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Mr. David Grim
Director, Division of Investment Management
Mr. Douglas J. Scheidt
Associate Director and Chief Counsel, Division of Investment Management
United States Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

Re: Request for interpretive guidance regarding Section 22(d) of the Investment Company Act of 1940

Dear Sirs:

We respectfully request the Staff of the Securities and Exchange Commission (the "Commission") to issue narrowly-tailored interpretive guidance that the restrictions of Section 22(d) of the Investment Company Act of 1940 (the "Act") do not apply to a broker, as that term is defined in the Act, when the broker acts as agent on behalf of its customers and charges its customers commissions for effecting transactions in a class of shares of a registered investment company (a "fund") without any front-end loads, deferred sales charge, or other asset-based fees for sales or distribution ("Clean Shares") as set forth in this letter. Such guidance would alleviate many of the issues that have arisen for the mutual fund industry under the Department of Labor's fiduciary rule (the "DOL Rule"). Further, the proposed guidance would allow for a brokerage model where funds, ETFs, individual securities and other 'like' investment options could compete on returns and fees. The proposed model also preserves choice for investors who prefer to invest through a brokerage model and provides further transparency regarding the fees they pay and the associated services.

The DOL Rule was designed to mitigate conflicts of interest in the provision of investment advice to retirement plan participants, including Individual Retirement Account ("IRA") investors. It is particularly focused on the activities of brokers. A principal way that the DOL Rule seeks to address conflicts is by eliminating financial incentives that could cause a broker to recommend one investment offering over another. In this regard, the DOL Rule shows a preference for arrangements in which the financial adviser receives payments only from the investor and not from third parties. We believe, however, that as a matter of practice the standard created by the DOL Rule will become the de facto standard for all account types. Conversations we have had with many broker-dealers and our past experience with them result in our view that a vast majority of broker-dealers will not be able to (or want to) treat a client's IRA account and taxable account differently.

Because Section 22(d) and Rule 22d-1 under the Act generally require that funds, and not broker-dealers, set the pricing on sales charges to investors, broker-dealer firms would appear unable to unilaterally adjust their business models to preserve a brokerage option that meets the requirements of the DOL Rule. Further, broker-dealer firms employ a diverse array of business models. Given that fund firms may not collaborate on pricing models due to concerns around anti-trust violations, the industry is finding it difficult to coalesce around commission-based share class pricing structures that would work under the DOL Rule.

Without a viable brokerage solution, investors who are in a brokerage account will (i) be moved at a rapid pace to an advisory model with ongoing, asset-based fees for advice and service, (ii) find their investment options significantly limited and/or (iii) no longer have access to investment advice. These outcomes cannot be what was intended by the Department of Labor when designing this rule, as they are clearly less advantageous than brokerage-type investing for many investors. This is particularly true for buy-and-hold investors who can save considerably by paying a one-time commission rather than an ongoing annual advisory fee.

We understand that certain broker-dealer firms are contemplating a brokerage platform on which they will apply their own commission to fund transactions. Other firms are taking a more cautious approach, in part due to uncertainty around the applicability of Section 22(d). Though Section 22(d) does not apply to brokers, many firms are unsure whether their sales-related activities under these new business models could cause them to be treated as dealers by the Commission. The Staff could solve for this confusion by clarifying that when a broker-dealer acts as agent on behalf of its customers and effects transactions in Clean Shares (with the consent of the fund firm), that broker-dealer may charge a commission without being subject to the restrictions of Section 22(d). This reasoning follows from Commission guidance and Staff no-action letter precedent. Without such Section 22(d) guidance, the current state of play could create a first mover advantage for those firms that are planning to implement this type of brokerage platform. The industry would benefit from a level playing field, where all broker-dealer firms are on the same footing.

The proposed guidance would not require the Commission to weaken any of the important public policy considerations supporting Rule 22(d). It would simply clarify the conditions under which a broker-dealer would be considered to be acting as a broker in the fund context, which conditions are fully aligned with the DOL Rule's focus on transparency and conflicts of interest. This would allow the Commission to control the practices in this area rather than allowing broker-dealer firms to pursue practices that may be inconsistent with Section 22(d).

Section 22(d) guidance

Section 22(d) and Rule 22d-1 under the Act require that funds, and not broker-dealers, set the pricing on sales charges to investors. As such, sales charge schedules are embedded in the share class structure of funds in the current brokerage model. In part due to these embedded payments, there are appropriate questions about whether broker-dealers are acting in a broker or dealer capacity when engaged in the distribution of fund shares with embedded sales charges.

