S70303-18

Capital Research and Management

Capital Research
and Management Company
333 South Hope Street
Los Angeles, California 90071-1406

Phone (213) 486 9020

David M. Givner
Counsel

April 17,2003

Mr. Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, DC 20549-0609

Re: Compliance Programs of Investment Companies and Investment Advisers
File No. S7-03-03

Dear Mr. Katz:

We appreciate.the opportunity to respond to the Commission's release seeking comments and suggestions on (i) compliance programs of investment companies and investment advisers and (ii) enhanced private sector involvement in overseeing compliance. Capital Research and Management Company is the investment adviser to a number of registered investment companies, including The American Funds Group. With approximately $330 billion in assets, The American Funds Group is the nation's third largest fund complex.

We believe that generally speaking, compliance procedures at advisers to mutual funds are comprehensive and excellent. However, given the important role of compliance relative to mutual funds, **we** support the concept of, in essence, codifying compliance best practice in a rule, but strongly **oppose** the concept of reducing direct oversight of fund advisers by the Commission.

We appreciate the opportunity to comment specifically on the main parts of the release, starting with compliance programs of investment companies and investment advisers.

I. Compliance Programs of Investment Companies and Investment Advisers

In the release, the Commission is proposing new rule 38a-1 under the Investment Company **Act** of 1940 (the "Investment Company Act"). This proposed rule would require funds and advisers to (i) adopt and implement policies and procedures reasonably

designed to prevent violations of the securities laws; (ii) review these policies and procedures at least annually; and (iii) designate **a** chief compliance officer.

A. Policies and Procedures Reasonably Designed to Prevent Violations of the Securities Laws

The first part of proposed rule 38a-1 would require funds and advisers to adopt and implement written policies and procedures reasonably designed to prevent violations of the securities **laws.** The Commission notes that the policies should be designed to prevent violations, detect violations, and correct promptly any material violations. Further, the Commission states that policies and procedures required under the proposed rule may incorporate policies and procedures already required by federal securities laws. Finally, **the** rule would allow funds and advisers to delegate compliance functions to service providers, with proper oversight.

We agree that any rulemaking in the compliance area should recognize the fact that internal controls cannot and should not be expected to guarantee that violations will not occur per ***se.*** Accordingly, **we** think the Commission's "reasonably designed to prevent violations" standard may not be the best guideline. Perhaps a "promoting compliance" standard would be more appropriate. In addition, we have a few general concerns with the rule as currently proposed. These concerns are divided into three categories: (i) overlapping policies and procedures; (ii) minimum compliance standards; and (iii) burden.

1. Overlapping Policies and Procedures

In the release, the Commission enumerates over **a** dozen possible areas the policies and procedures might cover if the proposed rule were adopted, and notes that funds and advisers may incorporate policies and procedures that are already required under federal securities **laws** to satisfy proposed Rule 38a-1.

We support the idea of a comprehensive listing of policies and procedures, but urge the Commission to allow a fund to incorporate by reference applicable policies and procedures of its service providers. For the vast majority of the compliance areas proposed in the release, federal securities laws require funds and advisers to maintain policies and procedures

already, absent proposed rule 38a-1.[1] We suggest that when funds and advisers, or other service providers already have policies and procedures that are also required under proposed rule 38a-1, that reliance upon, or a simple cross-reference to, such policies and procedures be sufficient to satisfy that portion of policies and procedures drafted pursuant to the proposed rule. The goal should be that a fund, in conjunction with its adviser and other service providers, maintain all appropriate policies and procedures, regardless of whether all *of* these policies and procedures are maintained by the fund itself or in one central location.

2. Minimum Compliance Standards

The Commission specifically asked in the release whether there should be certain minimum policies and procedures. We believe that such a requirement could be counter-productive and, at a minimum, unnecessary.

