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July 21, 2015

VIA E-MAIL

Office of Regulations and Interpretations
Office of Exemption Determinations
Employee Benefits Security Administration
U.S. Department of Labor
200 Constitution Avenue, N.W.
Washington, DC 20210

Re: RIN 1210-AB32: Definition of Term "Fiduciary"; ZRIN: 1210-ZA25: Proposed Best Interest Contract Exemption; Proposed Class Exemption for Principal Transactions; Proposed Amendment to Prohibited Transaction Exemption (PTE) 75-1; Proposed Amendment to and Proposed Practical Revocation of Prohibited Transaction Exemption (PTE) 84-24; Proposed Amendment to and Proposed Practical Revocation of Prohibited Transaction Exemption (PTE) 86-128; Proposed Amendment to Class Exemptions 75-1, 77-4, 80-83, and 83-1

Ladies and Gentlemen:

We appreciate the opportunity to share the views of State Farm Mutual Automobile Insurance Company ("State Farm Mutual") and its subsidiaries (collectively, "State Farm") on the proposed regulations of the Employee Benefits Security Administration of the Department of Labor ("DOL") regarding the *Definition of the Term "Fiduciary"; Conflict of Interest Rule-Retirement Investment Advice*, and on the Notice of Proposed Class Exemption for a best interest contract exemption ("BIC Exemption") and other proposed new or amended class exemptions (collectively, the "Proposal"). As explained in the attached comments, State Farm believes the Proposal, as currently formulated, will have the unintended and unwarranted effect of reducing access for many consumers to retirement services and important investment information, without offering commensurate benefits.

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

Sincerely,

Jeffrey W. Jackson
Senior Vice President and General Counsel

COMMENTS OF STATE FARM MUTUAL AUTOMOBILE INSURANCE COMPANY AND ITS SUBSIDIARIES ON PROPOSED RULES OF DEPARTMENT OF LABOR REGARDING DEFINITION OF THE TERM "FIDUCIARY," PROPOSED BEST INTEREST CONTRACT EXEMPTION, AND RELATED PROPOSED EXEMPTIONS

July 21, 2015

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EXECUTIVE SUMMARY

In the 93 years since State Farm Mutual Automobile Insurance Company ("State Farm Mutual") was founded, there have been very few Acts of Congress, let alone regulatory rules, that would have a more adverse impact on our ability to help and support our customers than the recent Department of Labor ("DOL") Proposal.[1] And the timing could not be worse, as the need for Americans to save for retirement has never been greater. After careful study, it is our belief that the Proposal falls far short of encouraging continued confidence among American investors in saving for retirement; indeed, it would result in reduced access to information, educational materials, and recommendations for investors and would undermine the ability of consumers, particularly less affluent consumers, to choose whether to work with a knowledgeable fiduciary or a non-fiduciary investment professional with whom to discuss their financial situation and investment options.

The central mission of State Farm Mutual and its subsidiaries (collectively, "State Farm") is to help individuals manage the risks of everyday life, recover from the unexpected, and realize their dreams. Using its exclusive independent contractor agent business model to market products and services, State Farm has been an industry leader for decades because of its focus on serving each customer's needs with personalized attention. Consistent with this focus, it is a fundamental premise of State Farm that products and services should be offered that are in the best interest of each customer. Although the Proposal purports to ascribe to that premise, its provisions would, in fact, undermine the ability of State Farm and others to serve customers according to their needs, and would deprive consumers of choices with regard to the nature of investment guidance they may obtain. Accordingly, State Farm cannot support the Proposal, at least as it is currently drafted.

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[1] For purposes of these comments, we use the "Proposal" to refer, collectively, to the following notices of proposed rulemaking published on April 20, 2015: Definition of Term "Fiduciary"; Conflict of Interest Rule—Retirement Investment Advice, 80 Fed. Reg. 21,928 (proposed Apr. 20, 2015) (to be codified at 29 C.F.R. pt. 2509-10); Proposed Best Interest Contract Exemption, 80 Fed. Reg. 21,960 (proposed Apr. 20, 2015) (to be codified at 29 C.F.R. pt. 2550); Proposed Class Exemption for Principal Transactions in Certain Debt Securities between Investment Advice Fiduciaries and Employee Benefit Plans and IRAs, 80 Fed. Reg. 21,989 (proposed Apr. 20, 2015) (to be codified at 29 C.F.R. pt. 2550); Proposed Amendment to Prohibited Transaction Exemption (PTE) 75-1, Part V, Exemptions from Prohibitions Respecting Certain Classes of Transactions Involving Employee Benefits Plans and Certain Broker-Dealers, Reporting Dealers and Banks, 80 Fed. Reg. 22,004 (proposed Apr. 20, 2015) (to be codified at 29 C.F.R. pt. 2550); Proposed Amendment to and Proposed Partial Revocation of Prohibited Transaction Exemption (PTE) 84-24 for Certain Transactions Involving Insurance Agents and Brokers, Pension Consultants, Insurance Companies and Investment Company Principal Underwriters, 80 Fed. Reg. 22,010 (Apr. 20, 2015) (to be codified at 29 C.F.R. pt. 2550); Proposed Amendment to and Proposed Partial Revocation of Prohibited Transaction Exemption (PTE) 86-128 for Securities Transactions Involving Employee Benefit Plans and Broker-Dealers; Proposed Amendment to and Proposed Partial Revocation of PTE 75-1, Exemptions From Prohibitions Respecting Certain Classes of Transactions Involving Employee Benefits Plans and Certain Broker-Dealers, Reporting Dealers and Banks, 80 Fed. Reg. 22,021 (proposed Apr. 20, 2015) (to be codified at 29 C.F.R. pt. 2550); Proposed Amendments to Class Exemptions 75-1, 77-4, 80-83 and 83-1, 80 Fed. Reg. 22,035 (proposed Apr. 20, 2015) (to be codified at 29 C.F.R. pt. 2550).

The Proposal's definition of "advice" is overly broad and its definition of "investment education" is unduly restrictive. The Proposal jettisons current, well-understood standards and a substantial body of regulatory guidance for distributing tax-qualified investment products offering different levels and types of investment guidance. The proposed new regime is centered on an ill-defined and impractical application of the fiduciary standard with almost no objective guidelines, relying instead on future litigation to define that standard on an unpredictable case-by-case basis.

The Proposal would eliminate the role of "sellers" and transform them into personal investment advisers. The Proposal would turn currently commonplace means of communicating information and educational materials into "fiduciary" advice—when many consumers, particularly middle-income Americans, may prefer to shop for and purchase investments without incurring separate fees for fiduciary advice (which fees could significantly consume their investment returns). As a result, if adopted, the Proposal could cause some providers to retreat from offering needed services outside of the affluent market—such as providing guidance that is solely incidental to the purchase of investment products. Combined with the additional regulatory restrictions it imposes that are likely to make investment products more expensive to provide, the Proposal would leave consumers less informed and more likely to forego opportunities to make decisions best suited to their needs.

Due to the proposed rules' lack of objective guidelines and the litigation risk the proposed new fiduciary standard presents, the Proposal would make it more difficult for Americans to obtain guidance for making savings decisions. The Proposal could have the unintended effect of eliminating valuable investment information channels, thereby depriving consumers of important information and guidance on tax-qualified investment products. Those with only modest amounts to invest are likely to be hurt the most.

State Farm believes strongly that a vibrant and competitive market drives innovation and the provision of better products and services to customers. A healthy retirement savings market depends in part on a well-informed customer base. Accordingly, State Farm supports strong and meaningful consumer disclosures, education, and guidance to help consumers better understand available products and services. Today, State Farm customers who are considering investing meet with a registered representative to select a suitable investment under well-established guidelines and regulatory oversight. The Proposal, however, rather than reinforcing the existing regulatory framework and beneficially enhancing it, would detrimentally disrupt customer service by State Farm and other members of an already highly-regulated industry, and thereby unintentionally deprive consumers of the benefits of multiple distribution models.

Key Shortcomings of the Proposal

As detailed in the following discussion, the Proposal:

- will, if adopted, harm American consumers—especially small investors and small businesses—by limiting choices and access to retirement

investing services, leading to further under-saving for retirement; and by imposing added costs, administrative burdens, and excessive and unproductive risks on providers of tax-qualified products;

- is beyond the authority of DOL and conflicts with Congressional intent regarding IRAs established outside of the employee-employer relationship;
- entails a new set of complex requirements, in conflict with existing guidance, that would constrict services that are already subject to detailed, extensive regulation and supervision under securities, banking and insurance laws that protect investors and consumers;
- is costly, impractical, and ignores other solutions that could meet DOL's policy objectives without these flaws;
- has not been subjected to a rigorous and objective cost/benefit analysis;
- overstates the predicted benefits of the Proposal and understates the estimated costs of compliance;
- does not provide a sufficient implementation time period; and
- does not provide adequate grandfathering of existing accounts.

Harms to Small Investors

Among the significant shortcomings of the Proposal, the one of most concern to State Farm is the harm to middle- and modest-income American consumers. This harm is so concerning as to merit serious and particular focus by DOL.