A fund share class that does not pay any compensation to third parties looks very much like ETF shares. It should be noted that ETFs do not typically pay any compensation to third parties (other than fees paid to its investment adviser) out of fund assets, including rule 12b-1, sub-transfer agency and record-keeping fees. In fact, ETFs and funds are increasingly being used side by side. Evidence of this is the fact that Morningstar recently announced that it will no longer treat ETFs and funds separately. Morningstar will now commingle them in common categories since they are used interchangeably in portfolios. While fund shares do not trade on an exchange at a price other than net asset value, we believe that the activities performed by brokers when using each of these structures is consistent in a way that warrants equivalent treatment for Section 22(d) purposes.

We are seeking narrowly tailored guidance from the Staff that broker-dealers making available Clean Shares would be acting as brokers, and not dealers, and thus able to set commissions on such transactions without being subject to Section 22(d). This type of Clean Share class is more closely aligned with an ETF share and should be treated the same. This would allow funds to exist on the same brokerage platform with ETFs and individual securities. This brokerage model would eliminate broker conflicts of interest, mitigate compliance risks for brokers under the DOL Rule and preserve choice for investors who prefer to invest under a brokerage relationship. Further, this model would provide greater transparency for investors who would be better able to discern to whom the fees they pay are going and what those fees are paying for. It would also solve for the collective action problem by letting each broker set pricing of all of the investment options it provides (e.g. funds, ETFs and individual securities).

Investors will have the ability to compare and contrast the commissions charged by different brokerage firms in the same way they do today with ETF and individual securities transactions and determine which combination of commissions and services suits their investment needs. In addition to brokers having an incentive to 'advertise' the commissions they charge and the services they provide as they compete for investor assets, pursuant to Rule 10b-10 under the 1934 Act, a broker in these circumstances would be required to disclose in writing to a customer for which it transacts information specific to the transaction, including, among other things, whether the broker is acting in an agency or principal capacity and, if it is acting as agent, its remuneration, including any third-party remuneration it has received or will receive. Further, the DOL Rule provides for point of sale disclosure that includes the amount of commission the investor will pay on a transaction, a practice that will likely extend beyond transactions made for IRA accounts.

The Schwab and LPL line of Staff no-action letters[1] stand for the proposition that a broker-dealer acting in its capacity as a broker only, could charge a 'transaction' fee for the sale of a no-load (or low load) fund share class to the extent that fee is solely for the cost of the services provided to its customers and not a duplicate fee without running afoul of Section 22(d). The Staff addressed the no-action requests in the 1992 Schwab and the LPL letters on the basis of the firm acting as a broker and the applicability of Section 22(d) to dealers and not brokers. This view is consistent with the wording of Section 22(d) and both early Commission and Supreme Court interpretations of Section 22(d). Shortly after the Act was adopted, the Commission's General Counsel noted[2] that there was a difference between acting as a broker and acting as a dealer. The guidance stated that "the term dealer, as used in Section 22(d), refers to the capacity in which a broker-dealer is acting in a particular transaction. It follows, therefore, that if a broker-dealer in a particular transaction is acting solely in the capacity of agent for a selling investor, or for both a selling investor and a purchasing investor, the sale may be made at a price other than the current offering price described in the prospectus." The Supreme Court also considered the scope of Section 22(d) in the U.S. v. National Association of Securities Dealers (1975)[3] anti-trust case, stating that "neither the language nor legislative history of Section 22(d) justifies extending the section's price maintenance mandate beyond its literal terms to encompass transactions by broker-dealers acting as statutory brokers."

Extending the reasoning of the 1992 Schwab letter and the LPL letter, the requested guidance would recognize the ability of a broker-dealer acting as a broker, to charge a commission that would compensate its registered representative for the sale of fund shares also without running afoul of Section 22(d). Because Section 22(d)'s restrictions apply to dealers, brokers would have to represent that they are acting solely in an agency capacity when they sell fund shares to clients on these brokerage platforms. Any broker-dealer transacting in fund shares under this model would have to make this representation in a selling agreement, or an amendment to an existing selling agreement, with the fund's underwriter.[4] The LPL Staff no-action letter recognized that the broker-dealer firm may have selling dealer agreements with funds that are available on certain platforms, but that it could act solely on an agency basis for those funds on another platform in another capacity. Further, as previously stated, pursuant to Rule 10b-10 under the 1934 Act, the broker is required to notify the client for which it transacted whether it acted in an agency or principal capacity.

