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VIA FEDERAL EXPRESS

November 5, 2010

Ms. Elizabeth Murphy
Secretary
United States Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: File Number S7-15-10

Dear Ms. Murphy:

We serve as investment adviser to American Funds, one of the oldest and largest mutual fund families in the nation. We are pleased that the Commission's proposal regarding rule 12b-1 fees recognizes the value of using fund assets to pay for marketing and service. Nonetheless, as explained below, we believe that the proposal is premature and at odds with market forces; it also suffers from an incomplete cost-benefit analysis.

1. Timing of the proposal

Before radically altering rule 12b-1 the Commission should first address the broader range of distribution-related issues facing the financial services industry. In particular, it makes little sense to proceed with this proposal before completing the study regarding the appropriate standard of care for broker-dealers and investment advisers. For example, if a fiduciary standard of care is adopted for broker-dealers, it would impose additional obligations on broker-dealers and likely require them to provide additional services to their clients. Accordingly, constraining the level of compensation broker-dealers may receive from funds without thoroughly analyzing the implications of the additional obligations and workload that would be associated with a higher standard of care is problematic.

The proposal also raises concerns related to "revenue sharing" payments from mutual fund advisers to broker-dealers. The proposal notes that the Commission is considering further rulemaking related to revenue sharing. Again, we believe the Commission should fully consider this issue before making significant changes to rule 12b-1. This is because changes to industry revenue sharing practices will likely impact how broker-dealers are compensated as well as the disclosures provided to investors.

In addition, the proposal notes that the staff is considering new rules regarding point of sale disclosures. The proposed confirmation statement disclosure requirements seem more appropriate as part of a more detailed and thoughtful point of sale disclosure proposal. If the Commission believes additional disclosure regarding 12b-1 fees is necessary, it should first ensure that investors are provided comprehensive disclosure regarding all distribution expenses, not just 12b-1 expenses, at the point of sale so that investors can consider the disclosure before making an investment decision.

2. Market forces

The proposal arbitrarily subjects amounts now paid under rule 12b-1 in excess of 25 basis points to the maximum front-end sales charge in effect for the fund in question. These proposed limits are significantly more restrictive than the current limits on asset-based sales charges now imposed by FINRA and approved by the Commission. The Commission's proposal in this regard raises significant public policy issues. Limits imposed by the Commission should not be tantamount to "rate-making." Rather, such limits should serve to protect consumers from paying expenses that are substantially above market rates. Unfortunately, the proposal appears to be closer to the former, not the latter situation. Further, because of the administrative complexities associated with applying these new limits, we believe that in many cases market forces will simply reject them as impractical. Alternatives such as fee-based arrangements, group annuities and collective investment trusts (which would not be subject to these limits) will inherit more flows as a result. Perversely, in many cases this could result in consumers paying more, not less, for distribution services without the protection of the federal securities laws.

FINRA currently limits aggregate 12b-1 fees to no more than 100 basis points. Interestingly, the share classes that typically charge the maximum permitted 12b-1 fees (B and C shares) constitute a relatively small percentage of current fund flows. For example, American Funds no longer offers B shares and C shares constitute less than 4% of our flows. Accordingly, the Commission does not need to take action to limit 12b-1 fees because the market is working to reduce fees. We think it is unwise for the Commission to engage in rate-making in this area, where a vibrant market has created investor choice and driven costs down. However, if the Commission wants to put itself in this position, its sole focus should be on protecting consumers from paying fees and charges that are substantially above current market rates in light of the services received.

At the same time, the proposal, if adopted, would result in significant costs associated with complying with the limits on 12b-1 (now 12b-2) fees. These additional costs would effectively limit 12b-2 fees to 25 basis points. For example, the proposal would require retirement plan recordkeepers to develop systems to age and convert shares that carry a 12b-2 fee greater than 25 basis points. This would require shares of funds with a sales load of 5.75% and a 12b-2 fee of 50 basis points to convert after 23 years. Most plan participants hold shares for less than 23 years. Consequently, the costs to develop systems to age and convert shares would be unlikely to provide any benefit to participants.