- The Proposal, if adopted, will be particularly harmful with respect to consumers with modest investment accounts—it will be more difficult and more expensive for many consumers to obtain investment assistance with tax-qualified products and may ultimately lead to further under-saving for retirement. The lack of objective standards or guidance in the Proposal will likely cause broker-dealers and their representatives, insurance companies and their producers, and others to cease or reduce offering retirement investment services.
- Consumers likely will be left to seek basic investment education or guidance from other sources, but registered investment advisers and large wire house firms typically do not offer separately-managed advisory accounts to the non-affluent market. Investment advisers will generally not manage small amounts because the asset-based fee does not generate sufficient income to offset the substantial cost of providing such service. For example, the average size of a tax-qualified mutual fund account for a

State Farm customer is approximately $22,000. The median tax-qualified mutual fund account size is approximately $6,500. Investment advisers will generally not manage such small amounts because the asset-based fee (typically averaging 1.48% annually for accounts under $100,000[2]) will not generate sufficient income (the amount would be $326 per year on an account of $22,000, and less than $100 per year for accounts of approximately $6,500). This is why many providers often set minimum account sizes from $100,000 to $250,000 or above.

- For State Farm customers, overall investment retention and customer satisfaction is high, turnover is low and investments are held for the long term. This means that for our customers, using front-end sales loads and commissions to pay for basic investment advisory services often result in the most cost efficiency to the customer over the life of his or her investment. Moreover, during 2014, State Farm had less than 6 complaints per every 100,000 mutual fund tax-qualified accounts.

- The Proposal will reduce the amount of investment education materials available to consumers. These materials are an efficient and low-cost way for consumers to learn about investment options. A reduction in these materials will create an investment information gap for middle- and modest-income Americans. The reality is that middle- and modest-income consumers with smaller amounts to invest may not receive any investment guidance (or may not save at all) unless someone like State Farm—a proprietary investment product source that provides guidance only of a general educational nature and incidental to the sale of investment products—is there to provide it.

<u>Essential Changes to Make the Proposal Potentially Viable</u>

An effort at regulatory reform that is coordinated with functional regulators, more inclusive of the variety of established delivery models and more supportive of consumer choice is in the best interest of consumers, industry, and the economy as a whole. However, in the event DOL moves forward with adoption of the Proposal, changes to the Proposal must be made in order to make it workable for consumers and not overly disruptive to the market. In the spirit of positive participation in the DOL's rulemaking process, we offer some suggested modifications to the Proposal:

- Adopt a broad seller's exception that includes non-fiduciary selling activity as originally contemplated in DOL's 2010 proposal;

- Preserve DOL Interpretive Bulletin 96-1 in order to allow investors to receive educational materials as they do today, without establishment of any fiduciary relationship;

[2] Based on data from Strategic Insight (2011).

- Make the proposed best interest contract exemption ("BIC Exemption")[3] more workable by:
    - Revising the timing for execution of a best interest contract so that execution is required at the time of the sale of a product, not before having any discussions;
    - Maintaining existing enforcement regimes and not creating a private right of action for IRAs, to ensure consistency with Congressional intent and well-established understandings under current law;
    - Providing safe harbors, rebuttable presumptions and other objective standards so that financial institutions and advisers have clear guidance as to the behavior the rules are seeking to achieve;
    - Deleting the proposed requirement of making recommendations with respect to "all" asset classes;
    - Removing the additional requirements imposed on proprietary products and clarifying that, if properly disclosed, proprietary products do not constitute evidence of a violation of the best interest standard;
    - Revising the definition of a "financial institution" to include (i) all depository institutions, whether or not they have trust powers, and (ii) all entities within an insurance group that arrange for the marketing of insurance products;
    - Simplifying and reducing the burdens associated with disclosures required under the Proposal and coordinating new disclosure requirements with all governing agencies; and
    - Preserving the choices that investors have today in determining the level of service and the fee structure they want, including the option of commission fee structures;
- Provide an implementation period of at least 3 years; and
- Provide complete grandfathering of all existing tax-qualified product customers (including ERISA plans and other tax-qualified accounts maintained at one financial institution but funded with a product from another financial institution), whether or not new money is added to such a tax-qualified customer relationship after the implementation date.

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[3] Proposed Best Interest Contract Exemption, 80 Fed. Reg. 21,960 (proposed Apr. 20, 2015) (to be codified at 29 C.F.R. pt. 2550).

BACKGROUND ON STATE FARM

State Farm Mutual, headquartered in Bloomington, Illinois, is the largest insurer of automobiles and, through its subsidiaries, the largest insurer of homes and the largest issuer of individual life insurance policies in the United States. State Farm Mutual is organized as a mutual insurance company—it does not have shareholders.

State Farm products and services, including insurance, savings, and financial products and services, are made available through more than 18,000 exclusive independent contractor insurance agents. Each State Farm agent hires his or her own employees and conducts his or her business as an independently owned and operated small business. Over time, State Farm agents, who operate in storefront locations in metropolitan areas and small and mid-size towns throughout America, generally develop long-standing ties to the customers in their communities.

State Farm Mutual and its 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 Co.) that manages a family of proprietary mutual funds, and a federally chartered savings bank (State Farm Bank). State Farm's business focuses on serving individuals and families and small business, especially in the middle-market. State Farm's customers range from the more affluent 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 and checking accounts). State Farm also offers investment, annuity, insurance and banking products that generally may be held through tax-advantaged accounts.[4] Thus, State Farm's business model is based on its ability to offer customers "one stop shopping" for a full range of financial services.

State Farm agents offer insurance products and, since State Farm began offering a line of mutual fund products in 2001, a great majority of the agents have become registered representatives in order to serve existing customers with additional financial services products. 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 those additional products. These agents also

[4] References herein to tax-advantaged accounts (and similar terms) generally refer to all types of tax-qualified vehicles, including but not limited to 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 Proposal, including Health Savings Accounts and Coverdell Education Savings Accounts.

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 Securities and Exchange Commission ("SEC") if they violate any of the customer protection and other regulations imposed on them by law and regulation.

State Farm's retail mutual funds business has grown organically since 2001 to reach over $11 billion (both tax-qualified and non-tax-qualified accounts) in assets currently under management. We have helped build the business through registered representative agents meeting individually with existing State Farm customers to discuss how mutual funds can provide the customer with choices to meet his or her particular retirement and educational savings needs. State Farm products and services are flexible enough to meet the needs of all investors, from the affluent market to the small investor. For example, when State Farm mutual funds began offering funds to the public, its minimum investment was only $250. The minimum has recently been raised to $1,000, which is still very low compared to the rest of the market. In addition, the minimum monthly investment is only $50. Thus, these mutual funds are accessible to all investors.

In many cases, our customers do not work with a registered investment adviser—often because of the relatively small amounts they seek to invest. Indeed, a State Farm agent may be the first representative to discuss with a consumer the importance and benefits of beginning to save for retirement and education expenses. State Farm agents do not offer discretionary trading services or products and do not make investment decisions on behalf of their customers. The mutual funds products were designed to be extensive enough to meet the needs of each investor, yet simple enough to be easily understood by the customer. Since State Farm's mutual funds were initiated, the strategy has been to grow organically, to keep a long-term perspective, and to grow with customers while providing agents with appropriate commission-based compensation reflecting the complexity of the products and the amount of time, effort and training required to properly market them. Sales commissions for agents do not vary by the customer's fund selection, and customers can make load-free exchanges between funds within the State Farm family of funds. State Farm has found that a commission-based model is a cost-effective, easy to understand, and fair way to compensate its agents. A levelized compensation plan or wrap-fee structure would likely be more expensive for both the customer and State Farm.

While we recognize there are a multitude of State Farm products that can be used to fund tax-qualified accounts, many State Farm customers utilize mutual funds to fund tax-qualified accounts. State Farm has invested a great deal in building a strong suite of proprietary mutual funds broad enough to fulfill the investment objectives of almost all investors. In offering its mutual funds to customers, State Farm's goal is to match the customer with an investment option that meets his or her needs and objectives. In order to achieve this suitability goal, State Farm has developed a rigorous process, designed and implemented in accordance with FINRA regulations, to inform the customer of investment considerations so that he or she can choose the best option for his or her individual situation. Suitability is initiated by the agent during the sales process. Information about the customer is gathered, including risk tolerance, time horizon,

financial situation, investment experience, and investment objectives, among other pertinent information. A suitability review is then performed to ensure the information gathered matches the recommended investment product.

The above-described suitability process has proven sound by protecting customers and providing them with valued education and options. To illustrate, even during periods of significant market volatility and crisis, State Farm's redemption ratio has been half that of the industry. In addition, complaint levels are extremely low. Well-defined regulatory expectations are essential to delivering a cost effective and consistent suitability process for customers. Automation relating to online resources and ease of transacting business with us, along with a training program, allow State Farm to provide a consistent customer experience and for agents to assist customers in their personal investment choices.

In sum, the State Farm mutual funds product offering, as currently structured, provides a viable and valuable choice to customers to act on their retirement and education savings needs.[5] In determining its next steps on the Proposal, we urge DOL to consider the value to consumers of State Farm's investment products and services, and the State Farm business model, in relation to the Proposal's likely adverse effects described below.

SPECIFIC COMMENTS

I. The Proposed Rule Would Harm Middle-Income Americans and Small Businesses.

If adopted, the Proposal will be particularly harmful with respect to middle income investors. First, by discouraging the commission-based compensation model in favor of an asset-based model, and increasing compliance costs and legal uncertainty, the Proposal would adversely affect financial services firms that service smaller investors and therefore will likely reduce choices for consumers. Second, the Proposal's requirements would make it more difficult for many investors to obtain investment education, information and assistance in connection with tax-qualified products.

