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August 4, 2017

VIA EMAIL to EBSA.FiduciaryRuleExamination@dol.gov
Office of Exemption Determinations
Employee Benefits Security Administration- Attention D-11933
U.S. Department of Labor
200 Constitution Avenue, N.W.
Suite 400
Washington, D.C. 20210

RE: Request for Information Regarding the Fiduciary Rule and Prohibited Transaction Exemptions
RIN 1210-AB82

Ladies and Gentlemen:

State Farm Mutual Automobile Insurance Company ("State Farm Mutual") and its subsidiaries (collectively "State Farm") write in response to the current Request for Information (the "Request") issued by the Department of Labor (the "Department") in connection with the Department's regulation defining the term "fiduciary" under the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), the Best Interest Contract Exemption (the "BIC Exemption") and the amendments to ERISA Prohibited Transaction Exemption 84-24 (collectively, the "Rule") as issued by the Department on April 8, 2016. State Farm appreciates the opportunity to provide further comment to the Department.

In creating a stark regulatory divide between tax-advantaged accounts[1] and other investment accounts, the Rule poses an enormous—and undue—challenge to consumers of financial services products. Like other industry participants, State Farm has extensively catalogued its objections[2] to the Rule (in both proposed and final form). At this stage of the process, State Farm continues to believe that the Rule will harm American investors by depriving them of advice incidental to transactions on retirement investments. By introducing regulatory confusion and increasing compliance costs and litigation risks for industry participants, the Rule will reduce the

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[1] References in this letter to tax-advantaged accounts (and similar terms) generally refer to all types of tax-qualified vehicles, including but not limited to ERISA plans, tax-sheltered annuities, and all types of individual retirement accounts and individual retirement annuities (including any related policies). Such terms also refer to all other types of tax-advantaged accounts affected by the Rule, including Health Savings Accounts and Coverdell Education Savings Accounts.

[2] Please refer to the comment letters previously submitted by State Farm dated July 21, 2015 (available at: https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/public-comments/1210-AB32-2/00646.pdf), September 24, 2015 (available at: https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/public-comments/1210-ZA25/00359.pdf), April 14, 2017 (available at: https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/public-comments/1210-AB79/01255.pdf), and July 20, 2017.

ability of investors to receive the advice and guidance they need, thus weakening the retirement prospects of the same group of citizens the Rule intends to protect.

In response to the Request and as described in additional detail below:

- The Department should rescind the Rule and instead coordinate with the US Securities and Exchange Commission (the "SEC") to adopt a unified standard of care applicable to all securities products.
- In the event the Rule is retained, substantial modifications are needed to prevent it from reducing the ability of millions of Americans to receive the retirement advice they need.
- A delay in the January 1, 2018 applicability date will allow for a more considered implementation of the Rule's requirements.

BACKGROUND ON STATE FARM

State Farm subsidiaries include property and casualty insurance companies, life insurance companies (State Farm Life Insurance Company and State Farm Life and Accident Assurance Company), a broker-dealer (State Farm VP Management Corp. ("SFVPMC")), an investment management company (State Farm Investment Management Corp.) that manages a family of proprietary mutual funds, and a federally chartered savings bank (State Farm Bank, F.S.B.). The business of State Farm focuses on serving individuals, families and small businesses, especially in the middle-market. Customers of State Farm range from more affluent customers to small businesses and low- to moderate-income customers whose financial services needs are often underserved by other organizations.

State Farm agents market a wide range of basic insurance and financial services products to meet the needs of customers in their communities. Such products include automobile and homeowner's insurance, life insurance and annuities, long-term care and disability income insurance, and consumer banking products (including automobile and home loans, CDs, savings accounts and checking accounts). State Farm also offers investment, annuity, insurance and banking products that generally may be held through tax-advantaged accounts. Thus, the business model of State Farm is based on its ability to offer customers "one stop shopping" for a full range of financial services.