Funds and advisers should be allowed to match the level of detail of their compliance programs with the complexity of their business operations. We believe that charging funds and their advisers with creating policies **and** procedures reasonably designed to prevent violations obviates the need to attempt to set minimum standards. Furthermore, given the complex and diverse nature of this business, any attempt to **set** minimum standards could actually dilute compliance procedures which might be crafted more robustly in the absence of a minimum standard.

In addition, the Commission may wish to consider the impact of technology on compliance. We believe that funds and advisers should be allowed to decide for themselves how to incorporate technology into their compliance programs. Given the rapid advances in technology, requiring a minimum standard of technology that is both effective and suits all funds and all fund complexes is not possible.

If the Commission does adopt minimum compliance standards under proposed rule 38a-1, **we** urge the Commission to give maximum flexibility to funds and advisers in implementing the rule, perhaps by offering only suggested areas of coverage versus an enumerated list of areas that must **be** covered under the proposed rule.

---

[1] For example, **Rule** 17(j)-I of the Investment Company Act requires each fund, investment adviser and principal underwriter of the fund **to** "adopt **a** written code of ethics containing provisions reasonable necessary to prevent" certain persons affiliated with the fund, its investment adviser, or principal underwriter from engaging in certain fraudulent, manipulative, and deceptive actions with respect to the fund. See **17** CFR 270.17j-1(c)(1).

3. Burden

Mutual fund internal compliance procedures already mandated by the Commission place a significant burden on the fund industry. However, on balance we believe that this burden is outweighed by the benefits of a compliant fund industry. The Commission should carefully consider whether and to the extent to which additional regulation in this area could tip the scale in this regard. Could additional regulation be a net negative in that it does not produce significant benefits, but has the effect of driving out smaller fund advisers into mergers with larger fund advisers? If **this** would result in substantially less competition, would the investing public be well served?

B. Annual Review of Policies and Procedures

The proposed rule would require a fund **or** an adviser to review its policies and procedures **at** least annually to determine their adequacy and the effectiveness of their implementation. We generally believe that policies and procedures should be reviewed on an **"as** needed" basis. Some policies and procedures change more frequently than annually and should be reviewed as conditions warrant a change, not on an arbitrarily set, and possibly outdated and after-the-fact, annual schedule. Moreover, other policies and procedures may not change for years and an annual review of these policies and procedures would be unnecessary. Policies and procedures should be reviewed as circumstances warrant such a review, not on a specific time table.

C. Chief Compliance Officer

The proposed rule would require each fund and adviser to designate a Chief Compliance Officer ("CCO") for administering the compliance policies and procedures. For funds, fund boards would have to approve the CCO. Also, the CCO would be required to provide the board with an annual written report on the operation of the fund's policies and procedures. Finally, the CCO generally would not necessarily **be** liable for compliance violations if he or she acted reasonably in discharging supervisory duties and reasonably followed the compliance policies and procedures in place. There are three points we would like to make **with** respect to the CCO and the board requirements under **the** proposed rule.

Compliance is **a** vast, complex and diverse area, Accordingly, in larger organizations, compliance may be handled **by** many individuals. Therefore, **we** believe **that** funds and advisers should be given the option of designating a group

or committee to satisfy the CCO requirement. **A** representative of the group or committee could then be charged with reporting to fund boards.

In addition, the CCO should be the person or persons most knowledgeable about compliance matters. This person (or persons) may not necessarily be a member of senior management. For this reason, we believe that this requirement should be eliminated.

Finally, we believe that a fund's board should not have to approve the CCO. The Commission notes in the release that the proposed rule "would require board oversight of **the** fund's compliance program, but would not require directors to become involved in the day-to-day administration of the program." Approving **the** CCO, or other personnel, appears to be akin to day-to-day administration of the compliance program rather than oversight. Moreover, the CCO most likely will not be a fund employee, but rather an employee of a service provider, making it awkward for the fund board to approve an employee of a separate entity. For **these** reasons, we believe that a fund board should not have to approve the CCO. The board's oversight role should be limited to reviewing the written report presented by the CCO.