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[1] Charles Schwab & Co., Inc. (avail. Feb. 8, 1982); Charles Schwab & Co., Inc. (avail. Feb. 2, 1987); Charles Schwab & Co., Inc. (avail. Aug. 6, 1992); Linsco/Private Ledger Corp. (avail. Nov. 1, 1994).
[2] Inv. Co. Act Rel. No. 87 (Mar. 14, 1941).
[3] 422 U.S. 694 (1975)
[4] See attached Exhibit A for sample selling agreement language.

The requested guidance would also apply only to fund shares that did not have any compensation for distribution payable to the broker-dealer firm, further demonstrating that the broker is not associated with the fund in connection with these type of fund shares. The receipt of distribution payments from the fund by the selling broker-dealer or its affiliates or payments from the fund's underwriter, investment adviser or their affiliates to the selling broker-dealer for distribution based on transactions under this model would raise questions about whether the selling broker was acting as a broker solely on an agency basis for the customer. This would essentially create a brokerage offering analogous to the level fee fiduciary arrangement contemplated by the DOL Rule in which the financial adviser does not receive any third-party payments. Fund shares sold on other brokerage platforms that resemble current brokerage models (with "A" share type pricing) would remain subject to Section 22(d), Rule 22d-1 and the restrictions set forth therein.

We recognize that the Commission addressed Section 22(d) in 1972 in Release No. 7475 stating that "the imposition of any charge for recommending the shares or for effecting the purchase of… a [no-load] fund, especially if the fund encourages or has knowledge of the practice, has been viewed as an impermissible deviation from the prospectus representations as to no-load status as well as a violation of Section 22(d)." However, in 1974[5], the Commission authorized the Division of Investment Management staff to view favorably interpretive requests with respect to proposals that brokers which act independently of funds and their underwriters be permitted, under certain circumstances, to charge reasonable fees for sales-related services rendered in connection with no-load purchases. The Commission further stated that permitting such charges should provide brokers with an incentive to recommend no-load shares somewhat comparable to that existing with respect to other securities, and compensate brokers for services rendered in connection with no-load purchases.

We urge the Staff to recognize how the landscape of fund sales and the brokerage model has changed since this guidance was released in 1974, particularly in light of the DOL Rule. In 1974 the Commission could not have anticipated the proliferation of share classes within funds and that a single fund would have a 'no-load' share class sit alongside a share class with an up-front commission. The Commission could also not have anticipated the development of the ETF model and differences in the way ETFs would be sold as compared with funds. As previously stated, though the DOL Rule may have prompted this request, we found no reason under Section 22(d) to treat differently the activities of a broker selling Clean Shares to retirement investors from the activities of a broker selling Clean Shares to non-retirement investors.

Consistent with acting as a broker, the guidance could be conditioned on the following:

1. The broker will represent in its selling agreement with the fund's underwriter that it is acting solely on an agency basis for the sale of Clean Shares;

[5] SEC Investment Company Act Release No. 8570 (Nov. 4, 1974).

2. The Clean Shares sold by the broker will not include any form of distribution-related payment to the broker;

3. The fund's prospectus will disclose that an investor transacting in Clean Shares may be required to pay a commission to a broker, and if applicable, that shares of the fund are available in other share classes that have different fees and expenses;

4. The nature and amount of the commissions and the times at which they would be collected would be determined by the broker consistent with the broker's obligations under applicable law, including, but not limited to, applicable FINRA and Department of Labor rules; and

5. Purchases and redemptions of Clean Shares will be made at net asset value established by the fund (before the imposition of a commission).

<u>Narrowly-tailored guidance will preserve investor choice and create competition</u>

We urge the Staff to view the imposition of a commission by the broker subject to the conditions set forth above as a logical extension of the 1974 Commission guidance and relief granted in the Schwab and LPL line of Staff no-action letters. By their nature, the commissions charged by brokers on fund transactions will be reasonable. Brokers will compete on the commissions charged and the services provided. A free market of this kind will drive prices charged for the service provided to a reasonable fee an investor is willing to pay. Further, FINRA Rule 2121 imposes an obligation on a broker acting as an agent for his/her customer not to charge more than a fair commission or service charge, taking into consideration all relevant circumstances.

We believe that the proposed guidance is only an appropriate solution where the broker-dealer is acting solely as a broker and not receiving ongoing remuneration for distribution from the fund or other distribution-related payments from the fund's sponsor or its affiliates. We believe that funds should continue to maintain control of pricing when the broker-dealer is acting as in its capacity as a dealer and that Section 22(d) and Rule 22d-1 should still apply under those circumstances.