Because the proposed fiduciary standard lacks objective criteria, is overly broad and the definition of education is limited, the Proposal may cause broker-dealers, insurers, banks, and their respective representatives and others to cease or reduce offering investment retirement services out of fear of additional liability (*i.e.*, exposure to litigation, risk of severe excise tax penalties if complex conditions are not satisfied, etc.). If this occurs, consumers will be left to seek counsel from other sources, such as registered investment advisers and large wire-house broker-dealers—but these institutions typically do not offer separately-managed advisory accounts to the non-affluent market. Moreover, in addition to discouraging firms from serving the non-affluent market, the Proposal also would hinder market growth. Most start-up mutual

[5] Although other State Farm products are also used to fund tax-qualified accounts, mutual fund products comprise a substantial portion of our customers' tax-qualified portfolios.

fund or financial services companies would view the imposition of this Proposal—given all of its requirements, high compliance costs, and legal uncertainties—as tantamount to a barrier to market entry, as it would be extremely difficult to start offering mutual funds or other new funding vehicles for tax-qualified accounts subject to the Proposal. Consequently, we expect the number of firms offering tax-qualified accounts to shrink and we do not expect new firms to enter the market.

For State Farm, the uncertainty of the proposed rules threatens the viability and effectiveness of a process that has proven successful. As noted, State Farm agents run their own independent small businesses and hire their own employees. If the proposed rules had been in place when State Farm began offering mutual funds, it is questionable whether both State Farm and its agents would have chosen to undertake the investment services they provide, given the risks posed by the proposed rules' uncertain compliance standards, litigation-based compliance framework, bias for an open architecture of non-proprietary funds, and the resulting limitations on prospects for business growth. Absent State Farm's presence in the market, there would be a significant gap in the retirement savings of a large segment of more than 400,000 mutual funds customers currently with State Farm; they might not have received assistance elsewhere and therefore might not have decided to initiate what has amounted to billions of dollars in savings in tax-qualified accounts.

Some have argued that a commission-based model disadvantages investors. But the reality is that many small investors will simply not receive service unless someone like State Farm is there to provide it, and a commission-based fee is not adverse to these investors in this context. To illustrate, the average size of a tax-qualified mutual fund account for a State Farm customer is around $22,000 and the median tax-qualified mutual fund account size is approximately $6,500. In fact, 80% of State Farm mutual funds' investors have an account value of less than $25,000. Investment advisers will generally not manage such small accounts because the asset-based fee (typically averaging 1.48% of assets annually for accounts under $100,000[6]) will not generate sufficient income (the amount would come to $326 per year on an account of $22,000, and less than $100 per year for accounts of approximately $6,500) to cover the costs of the product and risk undertaken. This is why investment advisers often set minimum account sizes from $100,000 to $250,000 or above. Those investment advisers who do provide services to small accounts often charge much higher-than-average fees (on a percentage basis). A fee-for-service investment advice model does not meet the needs of investors with modest amounts to invest.

For State Farm customers, front-end mutual fund sales loads have proven an efficient means of providing appropriate products with an appropriate fee. Within State Farm's book of business, retention is high, turn-over is low and investments are held for the long term. For this group, front-end sales loads are economically advantageous.

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[6] Based on data from Strategic Insight (2011).

Although a wrap fee[7] is less expensive in the short run, a load fee is less expensive over longer terms. *See* Exhibit A (attached) for a comparison of a commission-based model to an assets-under-management ("AUM") or "wrap fee" model. Accordingly, for our customers who are saving for retirement (a long-term investment), front-end sales loads are cost-efficient. Further, because of the investment adviser economic model noted above, smaller account holders need this option if they are to get human assistance with their investments. Also, overall satisfaction is high among our tax-qualified mutual fund customers. Indeed, we experience very few complaints from our mutual fund investors. During 2014, State Farm had less than 6 complaints per every 100,000 accounts.

Concerns also have been raised about how some companies may be seeking to "churn" investments in order to generate additional fees. There are already regulations in place that prohibit such conduct.[8] At State Farm, we do not charge our IRA investors any additional fees for switching from one mutual fund investment to another within the State Farm family of funds. For example, a State Farm tax-qualified investor with a $6,500 account could switch from a stock fund to a bond fund and there would be no fees associated with that transfer. This is just one example of the steps State Farm takes to benefit customers. We have found that such policies contribute to the high retention rates we have for our customers.

State Farm's views are buttressed by recent commentary on the effects of the Proposal. In a recent paper,[9] noted economists Bob Litan and Hal Singer emphasize the potential detrimental impact of the Proposal on small investors. Specifically, they describe the costs of the Proposal as follows:

> These costs come largely from (1) small savers losing access to human financial advisers (because small accounts would become uneconomic to serve, and expose advisory firms to new liability risks), (2) small savers being forced into fee-based advisory relationships that cost more than current commission-based arrangements, and (3) small savers and firms not being encouraged to save more, take full advantage of employer matches, or create retirement plans in the first place.[10]

Litan and Singer go on to find that:

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[7] A "wrap fee" is a periodic fee based on assets under management that is paid by a customer and covers both brokerage and investment advisory services, in lieu of separate brokerage commissions and investment advisory fees.

[8] *See generally* 17 C.F.R. § 240.15c1-7 (implementing the prohibition of the use manipulative, deceptive, or other fraudulent devices or contrivances under the Securities Exchange Act); FINRA Rule 2111, Supplementary Material .05 (describing the reasonable basis, customer-specific, and quantitative suitability obligations of broker-dealers).

[9] Robert Litan and Hal Singer, *Good Intentions Gone Wrong: The Yet-To-Be Recognized Costs of the Department of Labor's Fiduciary Rule*, Economists Incorporated (July 2015), *available at* http://www.ei.com/support-_proposed_fiduciary_rule-roposed-fiduciary_rule/.

[10] *Id.*, abstract.

> The DOL's Regulatory Impact Analysis (RIA) thus concludes erroneously that the net benefit of the rule would be roughly $4 billion per year (the CEA, making related errors, pegs the benefit at $17 billion). A conservative assessment of the [Proposal]'s actual economic impact—taking into account the categories of harm noted above that are ignored by DOL and CEA—finds that the cost of depriving clients of human advice during a future market correction (just one of the costs not considered by DOL) could be as much as $80 billion, or twice the claimed ten-year benefits that DOL claims for the [Proposal].[11]

In addition, the Proposal could unintentionally eliminate an efficient means of providing investment guidance incidental to a transaction, which is a low-cost way for consumers to learn about investment options.[12] Many of those who are currently assisting small investors may find it uneconomical to continue providing this incidental advisory service. This would occur because the Proposal would retract DOL's guidance on investment education—Interpretive Bulletin 96-1.[13]

Small savers and investors should be educated as to the benefits of saving and should have choices as to the level of service they can receive. Interpretive Bulletin 96-1 allows the provision of certain educational materials to plan participants and beneficiaries without the communication being deemed "investment advice" and triggering fiduciary standards. The Proposal's definition of "investment advice" is overly broad and sweeps in almost any discussion regarding the benefits of IRAs and qualified plans and potential investment options. While there is a carve-out for educational communications, it is too restrictive. For example, unlike current standards, the linking of specific investment options with asset allocation models or other materials would be considered "advice," and not education. State Farm believes consumers are entitled to full disclosure with respect to possible investment vehicles and that agents should be able to provide such disclosures without becoming fiduciaries. Such disclosures help to educate consumers regarding their options so that they can make more informed decisions. In order to preserve the sharing of information, which helps to educate and empower consumers, the treatment of educational communications reflected in Interpretive Bulletin 96-1 should remain unchanged.

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[11] *Id.*

[12] A broker-dealer or broker-dealer representative "whose performance of [advisory] services is solely incidental to the conduct of his business as a broker or dealer and who receives no special compensation therefor" is not considered an investment adviser, and is therefore not subject to an adviser's fiduciary standards. Investment Advisers Act of 1940 § 202(a)(11)(C), 15 U.S.C. § 80b-2(a)(11)(C). *See also Certain Broker-Dealers Deemed Not to Be Investment Advisers*, Investment Advisers Act Release No. 2376 (Apr. 12, 2005). For any broker-dealer representative relying on the BIC Exemption, such "solely incidental" advice would be extremely difficult and perhaps impossible to provide because the BIC Exemption requires an adviser to provide a more fulsome set of advice than has traditionally been interpreted to meet this definition of "solely incidental."

[13] Interpretive Bulletin 96-1, Participant Investment Education, 61 Fed. Reg. 29,586 (June 11, 1996) (codified at 29 C.F.R. § 2509.96-1) ("Interpretive Bulletin 96-1").

Novel technologies, such as on-line "robo-advisers" may be an option for some. But many savers and investors prefer face-to-face individual contact. Anonymous websites, phone-tree services and call centers do not meet the retirement savings and investment needs or preferences of many people, especially older Americans. Investors should have choices as to the mode of communication through which they receive investment information, yet the Proposal would have the effect of reducing the options available.[14]

Registered representatives of broker-dealers and licensed insurance agents, including more than 18,000 State Farm agents, are very helpful in numerous ways to individuals who are planning for retirement. Conversations in the normal course of the insurance business can lead customers who are not currently saving for retirement to start investing for their future, even if they have humble financial means. These customers are not served by most investment advisers, and fee-for-service or percentage-of-AUM compensation models are neither affordable nor efficient for them. A known representative/agent in the neighborhood may help keep an investor from making a poor choice, such as selling his or her investment position after a market downturn. Small investors may never recover from making such an uninformed decision. Further, as an investor matures, his or her risk tolerance may change, and the local State Farm agent will be there if the investor wishes to discuss changes in asset allocation.