Therefore, we believe a far better approach would be for the Commission to allow funds to charge up to 75 basis points, provided that the fund boards determine that any amount in excess of 25 basis points is an appropriate fund expense. We believe a fee of up to 75 basis points is appropriate because it would allow most financial advisers to continue to provide shareholders with the same level of service they provide today. Furthermore, as noted below, American Funds share classes with 12b-1 fees of 75 basis points are primarily used by smaller retirement plans, which have significantly different servicing needs than retail shareholders. For example, the majority of small retirement plans investing in American Funds use R-2 shares or R-3 shares, which carry 12b-1 fees of 75 and 50 basis points, respectively.

The proposal notes that in circumstances where non-distribution related expenses are now paid under rule 12b-1, funds may be able to reallocate a portion of the non-distribution related expenses currently covered under a 12b-1 plan as administrative expenses. While this is helpful, the Commission should provide more definitive guidance as to the types of administrative, operational and service expenses paid to financial intermediaries that could be viewed as non-distribution related, along the lines of the guidance provided by the staff in the no-action letter to the Investment Company Institute on October 30, 1998 (the "Fund Supermarket Letter"). In the Fund Supermarket Letter, the Division of Investment Management expressed its view that payment of fees for service to participants in fund supermarkets could be made outside of a 12b-1 plan depending on the purpose of the payments, with such determination made by the fund's board of directors. Similar guidance would greatly assist fund boards in determining whether expenses paid outside of a 12b-1 plan are appropriate.

3. Retirement plans

Sponsors of small retirement plans rely on financial advisers to provide many services to plans and their participants. Advisers are often compensated for these services through 12b-1 payments. If 12b-1 payments are limited, as the proposal contemplates, many advisers will not offer these services to plans invested in mutual funds, particularly to small retirement plans.

a. R shares offered by American Funds

American Funds offer six R share classes exclusively for retirement plans to enable plan sponsors to choose a level of recordkeeping expense and intermediary compensation that best suits the needs of the plan. R shares are sold without a sales charge and include an annual 12b-1 fee ranging from 0% to 1.00%. R shares are designed to cater to retirement plans of all sizes and the choice of share class will depend on how much of the plan's required services are to be paid for from fund assets. For example, the sponsor of a very large plan would probably use R-4, R-5 or R-6 shares (classes with 12b-1 fees of 25 basis points or less). The sponsor could use R-4 shares if it wanted to pay the financial adviser and a portion of the plan's recordkeeping expenses through the fund. The plan sponsor could use R-5 shares if it wished to pay the plan's adviser directly, but wanted the fund to pay a portion of recordkeeping expenses. Finally, the sponsor could use R-6 shares if it planned to pay all adviser and recordkeeping expenses directly.

In contrast, sponsors of smaller plans typically want a greater portion of plan expenses to be paid through fund assets because the sponsor is unwilling to pay the expenses or deduct them from participant accounts. Since these smaller plans tend to have low average account balances, R-1, R-2 and R-3 shares (shares with 12b-1 fees higher than 25 basis points) would be appropriate because these share classes provide the basis points required to generate the absolute dollars needed to cover some or all of these expenses. For example, in our proprietary Recordkeeper Direct Program, the median plan size for plans invested in R-2 shares is approximately $250,000 with 10 participants. Annual 12b-1 payments (at a rate of 75 basis points), of which the adviser receives only a portion, would be approximately $1,900 a year for these plans. The median size of plans invested in R-3 shares through the program is approximately $750,000 with 15 participants. Again, annual 12b-1 payments (at a rate of 50 basis points) would be approximately $3,800 a year for these plans and the individual adviser would receive only a portion of this amount. For this compensation, financial advisers provide the range of services discussed below.

Flows into American Funds R-1 shares also demonstrate that the market for shares with 12b-1 fees of 100 basis points has diminished in recent years. Flows into our R-1 shares which have a 12b-1 fee of 100 basis points constitute less than 1% of American Funds total sales.

b. Role of financial advisers to retirement plans

Advisers offering R shares of American Funds provide significant services both to plan sponsors and plan participants. They assist plan sponsors with issues relating to plan design and administration and help them comply with regulatory requirements. For example, today the adviser often assists with the dissemination of information required to comply with Department of Labor regulations under section 404(c) of the Employee Retirement Income Security Act (ERISA), particularly in the case of smaller plans where compliance with the disclosure requirements cannot be fully automated. This may include the provision of fund prospectuses, annual reports and fund fact sheets to participants.