In 2001, State Farm began offering a line of mutual fund products. A significant majority of State Farm agents became registered representatives of the broker-dealer in order to offer these products to new and existing customers. Each registered representative agent must undergo substantial training and sign appropriate agreements with the relevant State Farm entity in order to receive authorization from State Farm to market securities products. These agents also must pass qualification examinations and register with the Financial Industry Regulatory Authority ("FINRA") as representatives of SFVPMC. They are subject to regulatory enforcement actions by FINRA and by the SEC if they violate any of the customer protection and other regulations imposed on them by law and regulation.

As we explained in great detail in prior comment letters, we offer tax-qualified products to an under-served market. The Rule has had a real-world impact on our customers and has placed the industry largely in a state of flux. For example, in response to the Rule and prior to the June 9, 2017 applicability date of the Rule's impartial conduct standards, State Farm made substantial modifications to its business and State Farm agents are no longer authorized to market or service State Farm mutual funds, tax qualified bank products and variable insurance annuity products. At present, purchases of State Farm mutual funds are made by customers on a self-directed basis through a non-advisory call center operated by State Farm. State Farm agents continue to market and service tax-qualified fixed annuities pursuant to a best interest standard. Thus, the concern is not with a best interest standard but rather it is with the BIC Exemption that has a very unfavorable impact on retail investors.

RESPONSES TO THE REQUEST

Regulatory Cooperation is Necessary between the Department and the SEC to Apply Consistent Principles of Securities Regulation to All Accounts

In Question 11 of the Request, the Department asks "[i]f the [SEC] or other regulators were to adopt updated standards of conduct applicable to the provision of investment advice to retail investors, could a streamlined exemption or other change be developed for advisers that comply with or are subject to those standards?"

For over 75 years, the federal securities laws have protected investors of all types through the comprehensive regulation of investment advisers and broker-dealers. Since their passage, these securities laws have been rigorously enforced by the SEC and other regulatory and self-regulatory agencies (including, for broker-dealers, FINRA). Today, these agencies comprehensively regulate broker-dealers and investment advisers, including all of those that serve tax-advantaged accounts. Under this framework, broker-dealers and investment advisers are required to make important disclosures, obtain client consents and adhere to well-established standards of conduct.

In adopting the Rule, the Department fundamentally altered the framework of regulation that has long recognized the difference in the functions of broker-dealers and investment advisers, apparently concluding that the regulation of the investment industry is flawed and unable to sufficiently protect the interests of retirement investors. This is incorrect and fails to recognize the important protections afforded to investors under SEC and FINRA regulation. Both registered investment advisers and broker-dealers are subject to comprehensive regulation and examination. For example, FINRA rules govern every aspect of a broker-dealer's interactions with customers, including requirements relating to:

- pre-relationship due diligence to ensure that the broker understands a customer's needs and can provide effective service (i.e., "know your customer" requirements);[3]
- an obligation of fair dealing, including the provision of recommendations that are objectively and subjectively suitable and satisfy any applicable product-specific requirements;[4]
- fair pricing of mark-ups and commissions[5];
- transparent communications with the public;[6] and
- disclosures to the customer.[7]

These requirements are aggressively enforced by both the SEC and FINRA. The SEC examines both investment advisers and broker-dealers. FINRA conducts routine "cycle" examinations predicated on a risk assessment of each broker-dealer under its jurisdiction as well as "cause" or "targeted" examinations based on consumer complaints, tips, referrals, or other market surveillance.[8] On average, FINRA conducts approximately 2,100 routine cycle examinations each year, with more than half of FINRA's members examined annually.[9] Of course, this active oversight includes examination of products and services offered in connection with tax-advantaged accounts.

The existing regulatory framework protects all investors, including those investing through tax-advantaged accounts. However, to the extent that changes are made to the regulation of broker-dealers or

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[3] FINRA Rule 2090 (Know Your Customer).
[4] FINRA Rule 2010 (Standards of Commercial Honor and Principles of Trade); FINRA Rule 2111 (Suitability).
[5] FINRA Rule 2121 (Fair Prices and Commissions).
[6] FINRA Rule 2210 (Communications with the Public).
[7] FINRA Rules 2260-69 (Disclosures) (including individual rules for the disclosure of specific information).
[8] SEC Section 913 Study at A-11.
[9] Id.; see also Oversight Statistics, FINRA (2014) (https://www.finra.org/newsroom/statistics) (stating that FINRA had 4,028 member firms in 2014).

investment advisers, such as a uniform or "best interest" standard of conduct,[10] these changes should be introduced by, or at a minimum, coordinated with, the SEC, as the agency entrusted to enforce the federal securities laws.