If the Proposal were adopted, this efficient means of educating middle-income consumers would no longer be a viable option. Small investors will be faced with the dilemma of receiving no advice or seeking advice they cannot afford. As a result, millions of customers would likely pay more for investment guidance, invest without obtaining investment guidance and make uninformed choices about tax-advantaged accounts, or not invest and remain unprepared for retirement. Thus, the Proposal would effectively shut out from the market the very people it is trying to protect. Without encouragement, education, support and service from local State Farm agents and similar

[14] Forcing investors to rely on less traditional investment advisory models may have many adverse consequences that are not immediately apparent and which are not considered by the DOL. For example, Litan and Singer discuss in particular certain weaknesses in the "robo adviser" model:

> [T]he decision to stay invested (or not) during times of market stress swamps the impact of all other investment factors affecting long-term retirement savings, including modest differences in advisory fees or investment strategies. "Robo-advice," which the DOL assumes will over time replace human advisers who find it uneconomic to serve small savers under the new rule, cannot effectively perform this critical role. (An email or text message in the fall of 2008, for example, would not have sufficed to keep millions of panicked savers from selling, with devastating consequences for their nest eggs). In effect, the DOL rule wagers the welfare of millions of Americans on the mistaken notion that ending commission-based compensation is better for small savers than assuring them continued access to human financial advice through an affordable and time-tested model.

Litan & Singer, *supra* note 9, abstract.

financial service providers, Americans' retirement savings rates may drop, further exacerbating the country's savings and retirement income shortfall.

The manner in which the Proposal seeks to elevate a single approach to the sale of investments and provision of advice, together with the potential liability exposure created by the Proposal, will have the unintended and undesired effect of deterring investment professionals and firms from providing consumers valuable educational communications and access to investment professionals with whom to discuss their individual circumstances and investment options, and to provide other guidance that is solely incidental to the sale of an investment. As a result, consumers will be less informed and more likely to make decisions ill-suited to their needs. At the same time, to account for the additional regulatory restrictions and the fact that fiduciary advice is essentially forced upon all consumers, investment products are likely to become more expensive. The greatest impact of the Proposal will be on those with relatively modest amounts to invest—an underserved population that needs more options, not fewer, to help them establish savings and to make informed investment choices.

Finally, if adopted, the Proposal will likely cause some small businesses to lose the help that they need when setting up retirement plans for the owner and employees. New and small enterprises frequently need assistance in selecting investment options for retirement plans. The Proposal would transform the function of educating the employer about such options into a fiduciary function. This may cause many otherwise perfectly capable firms and individuals to no longer offer such guidance because of the heightened risk exposure.

II. The Proposal Conflicts with Certain Statutory Provisions and the Intent of Congress.

Through the Proposal, DOL is effectively attempting a substantial re-write of the fiduciary provisions of ERISA[15] and the Internal Revenue Code (the "Code") that have been in effect for 40 years. By fundamentally altering the settled legal and regulatory scheme, the Proposal not only will disrupt the provision of a wide range of retirement investment services and harm investors, but will also run directly contrary to Congressional intent.[16]

When ERISA and related provisions of the Code were adopted in 1974, the following fiduciary-related provisions also were enacted:

- Title I of ERISA, which contains a statutory fiduciary duty, prohibited transaction rules, and an exclusive enforcement and remedy regime for use by DOL and plan participants. Employer- and union-sponsored employee

[15] Employee Retirement Income Security Act of 1974, 29 U.S.C. §§ 1001 *et seq.* ("ERISA").

[16] Indeed, far from adhering to congressional intent to make tax-favored accounts more widely available and accessible to a broader range of consumers, the burdens, costs, and legal uncertainties created by the Proposal would likely diminish the availability of such accounts to consumers.

benefit plans ("Employer-Sponsored Plans") are subject to these ERISA fiduciary standards.

- Code Section 4975, which contains nearly identical prohibited transaction rules to those in ERISA and—for purposes of applying those rules—the same definition of the term "fiduciary." Unlike ERISA, however, the Code does not impose any fiduciary duties. The Code's prohibited transaction rules are enforced solely by the IRS through excise tax penalties. Employer-Sponsored Plans and IRAs[17] are subject to these Code-prohibited transaction rules.

As discussed below, the Proposal conflicts with the plain language and structure of, and the Congressional intent behind, the underlying statutory framework applicable to IRAs and Plans.

A. Subjecting IRAs to ERISA Fiduciary Standards Conflicts with Congressional Intent.

The BIC Exemption requires advisers and financial institutions (both as defined with respect to the BIC Exemption) providing investment-related services to an IRA to agree, by contract, to be subject to the ERISA fiduciary standard of care. This extension of ERISA's fiduciary standards to IRAs through the BIC Exemption is at odds with Congress' clear intent. Employer-Sponsored Plans became subject to ERISA's fiduciary duty standards upon the enactment of ERISA in 1974. Simultaneously in 1974, Congress established IRAs, but subjected IRAs only to the Code's prohibited transaction rules and *not* to ERISA's fiduciary duty standards. It is simply implausible to think that Congress would condone the application of an ERISA fiduciary duty standard to IRAs, given that ERISA is inapplicable and the Code itself contains no fiduciary standards for IRAs.

Indeed, in the 40-plus years since Congress created IRAs, Congress has amended ERISA and the Code many times, but never changed its original decision to exempt IRAs from ERISA's fiduciary standards, thus demonstrating its satisfaction with existing law. Instead, while repeatedly amending ERISA and the Code in various respects, including by adopting new tax-favored retirement and benefit account savings programs, such as 401(k) plans, SEP and SIMPLE accounts and ROTH IRAs, Congress has intentionally chosen to continue to exempt IRAs from ERISA's fiduciary standards.

It is well established that Congress is deemed to be cognizant of the statutory interpretations of a regulatory agency, and when Congress amends a statute, but leaves

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[17] Certain types of IRAs may be subject to ERISA because they are created in connection with employer-sponsored pension plans. Accordingly, for purposes of these comments, they are considered Employer-Sponsored Plans and not IRAs. Most IRAs are in no way subject to ERISA. 29 C.F.R. § 2510.3-2(d) (IRAs not subject to ERISA in the absence of involvement of an employer or union); *see also Charles Schwab & Co., Inc. v. Debickero*, 593 F.3d 916, 919 (9th Cir. 2010) ("IRAs are specifically excluded from ERISA's coverage.").

provisions that have been subject to such interpretations unaltered, Congress is deemed to have accepted those regulatory interpretations.

> Congress is presumed to be aware of an administrative or judicial interpretation of a statute and to adopt that interpretation when it re-enacts a statute without change. . . . So too, where, as here, Congress adopts a new law incorporating sections of a prior law, Congress normally can be presumed to have had knowledge of the interpretation given to the incorporated law, at least insofar as it affects the new statute.[18]

In light of the numerous amendments to ERISA and the Code since 1975, all of which are premised on the existing 1975 regulation, it is implausible to surmise that Congress was unaware of the existing fiduciary standard or the state of the marketplace it was regulating. Congress, with informed awareness, took no action to change the statutory definition of the term "fiduciary." Agencies are not permitted to use their general rulemaking or definitional authority to override the choices of Congress.[19]

Because many ERISA and Code provisions overlap, President Carter, through the Executive Order: Reorganization Plan No. 4 of 1978 (the "Reorganization Plan"), allocated interpretive and enforcement authority relating to these provisions between DOL and the IRS. Under the Reorganization Plan, DOL generally has the power to issue regulations, rulings, opinions and exemptions relating to the fiduciary and prohibited transaction provisions of ERISA and the prohibited transaction rules the Code (as discussed above, the Code does not impose any fiduciary duties in respect of IRAs), but enforcement of the Code's prohibited transaction rules remains exclusively with the IRS. The BIC Exemption, however, in effect amends the Code by (i) extending ERISA fiduciary duties to IRAs and (ii) granting enforcement authority under the Code to the plaintiffs' bar. DOL lacks authority under the Reorganization Plan or otherwise to impose ERISA's fiduciary standards on IRAs or to allow anyone other than the IRS to take enforcement actions against IRAs.[20]

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[18] *Lorillard, Div. of Loew's Theatres, Inc. v. Pons*, 434 U.S. 575, 580-581 (U.S. 1978) (citing *Albemarle Paper Co. v. Moody*, 422 U.S. 405, 414 n. 8 (1975); *N.L.R.B. v. Gullett Gin Co.*, 340 U.S. 361, 366 (1951); *Nat'l Lead Co. v. United States*, 252 U.S. 140, 147 (1920); 2A C. Sands, Sutherland on Statutory Construction § 49.09 (4th ed. 1973)); *see also Texas Dept. of Housing and Cmty. Affairs v. Inclusive Communities Project, Inc.*, No. 13-1371, 2015 WL 2473449 (S. Ct. June 25, 2015).