Allowing brokers to impose their own commissions on the terms set forth above would put funds, ETFs and individual securities on equal footing on brokerage platforms and be consistent with the well-established purposes of Section 22(d) set forth below.

1. Riskless trading and dilution. The line of Schwab and LPL Staff no-action letters has established that the imposition of a fee on a fund share sold at net asset value is consistent with the purpose of 22(d) to address riskless trading by insiders and the dilution of fund assets.

2. Orderly distribution. By establishing that fund shares must be purchased or redeemed at the net asset value established by the fund, there would be no reason for a secondary market to evolve. Purchases and redemptions of fund shares would continue much like they do today, with the only difference being that the broker would set the commission instead of the fund. To the extent that there are concerns that externalizing commissions would facilitate the development of a secondary market in fund shares, Section 22(f) permits funds to manage any secondary market in fund shares and preserve an orderly distribution system. In this regard, a fund could restrict the sale or purchase of fund shares in its prospectus pursuant to Section 22(f) of the Act to transactions in which shares are only purchased by the investor from the fund or redeemed from the investor by the fund. The fund firm could also include language in its selling agreement with each broker-dealer prohibiting the firm from creating a secondary market in the fund's shares (see Exhibit A for an example).

3. Discrimination among investors. It is well founded that the purpose referred to is the 'unjust' discrimination among investors in the same fund. The Commission has followed the premise that discrimination is not unjust, and thus the purpose of Section 22(d) not violated, if there is a rational basis for the variation in the sales load. By creating competition amongst brokers charging commissions for their services, variations in commissions will by their very nature be derived from a rational basis and investors will benefit from being able to choose the brokerage model from the broker that suits their needs. As noted above, this type of free market will result in reasonable fees charged for the services provided, thereby eliminating any discrimination among investors.

<u>Benefits of relief</u>

We do not believe that the intention of the DOL Rule was to make the brokerage model no longer viable, but rather to eliminate the conflicts that the Department of Labor saw as inherent in the current brokerage model. That is, we do not believe that the DOL is opposed to commissions per se, but rather conflicts largely attributable to the product manufacturer setting commission rates for fiduciary financial advisers. Importantly, since most fund firms already offer stripped down, institutional-like share classes, the relief would be easy for most firms to implement without creating a further proliferation of share classes.

The solution we describe in this letter is one way to facilitate investor choice and to accomplish the DOL Rule's goal of eliminating conflicts in the brokerage model. Financial advisers would receive the same compensation on investment options they recommend for their client, thereby allowing the financial adviser to focus on the best investment for that client and his/her financial situation. When a financial adviser is acting in a dealer capacity there is a different relationship and funds should continue to control pricing.

The guidance we are requesting would allow for a brokerage model where all 'like' investment options were treated equally. This creates a fair, free-market environment where brokers compete on pricing and services. Further, this model preserves choice for investors who prefer to invest through a brokerage model and provides further transparency regarding the fees they pay and the associated services. This model would also allow funds, ETFs, individual securities and other 'like' securities to compete in a brokerage model on fees to the fund's investment adviser and returns, and not on external forces artificially driving sales to any specific investment option. In the end, all of these developments would benefit the investor who values the brokerage investment model. These investors will have greater clarity into the services and costs offered by different brokers which will create greater opportunity for the investor to pick the broker that offers the best combination of service and cost to suit their investment needs. Further, this brokerage model would subject fund commissions to the same competitive pressures that have been placed on equity and ETF commissions. We note that over the past couple of decades, equity and ETF commissions have fallen substantially for investors.

We believe the above sets forth the basis for the Staff to issue interpretive guidance under Section 22(d). We would welcome the opportunity to discuss this request at your earliest convenience.

Sincerely,

Michael Downer

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Senior Counsel and Secretary,
Capital Research and
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Paul F. Roye
Senior Vice President
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Capital Research and
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cc: Sara Crovitz, Associate Director / Deputy Chief Counsel, Division of Investment Management

EXHIBIT A

Sample Selling Agreement Language

1. You may charge a commission or other transaction based fee on purchases and sales of Class [ ] shares of the fund on your firm's brokerage platform. To the extent such a fee is charged, you represent that you are acting solely as an agent for your customer with respect to their purchase or sale of [ ] shares. Any such commission will be charged in a manner consistent with applicable FINRA rules.

2. Purchases and sales of the fund's Class [ ] shares may only be executed as purchases or redemptions between the investor and the fund. You shall not execute trades of Class [ ] shares between investors.