would serve as an alternative to the best interest contract exemption. We cannot help but view the discussion in the preamble of a low fee, high quality exemption as a reflection of the misguided notion that rank-and-file savers should be invested in index funds. And, regardless of style of investment management, we simply do not see an administrable way to "operationalize" an exemption based on high quality, low fee investments.

a. A streamlined exemption that preferences index funds over actively-managed funds would be misguided.

The assumption in the preamble seems to be that index funds are better for small retirement savers and therefore public policy should nudge investors in that direction. We appreciate that, on average, active managers beat the benchmark only about half the time. But the fact is that not all active managers are average. As the chart below shows, some active managers have a long record of generating superior investment results after fees relative to indexes -- results that translate into hundreds of thousands of dollars more in accumulated retirement savings for individual investors. In this context, it is plainly sound public policy to facilitate these choices and not to inhibit or inadvertently preclude access to active investment management by new regulations.



The chart shows the results net of fees for an investment of $10,000 in three kinds of funds since the inception of the Vanguard S&P 500 index fund in 1976.[16] Over the nearly 40 years since the inception of the S&P index fund, an investment in the American Funds produced a 90% larger nest egg for retirement than a comparable investment in the index fund.

Vanguard and American Funds are two of the largest low-fee active managers of mutual funds in the country. With life-changing results like these over long time periods, it is hard to imagine on what theory public policy would prefer index funds rather than continue to make these and similar actively-managed funds from other managers available to small retirement savers. To deny small investors such choices risks materially undermining their retirement security.

[16] The bottom gray line shows the Vanguard S&P 500 index fund; the black line shows the results of the same investment in the 16 Vanguard actively managed funds that are benchmarked against the S&P 500; and the top blue line shows the results for the seven U.S. equity American Funds that are benchmarked against the S&P 500.

b. **It is not possible to operationalize an exemption that focuses on low fees, high quality investments or both.**

There is an entire advisory industry built around identifying high quality investments. It is simply not possible to replace this function -- the role of the advisor -- with a simple and administrable metric or set of metrics.

An exemption focused on fees is clearly misplaced, except as a useful predictor of investment results net of fees. It is investment results net of fees that drive retirement outcomes. Small differences in results over long-periods can have an enormous impact on retirement adequacy.

We also question whether it is possible to define low all-in fees. Fees depend greatly on investment objective. Consider, for example, style box driven investing in which asset allocation is made to different asset classes, for example, domestic equity, international equity, government bonds. Each of these asset classes has different fees. And, even if one defines low-fee by reference to the asset class, for example, top quartile of developing markets funds, it can be very difficult to classify funds based on these style-box driven classifications. By way of example, we manage a mutual fund that provides exposure to developing markets by investing in companies based in developed markets that do substantial business in developing markets. This fund can be alternatively viewed as a developing markets fund or developed markets fund.

Moreover, an approach that focuses on asset classes would reflect a fundamental judgment about investment style. It would represent an implicit choice, for example, of style box-driven investing rather than objectives-based investing. In objectives-based investing, the goal is to achieve the investor's objective. An investor could have a goal of growth or of capital preservation. The investments that have low fees viewed from this perspective could be very different investments than ones that have low fees from a style-box perspective.

Mutual fund fees are also challenging because they often represent an apples-to-oranges comparison. Index funds typically do not include the cost of investment advice in their expense ratios; instead, the advisory fee is externalized. In contrast, many actively-managed funds include the cost of investment advice in their expense ratios, for example, the ongoing service fee of 0.25%. It makes little sense to distinguish low fee funds based on whether one fund internalizes investment advisor compensation while another externalizes it.

Perhaps most importantly, an exclusive or disproportionate focus on fees would be fundamentally inconsistent with existing fiduciary law which recognizes that fees should not be considered in isolation.

We appreciate that the discussion of a possible exemption is not for low-fee only mutual funds, but also for ones that are high quality. But we are similarly concerned that identifying high quality mutual funds in an objective and simple manner is simply an intractable problem. There is no independent observable data point that points to quality. Quality is entirely dependent on investment objective. An investor may be near retirement and have little appetite for risk of loss, particularly one that gives rise to sequence of returns risk near the commencement of drawdown. In that context, an investment option that prioritizes managing downside risk may be appropriate but its investment results are likely to lag other funds for that reason.