[19] *See Council for Urological Interests v. Burwell*, No. 13–5235, 2015 WL 3634632 (D.C. Cir. June 12, 2015); *Am. Bankers Ass'n v. Securities and Exch. Comm'n*, 804 F.2d 739 (D.C. Cir. 1986); *Bd. of Governors v. Dimension Fin. Corp.*, 474 U.S. 361 (1986).

[20] Particularly with respect to IRAs that hold insurance products or other investments sold or recommended by insurance agents, we question whether DOL has considered the comprehensive regulatory regime in place at the state level governing insurance products and the business of insurance, and the implications of the Proposal under the McCarran-Ferguson Act, 15 U.S.C. §§ 1011-1015, in relation to that comprehensive regime.

B. Providing a Private Right of Action to IRA Owners for Breach of Contract in the BIC Exemption Conflicts with the Code.

The BIC Exemption creates a private right of action for IRA owners and in doing so conflicts with the Code and ERISA.[21] Congress provided that the Code's prohibited transaction rules are enforced exclusively by the IRS. As a result, courts have made clear that there is no private right of action for a plan participant to enforce the Code's plan qualification requirements.[22] Further, the Reorganization Plan makes clear that enforcement power for the Code's prohibited transaction rules lies with the IRS. Congress could have created enforcement mechanisms for IRAs similar to those provided to ERISA plan participants by ERISA Section 502, but it did not. DOL's creation of a private right of action as to IRAs would allow the plaintiffs' bar, rather than solely the IRS as Congress intended, to police the prohibited transaction rules for IRAs.

The Proposal fails to include safe harbors, rebuttable presumptions or other defenses for responsible financial institutions. In its current form, the Proposal effectively serves as a road map for enterprising lawyers to launch class actions against any provider of retirement products. Even defendants who would prevail in litigation launched under the proposed rules would bear the high costs of litigation, lost time, and diverted resources. Most importantly, the costs of defending even meritless litigation will ultimately be borne by the investing consumers in the form of higher costs inherent in products and/or a retreat from the market by various participants, leading to fewer consumer choices. If DOL adopts the Proposal, the BIC Exemption must be revised to remove the private right of action and to include defenses and other protections, such as safe-harbors, for advisers and financial institutions.

C. DOL Regulation of Broker-Dealers' Compensation & Services Conflicts with the Exchange Act and Creates Conflicts with Investment Adviser Regulation.

Congress in the Exchange Act has vested in the SEC and FINRA functional authority to regulate the permissible services, disclosure obligations and compensation structures of broker-dealers and their registered representatives, and preserved parallel regulatory authority in the states. Congress has not granted authority to DOL to functionally regulate broker-dealers or their representatives or to override the transaction-based compensation structures authorized under the Exchange Act for broker-dealers and

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[21] The BIC Exemption's creation of a private right of action for participants in Employer Sponsored Plans also conflicts with ERISA. ERISA provides plan participants with the exclusive and limited enforcement mechanisms and remedies set forth in Section 502 of ERISA. The Supreme Court has repeatedly held that "[t]he six carefully integrated civil enforcement provisions found in § 502(a) of the statute as finally enacted . . . provide strong evidence that Congress did *not* intend to authorize other remedies that it simply forgot to incorporate expressly." *Aetna Health Inc. v. Davila*, 542 U.S. 200, 209 (2004) (emphasis supplied) (quoting *Pilot Life Ins. Co. v. Dedeaux*, 481 U.S. 41, 54 (1987)); *see also Mass. Mut. Life Ins. Co. v. Russell*, 473 U.S. 134, 146 (1985)

[22] *See Reklau v. Merchants Nat'l Corp.*, 808 F.2d 628 (7th Cir. 1986) (holding that Section 401 of the Code does not create substantive rights under ERISA that can be enforced in a private cause of action).

their registered personnel in respect of IRAs and plans. Nor has Congress granted authority to DOL to impose compensation restrictions on broker-dealers for transactions and investments of IRAs and plans analogous to those that apply to banks under the Exchange Act. Indeed, Congress expressly preserved in the Gramm-Leach-Bliley Act of 1999 the authority of broker-dealers to be paid commissions and sales loads in respect of sales to IRAs and qualified plans.[23] Most recently, in the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("DFA"), Congress directed the SEC to study potential fiduciary standards and customer disclosures for broker-dealers, but specified that commissions or other standard compensation structures shall not of themselves constitute a violation of a broker-dealer's duty to its customers.[24]

The SEC and FINRA comprehensively regulate broker-dealers, including requiring detailed disclosures of conflicts and fees, customer informed consents, regulation of compensation and fees, and objective suitability requirements which are enforced with vigor as regards, in particular, IRA accounts.[25] The Proposal's BIC Exemption would also require providers to supply projected investment costs for periods of up to ten years, which implicates calculation of projected performance and returns and thereby runs afoul of SEC and FINRA rules.[26] Thus, the proposed fiduciary definition and BIC Exemption, as currently formulated, exceed the statutory authority of DOL, conflict with the Exchange Act, and therefore would be void as applied to securities broker-dealers and their representatives.

The Proposal also creates conflicts with the requirements of the Investment Advisers Act of 1940 ("Advisers Act") and state laws that govern investment advisers. These laws and their associated regulations establish comprehensive registration and compliance requirements for persons that provide investment advice for compensation. However, under the Advisers Act, any broker-dealer or broker-dealer representative (who is already subject to rigorous regulatory oversight) "whose performance of [advisory] services is solely incidental to the conduct of his business as a broker or dealer and who receives no special compensation therefor" is not considered an investment adviser.[27]

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[23] Under the Exchange Act and SEC regulations, when effecting securities transactions for plans, IRA and similar accounts, registered broker-dealers and their registered representatives are permitted to receive transaction-based compensation, while banks and their employees are not. Securities Exchange Act of 1934 §§ 3(a)(4)-(5), 15 U.S.C. §§ 78c(a)(4)-(5); 12 C.F.R. § 218.760; 17 C.F.R. § 247.760.

[24] Dodd Frank Wall Street Reform and Consumer Protection Act of 2010 § 913(g), 15 U.S.C. § 78o(k) ("The receipt of compensation based on commission or other standard compensation for the sale of securities shall not, in and of itself, be considered a violation of such standard applied to a broker or dealer").

[25] *See, e.g.*, SEC, Office of Compliance Inspections and Examinations, *National Exam Program Risk Alert: Retirement-Targeted Industry Reviews and Examinations Initiative* (June 22, 2015), *available at* http://www.sec.gov/about/offices/ocie/retirement-targeted-industry-reviews-and-examinations-initiative.pdf; FINRA, *Regulatory and Examinations Priorities Letter* 7 (Jan. 6, 2015), available at http://www.finra.org/sites/default/files/p602239.pdf.

[26] *See* SEC Rules 34b-1, 156(b)(2), 482; FINRA Rule 2210.

[27] Advisers Act § 202(a)(11)(C), 15 U.S.C. § 80b-2(a)(11)(C).

The Proposal would undermine this pattern of state and federal regulation. As just one example, the BIC Exemption requires a firm and its representatives to contractually warrant, when offering a tax-qualified account, that they are acting as a fiduciary on behalf of the customer, and that they will provide "advice that reflects the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person would exercise based on the investment objectives, risk tolerance, financial circumstances, and needs of the Retirement Investor."[28] It is hard to imagine how a representative or firm can provide such advice, or be contractually held to a fiduciary standard, while limiting such investment advice to that which is "solely incidental." As a result, registered representatives of broker-dealers who provide investment services to tax-qualified accounts will need to evaluate whether they must register as investment advisers and pass the appropriate FINRA examination. Given the obstacles to meeting customer needs, the higher litigation risk, and the costs of regulation over and above existing oversight by state and federal insurance and securities regulators, products, education, and advice from many registered representatives will become less available.[29]

D. The Proposed BIC Exemption Is Not Feasible.

Congress authorized DOL to issue class exemptions from the prohibited transaction rules only if it finds that the exemption is: (i) administratively feasible; (ii) in the interests of plans, participants and beneficiaries; and (iii) protective of the rights of participants and beneficiaries.[30] These findings cannot be made for the proposed BIC Exemption. The BIC Exemption is not feasible and not in the interests of, or protective of, plan participants.

First, its conditions are vague and without clear standards or benchmarks for compliance. For example, a firm is to represent and warrant compliance with the rule and that actions are in the best interest of the customer. Yet there is nothing in the proposed BIC Exemption to clarify in an objective manner what actions and activities

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[28] 80 Fed. Reg. at 21,984.

[29] In the DFA, Congress directed the SEC to conduct a study of the effectiveness of legal or regulatory standards of care (imposed by the SEC, FINRA, and other authorities) for providing personalized advice and recommendations to retail customers. The SEC issued a Staff report, *Study on Investment Advisers and Broker-Dealers,* in January 2011. The report recommended consistent standards of care between advisers and broker-dealers. But consistent standards are appropriate only where circumstances and conditions are the same, and there are fundamental and significant differences between investment advisers and broker-dealers. While the conclusions of the Staff report were challenged by certain Commissioners, the SEC nonetheless has spent several years in an effort to determine whether and if so, how, to impose a uniform fiduciary duty on brokers and investment advisers. The amount of time spent on this endeavor does not reflect a lack of will on the part of the SEC, but evidences the complexity of the task. In this context, we believe the Proposal is premature and that DOL should allow FINRA and the SEC time to further consider rulemaking. If DOL continues forward with the Proposal without pausing for meaningful input from functional regulators, firms will be left to wrestle with one regulator's standard of care conflicting with another's, as well as concerns as to whether a fiduciary representation eliminates the ability to rely on the broker-dealer exemption from regulation as an investment adviser.