The primary importance of the SEC in this area was clearly recognized by the Dodd-Frank Act, which authorized the SEC to study and possibly promulgate a uniform standard of conduct for broker-dealers and investment advisers.[11] Importantly however—and underscoring the existing regulatory framework's success in serving investors—this authorization also included a mandate to preserve existing business models and forms of compensation.[12]

Certain commenters have previously asserted that a fiduciary duty standard applicable to investment advisers offers inherently better investor protection than the suitability standard to which broker-dealers are subject, and that the fiduciary duty would increase net returns and result in additional savings to investors. State Farm disagrees. These commenters fail to acknowledge that the Rule shifts millions of accountholders to an enforcement framework for investment advisers based on a vague, open-ended standard, thereby forfeiting the robust and clearly defined enforcement framework, administered by the SEC and FINRA, to which broker-dealers are currently subject. They further ignore the fact that investors can and do understand the interests of different providers of investment advice.

Seen in this context, it is clear that the regulatory changes ushered in by the Rule are incompatible with the regulatory framework that has served investors for many decades and unnecessarily divides tax-advantaged savings into a new category for regulatory purposes. State Farm emphatically agrees with the recent statement made by SEC Chairman Clayton that "clarity and consistency—and, in areas overseen by more than one regulatory body, coordination—are key elements of effective oversight and regulation."[13] Thus, in order to help ensure consistent consumer protection regulations across multiple agencies, the Rule should be rescinded pending the resolution by the SEC of its proceedings with respect to a uniform standard of conduct.[14]

In the Event the Rule is Retained, Substantial Modifications are Needed to the Rule to Prevent it from Reducing the Investment Services Available to Millions of Americans.

In the Request, the Department asks a number of questions that suggest it is weighing the need for additional efficiency in the Rule, to ease costs and burdens on industry participants. For example, in Question 3, the Department asks, "do the Rule and the related PTEs appropriately balance the interests of consumers in receiving broad-based advice while protecting them from conflicts of interest?"

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[10] State Farm notes that a similar (though not identical) "best interest" concept is already embodied in broker-dealer regulation. In particular, FINRA has bolstered its Suitability Rule by providing regulatory guidance interpreting the Rule to require "best interest" considerations during the course of a broker-dealer's mandated suitability analysis. See FINRA Rule 2111 (Suitability) FAQ (https://www.finra.org/industry/faq-finra-rule-2111-suitabilityfaq#_edn3). FINRA has also broadened the applicability of the Rule by, for example, requiring suitability analysis to be conducted in the context of recommendations to hold securities, not simply recommendations to transact in securities. See FINRA Regulatory Notice 11-02, Know Your Customer and Suitability (Jan. 2011).

[11] Dodd-Frank Wall Street Reform and Consumer Protection Act § 913(g), amending the relevant provisions of the Securities Exchange Act of 1934, 15 USC § 78o (k).

[12] Id.

[13] Statement of Chairman Clayton, *Public Comments from Retail Investors and Other Interested Parties on Standards of Conduct for Investment Advisers and Broker-Dealers*, June 1, 2017 (available at: https://www.sec.gov/news/public-statement/statement-chairman-clayton-2017-05-31).

[14] An alternative approach would be for the Department to delay the implementation of the Rule until the resolution by the SEC of its proceedings with respect to a uniform standard of care. Once the SEC acts, the Department should issue an exemption for those advisors that satisfy a uniform standard of conduct.

This is the crucial question. The Rule has and will continue to increase regulatory costs and burdens and will increase litigation risk and expenses for those that provide investment services to tax-advantaged accounts. As the provision of investment advice and services becomes more expensive and burdensome to deliver, fewer firms will provide such services to retirement investors[15] and the costs will likely be passed on to consumers. Limited access and higher costs will primarily harm low and moderate income consumers—those most in need of sound retirement advice.