Advisers can also assist in the search for plan service providers and serve as a liaison between service providers and plan sponsors during the establishment or conversion of the plan. During plan establishment, the adviser typically assists with the participant enrollment process. Often a series of participant meetings are held to inform employees about the plan's terms and its investment options. These meetings may be held on multiple occasions in multiple locations. The adviser may also help employees to complete the appropriate paperwork such as enrollment forms, beneficiary designations and investment selections. For conversion plans, the adviser may also be called upon to assist with the preparation of the blackout notice required by Sarbanes Oxley.

Advisers often provide ongoing education to plan participants and take phone calls from participants regarding plan-related issues such as the impact of taking loans or early distributions. Advisers also frequently assist retiring or terminated employees who need help in understanding their post-employment options. They also educate employees about general investment principles such as the power of compounding and the difference between stocks and bonds. Advisers may also help educate participants about the benefits of diversification and the specific investment options available in the plan.

Advisers prepare summary plan information and periodic reports for the plan sponsor and meet with them periodically to review plan administration, plan statistics and participation rates. Furthermore, advisers provide ongoing support for investment reviews. The investment review typically covers issues such as a comparison of the plan's investment results to relevant benchmarks, the appropriateness of the investment options for the plan's demographics and the consideration of changes to the plan's investment menu.

c. Impact of the proposal on small retirement plans

If the proposal is adopted in its current form, advisers that are compensated for their services through 12b-1 fees would likely no longer be able to provide their services to small retirement plans. Moreover, we have been advised that recordkeepers are unwilling to incur the costs to modify their systems to accommodate the aging and conversion of shares. As a result, only shares with 12b-1 fees of 25 basis points or less would be available.

As discussed in the example above, an adviser's firm receives $1,900 per year for the services the individual adviser provides to plans that invest in R-2 shares through our Recordkeeper Direct Program. The individual adviser receives a portion of this amount. The proposal would reduce this compensation to roughly $600 per year because the maximum payment to advisers could not exceed 25 basis points. For R-3 shares the annual compensation would be reduced from $3,800 per year to $1,900 per year. It is not economical for most advisers to provide their services for this level of compensation. It is also important to note that many plans (for example start-up plans) are much smaller than the plans in this example. In the case of these plans the adviser may not receive meaningful compensation for years despite providing significant services to the plans and their participants.

We believe that many small employers will not be able to pay for the services of an adviser directly. In addition, they would not want these expenses to be deducted from participant accounts. Therefore, the sponsor will either have to limit the benefits provided to plan participants or move the plan's assets to investments that provide a higher level of compensation for these services, such as group variable annuities or collective investment trusts. These investments have no constraints on compensation and are not subject to the protections of the federal securities laws. In fact, since the proposal was issued we have observed that many plan sponsors are considering moving their plans to group annuities and collective investment trusts. We believe these consequences are inconsistent with the broader policy of encouraging individuals to save for retirement through low cost, regulated investments and have the potential to exacerbate our country's retirement savings crisis.

An annual fee of up to 75 basis points would allow most advisers to continue to provide their services to small retirement plans at a reasonable rate. This fee would not result in a windfall to advisors to larger plans because ERISA requires that plan sponsors ensure the plan's fees are reasonable. Moreover, there have been a number of high profile lawsuits brought against institutions accused of causing plans to bear unreasonable expenses. Large retirement plans are also sophisticated and typically employ consultants to evaluate fees. Accordingly, it is unlikely that a large plan would overpay an adviser for services. The Department of Labor's recently adopted disclosure rules also enhance the transparency of fees paid by retirement plans. Furthermore, broker-dealers are prohibited from receiving excessive compensation and must recommend suitable plan investments. A fund with a 75 basis point payment to a financial adviser would likely not be suitable for a large plan. If a fiduciary standard is adopted for broker-dealers these protections would be further strengthened.

4. Costs and benefits of the proposal

We believe that the Commission's economic analysis contained in the proposal grossly understates the costs relative to the benefits associated with the proposal. The Commission must conduct a more thoughtful and extensive analysis of the costs and benefits of the proposal, particularly with respect to the proposed changes to rule 6c-10.