[30] *See* ERISA § 408(a); I.R.C. § 4975(c)(2).

would be in the best interest of the customer. A firm cannot, with 100% certainty, represent and warrant its compliance with standards that are not defined.

The BIC Exemption would effectively require a written contract *before* a customer decides to establish a relationship with the provider. An adviser cannot market any product to a customer in reliance on the BIC Exemption before a written, three-party contract that complies with all of the BIC Exemption's onerous requirements has been entered into by the customer, the adviser and the financial institution. It is hard to see how this could possibly work in the real world. In no other context is a retail customer required, by government regulation, to enter into a complex contract with the retailer before he or she is allowed to learn about what products are for sale. A competition-based market economy cannot function unless customers can quickly and easily obtain information about the competing products for sale in the marketplace. This unprecedented contract requirement at the outset of the relationship with a potential customer is likely to discourage many Americans from becoming IRA customers at all, to the detriment of their retirement savings and harming society as a whole by decreasing retirement savings.

In contrast, if a customer desires information about, or to buy, investment products available for his or her personal account (*i.e.*, not part of an IRA or other tax-qualified plan), an adviser is free, without the requirement of any sort of contract (or fiduciary concerns), to market to the customer the various financial products available through the adviser and, subject to the long standing suitability standard, provide incidental investment advice. If the BIC Exemption is issued, it should delete the requirement of an executed contract between investor, agent and financial institution prior to any discussion as well as delete the contractual warranty requirements.

For a class exemption to be feasible, the exemption's requirements and conditions need to be clear and objective so that the parties seeking to rely on the exemption can be certain that a prohibited transaction will not occur. For example, the widely relied upon exemption under Part I of PTE 84-14 (the Qualified Professional Asset Manager exemption) contains only objective conditions. By contrast, the subjective nature of aspects of the BIC exemption calls into question whether the marketplace will accept reliance on the BIC exemption. An exemption that is not feasible is in no one's best interest.

The Proposal is also administratively infeasible because (as described further below) it will require creation of completely new and expensive disclosure and documentation systems. DOL has mandated in the BIC Exemption that the financial institution and/or the adviser make substantial, material disclosure of the fees it charges, both generally on its website, and specifically with respect to each transaction. These complicated disclosures will overwhelm the consumer with information and fail any cost/benefit analysis as they are simultaneously very costly to create and maintain. Any required disclosures should be simple and include standardized assumptions so they are easily digested and understood by customers and are not prohibitively costly to provide.

The Proposal will also require changes to arrangements with hundreds of thousands of existing State Farm customers. Explaining the need for all-new paperwork, and obtaining new physical signatures will be extremely difficult, if not impossible in many cases. These cost factors, combined with increased litigation risk, will likely reduce the availability of offerings. This is not in the interests of participants and beneficiaries.

III. A Seller's Exception or BIC Exemption Must Protect Consumers' Ability to Access Proprietary Products and Products That Utilize Differing Compensation Models.[31]

In drafting the Proposal, DOL sought to distinguish between fiduciary investment advice and non-fiduciary investment or retirement education. In its counterparty carve-out provision (the "seller's exception"), DOL further sought to exempt "sellers" from the proposed rules where the recommendation is in an arm's length transaction and there is no expectation of fiduciary investment advice. However, the Proposal actually sweeps in many relationships that DOL expressly sought to except out of the guidance, prescribing a seller's exception that is extremely narrow and limited to very large benefit plan situations. For the reasons set forth below, a strong seller's exception, covering all tax-qualified plans and IRAs, is needed.

A. There is No Expectation of a Fiduciary Relationship.

We agree that DOL should apply fiduciary status and standards of conduct in the context of a relationship where it is commonly understood that the adviser has agreed to provide advice in the best interest of the customer without regard to the adviser's own interests. However, it is not appropriate to treat a seller of financial products as a fiduciary when all those involved in the transaction understand that neither party expects or intends a fiduciary standard to apply.

B. There Is No Reason for Different Standards Among Fiduciaries.

Retirement investors do not benefit by applying different standards to plan fiduciaries based on the size of the plan. Under ERISA, both small plans and large plans are subject to fiduciary duties and responsibilities. There is no basis for believing that fiduciaries of small plans are less capable than fiduciaries of large plans at recognizing those fiduciary duties and responsibilities. Many small plan fiduciaries are as sophisticated as large plan fiduciaries. Further, application of this rule could result in "mid-sized" plans moving into and out of the carve-out numerous times based on employee counts and investment returns. ERISA requires that all plan fiduciaries have or obtain the same type of financial expertise that DOL uses to support its exception for large plans. Further, IRA owners should also be responsible for their own decisions or

[31] In addition to the specific comments set forth herein, we share the concerns expressed in other industry and trade association comments regarding the Proposal, including but not limited to the BIC Exemption and the proposed amendments to PTE 84-24.

choose to hire fiduciaries to make such decisions. Therefore, there is no justifiable policy reason to allow a seller's exception only with regard to large plans.

C. Proprietary Products Are Valuable to Customers, Especially Investors with Smaller Amounts to Invest.

The potential impact of the Proposal on proprietary products is of particular concern. State Farm offers a wide range of proprietary products such as insurance, mutual funds, annuities and bank products. These products have been developed to meet the needs of a wide range of customers. We serve a broad market, including many customers who are small investors who might not be served by investment advisers focused on the affluent market. State Farm agents who are registered representatives do not hold themselves out as independent advisers on the entire universe of potential investment products. In fact, an exhaustive list of options, even if feasible to develop and present, would overload many investors and might deter them from investing in a tax-qualified product. Moreover, it is easier to train those who are assisting potential investors with respect to the particulars of a proprietary suite of products. Even augmenting a proprietary product offering to include a handful of third party products, if done solely for purposes of compliance with the Proposal's standards, would not help consumers when the proprietary product offering, in and of itself, is diverse, competitive, and meets the desires of customers. Competition should drive retirement service providers in this regard to offer products they believe are wanted and needed by their customers.

D. There Must Be a Strong Seller's Exception.

To properly reflect the parties' expectations, to treat fiduciaries similarly, and to preserve consumer access to proprietary products, the Proposal should be revised to include an expansion of the seller's exception to include non-fiduciary selling activity as originally contemplated in DOL's 2010 proposal,[32] and as long recognized by the courts. As noted by multiple Federal circuit courts, "[s]imply urging the purchase of its products does not make an insurance company an ERISA fiduciary with respect to these products."[33] A robust seller's exception would allow an investor to continue to have a *choice* with respect to the level and amount of advice he or she wants, by preserving a regulatory structure in which a non-fiduciary salesperson will be willing to offer investment services and affordable options. With necessary disclosures regarding the terms of offerings, proprietary products would then be preserved as an option.

In the exclusively proprietary product model, it is clear and obvious to consumers that the agent or company is marketing a company product. The agent's or company's title says it all. When people go into that agent's or company's office (or otherwise make

[32] Definition of the Term "Fiduciary," 75 Fed. Reg. 65,263, 65,267 (proposed Oct. 22, 2010).

[33] *Cotton v. Mass. Mutual Life Ins. Co.*, 402 F.3d 1267, 1278 (11th Cir. 2005) (quoting *Am. Fed'n of Unions Local 102 Health & Welfare Fund v. Equitable Life Assurance Soc'y*, 841 F. 2d 658, 664 (5th Cir. 1988)).

contact), they do so because they want to learn about that company's products, because they are considering a purchase of that company's product, or because they want to learn more about how to protect their family, including saving and investing for future needs (*e.g.*, education and retirement). The agent or company may share information about a variety of investment products, including the features of IRAs and annuities. After that discussion, the customer may invest or the customer may visit with other companies' representatives to learn about the products offered by those other companies. This is no different than when a consumer makes other purchasing decisions, such as the purchase of a home. Providers of proprietary products should not be forced by regulatory requirement to offer the products of competitors. Buying a product from an agent who markets only proprietary products means the agent has had thorough training in those products and is well-prepared to answer questions regarding those products. The agent and/or a registered representative is unable to address every product in the marketplace, but instead would provide advice that is incidental to the customer's specific transaction.

Further, buying through a representative who markets only proprietary products may mean fewer conflicts of interest with respect to fees. While there may be different fees associated with different product lines, there is less likely to be differentiation in fees in products of the same class. For example, at State Farm, while an agent may be paid more if a customer makes a mutual fund purchase than if the customer purchases a bank certificate of deposit (due to the differing product complexity), there is generally no fee difference in an agent's compensation if the customer buys shares in one proprietary mutual fund over a different proprietary mutual fund within the State Farm family of funds.

We agree with DOL that if a representative charges a separate fee for advisory services, the representative should be held to a fiduciary standard. But unlike an investment adviser, a registered representative is generally prohibited from charging a separate fee for any incidental advice regarding proprietary products. The customer pays the same amount for the proprietary mutual fund in one class regardless of whether the customer initiates the purchase through a call center, online or through an agent/representative.

Finally, it should be noted that financial services companies like State Farm work hard to protect their brands. These companies have a vested interest in standing behind their proprietary products and understand that their brand's future depends on effectively designing, delivering and servicing such products.