While State Farm is fully supportive of the need to protect investors, the Rule creates unnecessary burdens on industry participants that will ultimately reduce the ability of many Americans to receive the retirement advice they need.

A Compliance-based Safe Harbor Will Advance the Department's Goals and Ease the Compliance Burdens of the Rule.

A key practical objection of State Farm to the Rule is that it requires industry participants to adhere to a conceptual framework that is not well suited to the types of customer interactions that it seeks to regulate. For example, in many cases modest investors are looking for a simple, low cost solution to save for retirement. These interactions are typically far removed from the highly customized investment strategy that may be appropriate for a larger investor (which will often feature a level AUM-based fee of the type favored by the Rule). Adopting a regulatory approach that acknowledges the differences between these customer engagements is critical to developing a workable regulatory framework. The Department should change the Rule to lessen disruption and decrease litigation risk, making industry participants better able to serve the needs of their customers.

The core objection to the Rule is its use of a vague standard that is difficult to interpret and which will become still more complicated after diverging interpretations from various courts in different jurisdictions. A better approach would be the streamlined exemption suggested in the Request. For example, in Question 10, the Department asks whether an exemption could be crafted that is based on a set of policies and procedures that would require advisors to act in a manner consistent with the aims of the Rule. A compliance program of this type could be developed, which, if complied with, would provide a safe harbor from the BIC Exemption contract requirement and/or a private state law right of action.

The policies and procedures for a compliance program safe harbor could be quickly and efficiently developed. Given the clear benefits of this approach, State Farm is confident that industry participants would be eager to work with the Department towards the development of a standardized compliance program containing the elements suggested in Question 10 of the Request.

In fact, State Farm has previously suggested a compliance safe harbor of just this type in its September 2015 comment letter.[16] In that submission, State Farm argued that firms should have some level of certainty with respect to their ability to comply with the proposed BIC Exemption. A safe harbor created around a compliance program would provide that certainty, giving firms the ability to ensure compliance so long as they could establish adherence to a qualifying program.

As proposed by State Farm, this compliance safe harbor would require a firm to adopt written policies and procedures addressing, among other items,

- performing reasonable diligence on the needs and circumstances of an investor,
- a requirement to make a recommendation in the investor's best interest,
- the factors to consider when making determinations of an investor's best interest,

[15] CoreDate Research, Press Release, *Fiduciary Rule to Leave US Mass-Market Investors Stranded, Study Shows* (November 2016). In addition, a variety of press reports have chronicled changes made by various firms that will have the effect of limiting access to services by certain investors. The exact nature of the changes being undertaken by industry participants will likely be better quantified following the completion of the surveys a number of industry associations have undertaken following the partial effectiveness of the Rule.

[16] Comment Letter of State Farm Mutual Automobile Insurance Company, September 24, 2015, at 29.

- the records required to support such determinations,
- training requirements for advisors interacting with customers,
- annual certification requirements for compliance officers,
- the review, oversight and audit of the foregoing elements, and
- consequences for advisors failing to follow such policy.

The elements of this proposed compliance safe harbor were informed by certain of the compliance requirements applicable to registered investment advisers and/or federally chartered fiduciary banks, which similarly owe fiduciary duties to investment customers. As such, they should be generally familiar to most industry participants.

Of course, a degree of interpretation would still be necessary to determine whether the "best interest" of an investor was served in decisions that are later challenged. However, in providing a method to minimize state court litigation of contract claims, such a safe harbor would still provide meaningful relief to industry participants. This is especially true if the meaning of "best interest" is developed to be consistent with the suitability standards applicable to broker-dealers.

The Burdens of the Best Interest Contract Should be Eliminated or Reduced.