One conceivable approach would be to rely on third-party rating services, such as Morningstar and Lipper. These firms currently rate mutual funds using a comprehensive suite of criteria, including investment results, fees, firm stability, manager tenure, etc. But this brings up a number of issues. It first raises a question about whether the ratings would only be relevant at the time of purchase or whether there would be an ongoing requirement. It would also concentrate enormous power in the hands of a few agencies and the reasoning underlying a particular rating would be largely opaque given the subjective nature of the rating process. Many of these agencies also subscribe to certain theories of investing. The Department of Labor, if it chose to employ this approach, would effectively bless these investment theories to the exclusion of others. In other words, the Department could be perceived as inappropriately distorting the marketplace by picking "winners and losers." Finally, we note that the Department and other federal agencies have already learned of the risks of relying on commercial third party agencies, for example, the credit rating agencies, and we believe that a return to such an approach would be misguided.

6. The final regulations should include an exemption for subtransfer agency payments made by mutual funds to IRA platform providers.

Financial intermediaries, including broker-dealers and platform providers, have largely moved away from maintaining individual accounts that are held on the books of the fund complex. Instead, intermediaries maintain aggregated ("omnibus") accounts on the books of the fund complex with the intermediary maintaining individual accounts, such as participant or IRA accounts, on their books. The omnibus account holder in turn performs many of the common transfer agency functions the mutual fund would otherwise perform, including, for example, trade and settlement activities, account maintenance and periodic statement production. The mutual fund is relieved of the corresponding transfer agency expense and commonly compensates the omnibus account holder with subtransfer agency fees. That is, fees paid from the fund reflect the transfer agency work that is being done by the financial intermediary and would otherwise be performed by the fund's transfer agent.

Under the conflict of interest proposal, unless an advisor is relying on the best interest contract exemption, it appears that subtransfer agency payments would be prohibited to the extent that a fiduciary investment advisor has a material interest in an omnibus account provider, for example, an affiliation.[17] Absent the best interest contract exemption, for example, a broker-dealer would no longer be able to collect subtransfer agency payments with respect to omnibus accounts holding IRA assets. The notion is that a fiduciary investment advisor has a prohibited conflict of interest because in theory the advisor has an incentive to recommend a fund that pays subtransfer agency fees over other investments or that pays greater subtransfer agency fees. Thus, such amounts would, absent an exemption or offset program, be prohibited.

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[17] There are a number of theories justifying the receipt of subtransfer agency fees today, e.g., PTE 75-1, Part II, and PTE 86-128.

In contrast, however, it appears that subtransfer agency payments to third-party platforms that hold funds omnibus where the platform provider does not have an affiliated fiduciary investment advisor (or a material interest in such an advisor) would be permitted.[18] In such an arrangement, the introducing broker is clearly a fiduciary advisor but the clearing broker/platform provider will typically have no relationship with the end client.

This convoluted landscape for subtransfer agency payments makes little sense. Either subtransfer agency payments should be exempt from the prohibited transaction rules or all subtransfer agency payments to IRA platforms should be prohibited. It does not make sense that some platforms would have a competitive advantage over other platforms or that the treatment of third-party platforms would be opaque.

The notion that subtransfer agency fees may create an incentive for financial advisors to recommend some funds over other funds misapprehends the relationship between the individual advisor and his or her home office. Subtransfer agency fees are only payable to the extent fees are used to pay for transfer agency services that would otherwise be performed by the fund's transfer agent. The fund's independent directors have a fiduciary duty to ensure that subtransfer agency fees are only used for legitimate fund expenses of this sort. Correspondingly, we have never heard of a firm that takes into account subtransfer agency revenue in determining advisor compensation. That is, the individual financial advisor has no economic incentive to recommend a fund that has a higher subtransfer agency fee rate over another fund. These are not, for example, payments that are taken into account in firm's payout grid.

We believe the better approach is to exempt subtransfer agency payments as long as the fund boards reasonably determine the fee is paid for transfer agency services. Such an approach would ensure that funds are able to pay for reasonable transfer agency services that would otherwise be performed by the funds. It would also ensure that all platform providers are treating equally.

[18] The matter is not entirely free from doubt because the proposal includes an exception indicating that the mere offering by a recordkeeper of a 401(k) platform of investments is not considered a fiduciary recommendation. The proposal does not include a comparable carve-out for IRA platforms and, in the preamble to the proposal, the Department indicates that it considered and rejected a comparable carve-out for IRA platforms. The preamble explains that the carve out for 401(k) but not IRA platforms is due to the lack of an independent fiduciary in the IRA context and the possibility that platform marketing may rise to the level of a recommendation. Nonetheless, notwithstanding the negative inference created by the 401(k) platform carve-out, it is difficult to view the offering of an IRA platform as fiduciary investment advice under the general definition of advice.