E. Numerous Improvements Must be Made to the Proposed BIC Exemption.

If the seller's exception is not expanded, the proposed BIC Exemption must be revised. In particular, the additional requirements imposed by the BIC Exemption upon sellers of proprietary products should be eliminated. Financial institutions and their agent/representatives offering only proprietary products should be subject to the same rules as other financial institutions. So long as a financial institution and its registered representatives or investment advisers offer a broad range of investment options, there should be no requirement for additional documentation and representations.

Under the BIC Exemption, however, financial institutions must make available a range of assets that is broad enough to enable the registered representative or investment adviser to make recommendations with respect to all of the asset classes reasonably necessary to serve the investor's best interest.[34] As a threshold matter, we request that "all" be deleted. While financial institutions should provide a broad range of asset classes, they should not be required to offer every asset class. It is not clear how any institution could market all of the asset classes necessary for every investor.

While proprietary-only models are not expressly prohibited, it is unclear how a financial institution can be certain that the "best interest" standard in the BIC Exemption would be satisfied with an investment line-up that includes only proprietary products, regardless of how broad of a range of investment options are offered. In Section 913 of the Dodd-Frank Act, Congress made clear that "[t]he sale of only proprietary or other limited range of products by a broker or dealer shall not, in and of itself, be considered a violation of" standards of conduct that apply to investment advisers. Nowhere does the BIC Exemption indicate how a firm could offer only proprietary products and be confident that it will not be subject to the prohibited transaction excise taxes or can adequately defend itself in a lawsuit under the private right of action. We believe proprietary-only business models should be subject to the same requirements as business models offering a variety of proprietary and non-proprietary products. The additional requirements for proprietary products should be deleted and the Proposal should be revised to clarify that, if disclosed, the exclusive sale of proprietary products or services should not be considered evidence of a violation of the "best interest" standard, consistent with the Congressional directive of Section 913 of the Dodd-Frank Act. To impose additional requirements on financial institutions and their representatives who market proprietary products is unneeded, overly burdensome, and an unreasonable attack on such business models. Indeed, the Proposal's BIC "exemption" does not appear to be an exemption, but rather a conglomeration of conditions that effectively prohibit current, well-established practices.

F. Technical Changes Must be Made to Definition of "Financial Institution."

We note that Section VIII(e) of the Proposed BIC Exemption limits the definition of a "financial institution" in a manner that does not reflect the current variety of channels through which financial products and services are brought to market. For example, a company that meets the proposed definition of a "financial institution," such as an insurance company, with its representatives and agents, may market the products of

[34] It is impractical, if not impossible, for a financial services provider to offer *every* asset class. Asset classes might include, among many other possible examples, industry sector funds, country-specific funds or commodity-focused funds. In contrast, the ERISA Section 404(c) regulations, which generally make participants in participant directed ERISA plans responsible for their own investment decisions, require only that the plan make available to participants a menu of at least three investment alternatives from which to choose, so long as (i) each of which is diversified, (ii) each has materially different risk characteristics, and (iii) in the aggregate, allow participants, by choosing among them, "to achieve a portfolio with aggregate risk and return characteristics at any point within the range normally appropriate for the participant." 29 C.F.R. §2550.404(c)-1(b).

a second financial institution. However, the contractual arrangements that allow for this marketing frequently are with an entity that is affiliated with the insurance company, but which does not itself meet the proposed definition of a "financial institution." In order to give effect to the intent of BIC Exemption, we request that the definition of a "financial institution" in Section VIII(e) be revised to include all entities within an insurance group that arrange for the marketing of financial products. Similarly, the definition of a "financial institution" in Section VIII(e) should be revised to include banking entities that do not have trust departments. Many providers, including State Farm Bank, do not have trust powers or separate trust departments. In order to ensure consistent treatment, Section VIII(e)(2) should be revised to cover all banks and savings associations.

G. Commission Fee Structures Benefit Customers.

State Farm also notes that the Proposal discourages the use of fee structures other than level fee structures, even when alternative fee structures would be in the best interest of the customer. Many alternative fee structures, such as sales loads and commissions, are entirely appropriate for many customers and products. Investment products use different fee structures to account for the different benefits they deliver to the consumer, and the cost of providing the product or service. Because retirement saving is a long-term investment, fee structures should be evaluated over time. Often, when measured over a period of several years, a sales load or commission proves to be more cost effective to the customer than a level, ongoing percentage of assets under management fee. Particularly for small investors, the overall cost of investment is extremely important. *See* Exhibit A.

The Proposal assumes that level fee structures, as opposed to sales loads or commissions, are always better for the customer. SEC and FINRA have recognized that an array of fee structures can be appropriate for customers depending upon the specific facts and circumstances at hand (hence, the required suitability reviews).[35] Each type of fee arrangement has its place and time where it works for the customer and where it does not. The SEC and FINRA require a suitability review of recommendations of level fee structures to broker-dealer customers to ensure that the customer will benefit in the long-run by the fee structure selected and will not be subject to "reverse churning" (*i.e.*, the practice of a broker or adviser who is paid an asset-based fee providing minimal services and conducting too few portfolio transactions over time for the customer's account to justify the AUM-based fees).[36] Effectively prohibiting a compensation structure that has

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[35] SEC, Office of Compliance Inspections and Examinations, Examination Priorities for 2015 2 (2015), *available at* http://www.sec.gov/about/offices/ocie/national-examination-program-priorities-2015.pdf; Daisy Maxey, SEC Targets Reverse Churning by Advisers, WALL ST. J., Feb. 24, 2014, *available at* http://www.wsj.com/articles/SB10001424052702304610404579403251590760602; Mary Jo White, Chair, SEC, Remarks at National Society of Compliance Professionals National Membership Meeting (Oct. 22, 2013), *available at* http://www.sec.gov/News/Speech/Detail/Speech/1370539960588; Press Release, FINRA, FINRA Reminds Securities Firms Fee-Based Accounts Must Be Appropriate (Nov. 4, 2003), *available at* http://www.finra.org/newsroom/2003/nasd-reminds-securities-firms-fee-based-accounts-must-be-appropriate.

[36] Maxey, *supra* note 35.

been in place for decades and served customers well is not the most effective and efficient way to promote the long-term interest of savers who, in many cases, are better off paying a sales commission on a transactional basis rather than a significant ongoing AUM fee, especially when no further service is provided.[37] The market has shown that customers like having a choice of fee structures.

Indeed, outside of the investment or benefit plan/IRA context, sales loads, commissions and other variable fee structures are entirely permissible.[38] There is nothing special about retirement investment that justifies a perception that these fee structures are problematic when they are perfectly normal and accepted for all other investments. As discussed above, Congress in 1999,[39] and again in 2010,[40] specifically preserved commission and similar fee structures for broker-dealers, including when serving IRA and Plan accounts. Hence, the Proposal should not disfavor commission-based, non-level compensation models.

IV. The Costs of the Proposal Are Understated and the Benefits Are Overstated.

A. DOL's Cost Analysis is Incomplete.

DOL's cost analysis has grossly underestimated the time and expense individuals and firms will incur to comply with the Proposal. Indeed, the cost estimates appear to have been established on the basis of a limited sample of data, both in terms of volume and breadth, some of which may be irrelevant to the Proposal's requirements.[41] Moreover, although DOL's analysis contemplates up to a dozen systems, program, legal, and compliance costs,[42] its analysis of potential *indirect* costs is, at best, cursory. On this subject DOL concludes, without explanation or reference to empirical support, that it expects "[the Proposal] to have little effect on access to investment advice."[43]

The Proposal suggests that, despite DOL's current lack of reliable cost-benefit evidence, the current regulatory impact analysis is sufficient because such evidence will become available after the proposed rules are implemented. This suggestion is inconsistent with the requirements of administrative rulemaking and undermines the central purpose of Executive Order 12866: to require an economic basis for an agency to

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[37] Based on data from Strategic Insight.

[38] *See e.g.*, FINRA Rule 2121; Fair Prices and Commissions (permitting commissions and markups in securities transactions).

[39] Gramm-Leach-Bliley Act § 201, 15 U.S.C. § 78c(a)(4).

[40] DFA § 913(g), 15 U.S.C. § 78o(k).

[41] DOL, Fiduciary Investment Advice, Regulatory Impact Analysis 160 (Apr. 14, 2015) ("Regulatory Impact Analysis") ("[D]ue to the lack of other data sources on which [DOL] could base its cost estimates for the proposal, [DOL] used estimates submitted by SIFMA, IAA, and Charles Schwab to the SEC in response to its request to estimate costs.").

[42] *See id.* at 161.

[43] *Id.* at 175.

make an informed decision as to *whether and how* to finalize *proposed* rules. A post-promulgation analysis defeats the purpose: a robust and accurate cost-benefit analysis must accompany *proposed* rules.

We note that the Supreme Court recently addressed the importance of a robust cost/benefit analysis to federal agency rulemaking that takes into account all direct *and* indirect costs, and reversed an agency rulemaking that failed to do so.[44] Although costs incurred by affected industry participants are an important part of this analysis, the Court stressed that the analysis an agency must undertake is far broader in scope: "In addition, 'cost' includes more than the expense of complying with regulations; any disadvantage could be termed a cost."[45]

It follows that there is a broader range of costs that DOL must consider—in particular, the cost to Americans, especially those who may be traditionally underserved by the financial services industry, who will have fewer choices for and less access to retirement services if industry participants exit the business or decline to enter the business in the face of increasing compliance costs and regulatory risk. Lack of access could lead to harmful under-saving and greater reliance by these individuals on already strained public safety nets.