Although the proposal permits funds to offer a class of shares that would allow broker-dealers to set their own sales charges, we believe most funds will have no choice but to offer this share class because of broker-dealer demand. Section 22(d) of the Investment Company Act allows fund advisers to set the sales charges on the funds they manage. Advisers are in the best position to determine fund sales charges because they have two powerful incentives to set sales charges at a reasonable rate. One, advisers seek to maximize assets under management. Therefore, in setting sales charges, they seek to balance incenting broker-dealers with reducing the friction that would result from assessing sales charges that are too high. Two, advisers must deduct the maximum sales charge from fund investment results. Higher sales charges obviously hurt results and vice versa. Generally, better results equal more assets to manage. Allowing broker-dealers to set fund sales charges seems inconsistent with this policy since broker-dealers do not have the same incentives as fund advisers.

In addition, many fund complexes retain a portion of fund sales charges to pay for distribution-related expenses. For example, funds with front-end sales charges of 5.75% may retain 75 basis points for distribution-related expenses. If broker-dealers set the sales load, they could charge the same rate and retain an additional 75 basis points. This would result in shifting hundreds of millions of dollars per year in distribution costs to mutual fund advisers in exchange for little or no benefit to shareholders.

Furthermore, the proposal will impose significant programming costs associated with aging and converting shares. These costs will ultimately be borne by fund shareholders. As discussed above, the proposal's constraints on adviser compensation may result in investors moving to alternative investments that pay a higher level of compensation. It is unreasonable to impose the costs to develop systems to age and convert shares when the proposal is likely to cause investors to abandon mutual fund share classes with 12b-1 fees higher than 25 basis points. Allowing funds to charge up to 75 basis points with board approval, would accomplish the Commission's goal of limiting 12b-1 fees and significantly reduce the costs of complying with the rule.

Moreover, we do not believe the Commission can conduct a proper cost-benefit analysis without first determining the proper standard of care for investment advisers and broker-dealers. As discussed above, changing the standard of care of broker-dealers will result in additional obligations and require individual representatives to perform additional services for their clients. These costs must be considered to appropriately determine the level of compensation paid to advisers.

In addition to these issues, because the proposal will discourage many small employers from offering mutual funds in their 401(k) plans, it will have an adverse impact on the ability of small businesses to compete with larger businesses that can offer mutual funds in their plans. Therefore, the proposed rule should be considered "major" under the Small Business Regulatory Enforcement Fairness Act of 1996 and subject to Congressional review. Further, the proposal will likely make mutual funds less attractive to small retirement plans than other investment options. We believe this would place mutual funds at a competitive disadvantage with these alternative investments, and place an unnecessary burden on competition prohibited by section 23(a)(2) of the Securities Exchange Act of 1934.

5. Payments for personal advisory services

The proposal questions whether it is appropriate to use fund assets to pay for personal advisory services. We believe this use of fund assets is appropriate because the advice and service benefits shareholders of the fund. A contrary conclusion would be inconsistent with the Commission's endorsement of an ongoing marketing and service fee as well as the proposal's suggestion that certain expenses, such as plan administration and recordkeeping, may legitimately be included in fund expenses.

We also believe that many investors prefer to pay expenses for personal advice and service through the fund because it is more tax-efficient than paying the fees directly. This is because fees paid by funds are from pre-tax dollars, while fees collected from the individual shareholder are from after-tax dollars and deductible only to the extent they and other "miscellaneous" expenses exceed 2% of income. Additionally, fees for personal advice and service paid under a 12b-1 plan are clearly disclosed to investors as a separate line item in the prospectus.

The Commission also raises concerns that mutual funds may be subsidizing other investments held by retirement plans that do not provide compensation for plan service and recordkeeping. Based on our discussions with retirement plan administrators, other types of plan investments, such as collective investment trusts and group annuities also provide compensation for plan service and recordkeeping. Therefore, there is a substantial question as to whether this concern is valid.

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Thank you for considering these comments. Please contact me (213-615-0404), Mike Downer (213-486-9425) or Paul Roye (213-615-0418) if you have questions or would like additional information.

Very truly yours,

T. McH

Timothy McHale
Counsel

cc: The Hon. Mary L. Schapiro, Chairman
The Hon. Luis A. Aguilar, Commissioner
The Hon. Kathleen L. Casey, Commissioner
The Hon. Troy A. Paredes, Commissioner
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