

Letter of Comment No: 5
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THE CAPITAL GROUP COMPANIES, INC.

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JAMES M. BROWN
Senior Vice President and Treasurer

September 1, 2004

Mr. Lawrence W. Smith
Director – TA&I – FSP
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
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Subject: Comments on Proposed FSP Regarding Mutual Fund Distribution Fees

Dear Mr. Smith:

It was a pleasure meeting with you and others last week to discuss the above referenced issue. We certainly appreciate your time, but I'm only sorry that we were unable to have broader Board representation as it was apparent that there is still some confusion with respect to the specifics of 12b-1 B share plans, obligations of the parties and the flow of funds.

As we described in our letter of July 22, 2004, The Capital Group Companies, Inc. ("CG") is a privately owned investment management organization based in Los Angeles, California. It is the parent company of Capital Research and Management Company ("CRMC"), which is the investment adviser to the American Funds group of mutual funds. At June 30, 2004 the American Funds constituted the third largest fund complex in the country with fund assets approximating \$600 billion. For the year ended June 30, 2004, the American Funds sold approximately \$8.6 billion in B shares and since the product's inception in March 2000 sales have totaled approximately \$30 billion.

American Funds Distributors, Inc. ("AFD"), a wholly owned subsidiary of CRMC and principal underwriter and national distributor of the American Funds family of mutual funds (each a "Fund," and collectively the "Funds,"), began distribution of B shares pursuant to Class B Plans of Distribution with each of the American Funds in March 2000. Concurrent with the commencement of B share sales, AFD entered into a Purchase

Agreement (or the "Program") with an affiliate of Citibank whereby Citibank pays AFD a specified percentage of the total issue price of each Class B share sold during the term of the Program. In return for this payment, Citibank receives all right, title and interest in specified revenue streams that are associated with the shares (the "Receivables" or the "Purchased Receivables"). This revenue stream consists of the distribution portion of the 12b-1 fees ("Distribution Fees") and any contingent deferred sales charge ("CDSC") collected in respect of the sales of B shares. AFD has, since inception, accounted for the Program transactions as sales in accordance with the terms of the agreement.

Points of Clarification from our Meeting

- Mutual fund boards have not only the right to terminate 12b-1 plans but the obligation to review such plans annually and affirmatively vote on their continuation. The risk associated with plan termination is, in our case, transferred to Citibank.
- 12b-1 fees paid to B share distributors are typically in the amount of 1% of a fund's average net asset value ("NAV") and consist of a 75 basis points ("bp") fee for *distribution* and a 25 basis points fee for continuing shareholder servicing. The distributor earns the 75 bps at the time of sale of the B shares as all services entitling the distributor to receive the Distribution Fee have been rendered at that point. If the mutual fund board terminates the distributor (but does not terminate the plan) at this point, Citibank would still be entitled to the ongoing 75 basis points Distribution Fee in respect of B shares previously distributed. The 25 bps fee for shareholder servicing is not part of the Program.
- Once Citibank purchases AFD's 12b-1 Distribution Fee income stream, all payments of Distribution Fees from the funds and CDSC fees from shareholders in respect of such B share sales are directly deposited into a collection account designated, controlled, and owned by Citibank. This fact, together with the following Purchase Agreement terms with Citibank, makes it clear that not only is the price received by AFD fixed and determinable, but that AFD has no continuing involvement in the transaction. Pertinent Agreement terms include i) there is no provision for adjustment of the Purchase Price after the purchase; ii) AFD retains no interest in the Purchased Receivables; iii) AFD is not required to refund any portion of the Purchase Price under any circumstances; iv) AFD may not re-purchase the Purchased Receivables nor can Citibank Put the Purchased Receivables back to AFD; v) AFD relinquishes all control over the Purchased Receivables; vi) Both parties intend the transaction to be treated as a sale and under applicable bankruptcy and insolvency laws, the Purchased Receivables would be removed from the bankruptcy assets of AFD; and vii) the Agreement makes clear that Citibank is the party that "owns" the right, title, and interest in the Purchased Receivables.