Other opportunities exist to make the Rule more efficient to administer. In Questions 5 and 6 of the Request, the Department inquires as to the impact of the contract requirement under the BIC Exemption and the related warranty requirements. For State Farm, these are important questions. The requirement to enter into a separate contract with every existing customer is a costly and disruptive change. In addition, State Farm will need to implement costly control and review procedures to ensure compliance with the BIC Exemption's contractual warranty requirements, resulting in additional costs and/or service reductions that outweigh the benefits to customers.

The interests of investors could be served with less disruption through the creation of a simple, plain-English disclosure that would provide, as suggested in Question 13, information to the investor on the nature of the relationship between firm and client, the applicable sources of compensation and potential sources of conflict. Disclosure of this type would benefit consumers by providing relevant information in a simple, easy-to-understand and readily available format. Similar disclosure is already required of registered investment advisers and is disclosed in Part 2A of the Form ADV. Part 2A is publicly available and required to be provided to investors at or prior to the establishment of an advisory relationship. Part 2A could provide a model for disclosures under the Rule that would be in lieu of an individual customer contract (and for registered investment advisers subject to the Rule this might even contain the same disclosures).

In adopting required disclosures in lieu of the best interest contract, firms would provide clear information to investors without the need for a separate contract and, by extension, the imposition of a state law private right of action where none is authorized by statute.[17] The private right of action is a significant and serious flaw in the Rule, leading only to uncertainty, delay, and increased costs for both consumers and financial services firms.[18]

In the event the Department retains the requirement for a contract, compliance with this disclosure-based safe harbor should establish that the substantive requirements of the BIC Exemption have been met. In addition, the limitations on customary contractual provisions, including class action waivers, imposed by the BIC Exemption should be reconsidered. These limitations are ill-conceived, will create long-running challenges in serving consumers under the exemption and, in certain cases, are in conflict with federal statutes. Indeed, in a recent filing made in the US Court of Appeals, the Department acknowledged that it could not continue to defend the restriction of class action waivers set forth in the BIC Exemption in light of the position the Department was

[17] The private right of action is especially concerning given that even technical violations of the best interest contract where no consumer injury is present could possibly give rise to a breach of contract claim for private litigants.

[18] Additionally, as noted in the April 14, 2017 Comment Letter of State Farm, the Department's use of a private right of action ignores the use of arbitration panels, which are more efficient and effective for the investor than traditional litigation.

taking in other on-going litigation.[19] The government's inability to defend such a clause should initiate the reconsideration of all similar restrictions to the freedom of industry participants to contract with their customers. Continuing to prohibit such clauses (which are common in other contexts) will simply add costs to a financial institution's business that will ultimately be passed on to customers.

A delay in the January 1, 2018 applicability date of the provisions of the BIC Exemption and other elements of the Rule will allow for a more efficient implementation of the Rule's requirements.

Since the issuance of the proposed Rule, State Farm has been concerned that the Department does not appreciate the full scope and scale of the Rule. The Rule poses one of the most significant and adverse consumer developments State Farm has faced in almost a century of serving the needs of millions of Americans. In the last two years, State Farm has incurred substantial expenses and devoted countless employee hours to evaluate and ultimately comply with the Rule. In order to eliminate the potential of non-compliance with the Rule, State Farm and its agents have ceased making recommendations to mutual fund consumers. Many more expenses and hours are still to be incurred. State Farm therefore reiterates the position it articulated in its recent comment letter requesting a substantial delay in implementation of the Rule.[20]

Conclusion

State Farm appreciates the efforts undertaken by the Department to engage in a reexamination of the Rule and its effects on both industry participants and retirement investors. We believe this offers the Department the opportunity to collaborate with other interested regulators towards a single, uniform standard of conduct for the entire industry. Short of this, the Department has important opportunities to lessen the needless burdens of the Rule, and it should do so.

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We appreciate the opportunity to provide these comments. Please feel free to contact me if you should have any questions.

Sincerely,

Stephen McManus
Senior Vice President and General Counsel

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[19] Brief for Appellees at 59-60, Chamber of Commerce of the United States of America, et al. v. United States Dep't of Labor, et al., No. 17-10238 (5th Cir. Jul. 3, 2017).
[20] Comment Letter of State Farm Mutual Automobile Insurance Company, July 20, 2017.