II. Enhanced Private Sector Involvement in Overseeing Compliance

The release outlines several possible approaches to enhancing private sector involvement, including: **(A)** third-party compliance reviews and expanded audits by independent public accountants; (B) one or more self-regulatory organizations; and (C) fidelity bonds for advisers. We appreciate the opportunity to comment on each of these suggestions below.

A. Third-Party Compliance Reviews and Expanded Audits by Independent Public Accountants

The Commission has suggested that each fund and adviser could undergo periodic compliance reviews by a third party that would produce **a** report of its findings and recommendations. Alternatively, the Commission has suggested that the role of independent public accountants could be expanded to include certain compliance review procedures currently performed by the Cornmission during a compliance examination. While we believe that funds and advisers should be free to include third parties in their compliance programs, we urge the Commission not to make this a mandatory requirement. **A** mandatory requirement along these lines could actually be counter-productive.

For example, if funds and advisers are allowed to rely on third party compliance checks, they may reduce the number of their own internal checks, making the discovery of compliance problems less likely. If only a negative assurance audit would be required, there is **a** possibility that firms with currently robust compliance auditing procedures would cut-back on their auditing programs to a minimum level established by the Commission.

Finally, we also question how much of the Commission's examination time and effort would be reduced by either of these proposals. The Commission already reviews accounting records to find legal problems which are not currently **part** of the auditor's review. Going forward, we believe the Commission would most **likely** still review the accounting records.

If the Commission did delegate some of the examination duties to a third party, how would conflicts be addressed? What would **happen** if the third party auditors recommended one course of corrective action and **a** fund followed such action only to be told by the Commission that such action was incorrect? If the answer is that the fund should have followed the Commission's advice, then there is no incentive for any fund to undergo an expanded audit. We believe that an expanded public accounting/third party role would not substantially decrease the examination time needed by the Commission staff.

B. One or More Self-Regulatory Organizations

The Commission has suggested that a self-regulatory organization ("SRO") might enhance fund compliance. If established, the SRO would: (i) establish business practice **rules** and ethical standards; (ii) conduct routine examinations; (iii) require minimum education or experience standards; and (iv) bring its own actions to discipline members for violating its rules and the federal securities laws.

Again, we believe that the best regulator for the industry is the Cornmission itself, not an SRO. Given **the** highly sensitive nature of the investment advisory business, the Commission should be directly involved, and should not delegate its responsibility.

An SRO would add another, **possibly** duplicative, layer of regulation on funds and advisers. Also, we believe that whatever fees would be charged to funds and advisers for the creation and maintenance of an SRO would be substantial and ultimately would get passed on to the investing public.

In conclusion, we strongly believe that the Commission should speak with one voice and enhance **its** current enforcement procedures, not delegate them to **a**

third party, whether related to the Commission or not. Compliance and enforcement are too important to this industry to have the Commission delegate its power to a third party.

C. Fidelity Bonds for Advisers

The Commission has suggested that advisers obtain fidelity bonds from insurance companies. In practice, almost all advisers already have fidelity bond coverage. We do not have an issue with the Commission if it chose to codify a practice which is virtually universal throughout the industry.

III. Conclusion

We believe that a fully-funded and well-staffed government agency that deals with funds and advisers at arm's length, such as the Commission, is **the** best **way** to regulate our industry. Due to **the** increased funding recently received by the Commission, we urge the Commission to direct some additional resources to the examination effort. Hopefully, with increased resources the Commission will come to the conclusion that what is really needed is more resources in the examination area and enforcement of the rigorous set of existing rules already in place, not **the** creation of more bureaucracy, more rules, and potentially more regulators.

Again, we appreciate the opportunity to comment on the release and hope that the Commission's efforts in this area result in even further compliance in our industry on top of the exemplary compliance record our industry has shown for over seven decades.

If you have any questions or would like additional information, please contact the undersigned or Michael J. Downer at (213) 486-9020 or (2**13)** 486-9425, respectively.

Very truly yours,

David M. Givner