Accounting Discussion

There was a concern voiced by FASB that suggested that in order to have income recognition at the point of sale by the distributor, there needed to be a liability recorded

elsewhere. While perhaps desirable, the facts in our case don't support the conclusion as the fees sold come from two different payors. First the CDSC fees come from purchasers of the B shares and not the mutual fund. One can hardly imagine that an investor in a B share preparing a GAAP financial statement would record a liability on its financials as opposed to perhaps some footnote disclosure due to the contingent nature of the liability. Similarly, the mutual fund would not have a liability because it is not readily determinable and also subject to various contingencies (uncertainty of market movements, behavior of investors, macro and micro economic changes, etc.) It is the combination of these two disparate streams that form the sales transaction with Citibank.

All would acknowledge, I think, that this transaction does not fit neatly into either FAS 140 or EITF 85-24. However, the draft FSP indicates that the staff believes the classification of cash received from a third party should be based on the provisions of EITF 88-18 "Sales of Future Revenues" - that is, accounted for as either debt or deferred income. EITF 88-18, as you know, indicates "The Task Force did not address the circumstances, if any, in which immediate income recognition might be appropriate." We would respectfully submit that now is the perfect time to address those circumstances in an expansion of EITF 88-18.

Looking back at the specifics of EITF 88-18, the Task Force was faced with a number of situations where companies were selling interests in future, but as yet, unrecognized revenues. Many of the transactions were complex and had indicia of both a secured loan and a sale. The issue was not whether income should be recognized but whether, assuming income should not be recognized, what is the proper balance sheet treatment of a transaction where interests in future revenues are being transferred. Should they be treated as debt or deferred income?

To avoid debt treatment, EITF 88-18 lists six criteria that must be met. Each of the criteria are easily met here: i) each transfer of Purchased Receivables is characterized as a sale; ii) AFD has no continuing involvement in the earnings process since the Agreement expressly provides that at the point of sale AFD has completed the earnings process and its rights are earned and fully vested; iii) each transfer of Purchased Receivables to Citibank is non-cancelable; iv) Citibank's rate of return in respect of each Purchased Receivable is not limited and AFD will never be entitled to share in the return; v) AFD's income has no impact on Citibank's rate of return; and vi) Citibank has no recourse to AFD for default in the payment of the Purchased Receivables by the mutual funds or B share investors. Applying the analysis of EITF 88-18, we think it is clear that in the absence of income recognition, our transaction would be treated as deferred income as opposed to debt. It is equally clear, however, that current income recognition is appropriate as all events determinative of the earnings process have been completed and the amount of income earned has been both fixed and collected.

Final Comment

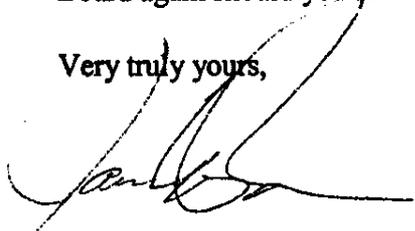
As pointed out in our meeting, the FSP as currently written would result in cash flows to which AFD is no longer a party flowing through its financial statements creating the

opportunity for significant mismatches of income and expense (unless you assume identical amortization of income and expense) or at best a grossed up balance sheet. Booking a deferred cost as an asset (where it's already been sold and proceeds received) and a deferred revenue or debt as a liability (where none contractually exist) appears questionable given our facts.

Lastly, while FASB did not seem particularly concerned with the potential impact to net capital requirements of distributors, which the draft FSP might cause, we would suggest that the possible resulting transfer in cash of \$6-8 billion across the industry required to avoid running afoul of a regulatory requirement is something FASB should consider and perhaps discuss informally with the Division of Market Regulation.

We would welcome the opportunity to provide additional information or meet with the Board again should you have further questions or require additional information.

Very truly yours,

A handwritten signature in black ink, appearing to read 'James M. Brown', written over a horizontal line.

James M. Brown