B. The Predicted Benefits of the Proposal Are Overstated and Misleading.

On the benefit side of its analysis, DOL uses estimates of savings and additional net returns to investors that are speculative and unrealistically optimistic. Moreover, DOL's expectation of savings to investors must be balanced with a careful analysis as to the likelihood and effect of the withdrawal of services from the market. The preamble to the Proposal gives only the slightest of nods to that issue:

> Some small service providers may find that the increased costs associated with ERISA fiduciary status outweigh the benefit of continuing to service the ERISA plan market or the IRA market. The Department does not believe that this outcome would be widespread or that it would result in a diminution of the amount or quality of advice available to small or other retirement savers.[46]

DOL has not sought to quantify the number, geographic locations, or market sectors where such small providers may depart the market. State Farm has over 18,000 independent contractor agents who function as small service providers. As discussed in greater detail below, the Proposal would place very real burdens on these agents and other financial industry participants. Some firms may find that the burdens "outweigh the benefit of continuing to service" this market, which in turn could result in significant lost

[44] *Michigan et al. v. Envtl. Prot. Agency et al.*, Nos. 14-46, 14-47, 14-49, 2015 WL 2473453, at *6 (S. Ct. June 29, 2015).

[45] *Id.* at *7.

[46] 80 Fed. Reg. at 21,954.

benefits to the investing public. Nor has DOL sought to quantify the benefits that financial services firms provide to their customers under the current regulatory framework.[47] These benefits, which include starting customers on retirement planning and saving, and counseling these customers in adverse market conditions, may well be substantially diminished by the restrictions contained in the Proposal. DOL must seek, analyze and carefully consider such data before acting on its Proposal.[48]

Finally, with respect to the substantive basis for undertaking its proposed reforms, DOL states that investors, most notably IRA investors, "cannot effectively assess the quality of the investment advice they receive or even the investment results they achieve."[49] DOL also cites a study by the RAND Institute that found that consumers do not understand the technical distinctions between brokers and registered investment advisers.[50] Yet, the RAND study also found that despite this purported confusion, the study's respondents were largely satisfied with the quality of and the personal nature of the service provided.[51] This level of satisfaction that consumers have with investment professionals should not be ignored. However, DOL, using its own largely conclusory analysis as its justification, presumes that consumers are incapable of measuring the quality of the advice they receive. On the basis of this presumption, DOL appears to discredit data on consumers' reported level of satisfaction with the financial professionals who provide them with advice and services, and even their understanding of the returns received on their investments. We disagree with this logic and encourage DOL to produce a well-reasoned assessment of anticipated benefits under the proposed rules which properly addresses the fact that investors largely are satisfied with current services, rather than solving for a problem DOL presupposes to exist.

C. DOL's Estimated Costs of Compliance Are Understated.

In general, among other things, to implement these regulations, a firm will have to:

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[47] Litan & Singer, *supra* note 9.

[48] In its press release regarding the withdrawal of its earlier 2010 proposal, DOL stated: "The re-proposal is designed to inform judgments, ensure an open exchange of views and protect consumers while avoiding unjustified costs and burdens. When finalized, this important consumer protection initiative will safeguard workers who are saving for retirement as well as the businesses that provide retirement plans to America's working men and women. The decision to re-propose is in part a response to requests from the public, including members of Congress, that the agency allow an opportunity for more input on the rule." Press Release, U.S. Department of Labor, News Release No. 11-1382-NAT (Sept. 19, 2011). DOL also promised in the press release to "harmonize" its reproposal with rulemakings by the SEC and the CFTC. DOL did not accomplish what it sought in the reproposal, as the Proposal will create unjustified costs and burdens and will overshadow and make moot the carefully considered rulemaking efforts of other regulators.

[49] Regulatory Impact Analysis, *supra* note 41, at 59.

[50] 80 Fed. Reg. at 21,934.

[51] Angela A. Hung *et al*., Investor and Industry Perspectives on Investment Advisers and Broker-Dealers, RAND Institute for Civil Justice 87 (2008), *available at* http://www.sec.gov/news/press/2008/2008-1_randiabdreport.pdf.

- review and assess its current operations;
- determine its abilities and litigation risk appetite;
- revise its compliance structures;
- develop, implement, and maintain new training protocols and associated systems and retrain thousands of employees, representatives, and agents on the complex new requirements;
- create new sales literature, including hundreds of print and online marketing materials;
- revise offering documents;
- create a brand-new, untested "mini-EDGAR" machine-readable website;
- revise compensation systems;
- create all-new supervisory policies and procedures;
- establish new compliance and audit parameters and implement new training modules; and
- educate millions of customers on the changes, send new documents to them, meet one-on-one with many of them, and persuade them to sign and return updated agreements and disclosure acknowledgements.

DOL estimates that it will take approximately 100 hours for a company to update its computer systems and websites to comply with disclosure and contractual requirements of the Proposal. This estimate is off by a multiple of at least 1,000. To illustrate, consider that compensation systems at State Farm are integrated across group business lines. Each systems change would require a series of underlying adjustments—including, for example, adjustment to vendor contracts or the development of new vendor relationships and the purchase, adoption, and maintenance of new software. New standards will require changes to systems that operate across all lines of business and across the entire country.

Other expenses would include the costs associated with:

- the development of personalized cost and expense disclosures for each customer, which will require substantial expenditures and IT systems programming;
- the commitment of time and resources from multiple business units, such as agency/sales training, legal, financial operations, mutual funds, banking, life insurance, internal auditing, risk management, compliance

and ethics, and others that will be called upon to implement compliance with the Proposal;

- extensive, costly revisions to marketing and sales process materials. For example, we estimate that approximately 700,000 customer accounts will be impacted under the proposed rules. This would require the updating of millions of printed marketing materials which contain discussion of ERISA and non-ERISA plans and arrangements;

- substantive and system-related reforms to training programs. For example, significant effort will be required to deliver training protocols to our agency distribution channel, which includes 77,493 total associates—18,261 agents, 56,620 employees of licensed agents, and 2,612 internal State Farm employees responsible for carrying out a multitude of internal functions and company operations. This cost will be in the millions of dollars; and

- new and ongoing expenses for over 18,000 State Farm agents (not just those who are registered representatives). Each agent's business will have to adopt and continually monitor new procedures to ensure compliance with the new rules and fiduciary standards.

V. A Longer Implementation Period And a More Expansive Grandfathering Clause Are Required.

A. A Longer Implementation Period Is Critical.

The Proposal would allow an eight month compliance period for firms to reinvent business models that have evolved gradually since the enactment in 1974 of ERISA and the Code's prohibited transaction rules. Within eight months, firms will also have to design (or hire consultants to create) machine-readable website data displays that have never before been required or implemented for any industry. They will also have to create and execute new contractual arrangements with, and obtain signatures from, tens of millions of customers throughout the industry (and hundreds of thousands of customers at State Farm alone). In addition, they will need to create new business and compensation models compliant with the very complex proposed rules. And these are just a few of the tasks that will be required—there will be many more.

The proposed eight-month implementation period appears arbitrary and is inadequate. It is unrelated to any business' operational realities and it disregards the effort that will be required in order to avoid disruptions in the ability of financial services firms to meet customer needs. To illustrate the scope of the work required, consider that State Farm, with over 18,000 agents and operations spread over the United States, will likely have to:

- develop new product and services configurations;

- obtain approvals for any new product changes from the appropriate functional regulators;

- create, conform and update account agreements, revise brochures, forms, and other documentation;

- update computer, compensation, and accounting systems;

- create and implement new compensation structures; and

- develop and conduct training for personnel and implement new policies and procedures, including oversight and compliance structures.

The Proposal also fails to take into account the substantial lead-time required to implement complex changes to long-term compensation arrangements that are already in place between insurance companies and agents and broker-dealers and registered representatives.

The implementation time period should be at least three years to enable completion of this work. We note that other federal agencies have allowed significantly longer periods than DOL has proposed for implementation of complex new rules.[52] The effective date prescribed in the Proposal fails to take into account the hundreds of thousands of hours that will be necessary for any large financial institution to perform these tasks. Further, the effective date should be at the start of a fiscal year in order to provide a clean break with respect to changes to procedures and changes to compensation arrangements, some of which may span the full calendar year.

B. A More Expansive Grandfather Clause is Needed.

If the proposed rules are adopted, they should provide for complete grandfathering of all existing tax-qualified product customers (including ERISA plans and other tax-qualified accounts maintained at one financial institution but funded with a product from another financial institution), whether or not new money is added to such a

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[52] *See, e.g.*, Institutional Eligibility Under the Higher Education Act of 1965, as Amended; Delay of Implementation Date, 79 Fed. Reg. 35,692 (June 24, 2014) (providing a nearly five-year implementation deferral for Department of Education rule); Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds, 79 Fed. Reg. 5536 (Jan. 31, 2014) (deferring effective date of the Volcker Rule to five years after enactment and three years after 2012 statutory effective date specified in 12 U.S.C. § 1851(c), with subsequent deferral of compliance for preexisting investments through July 21, 2017); Disclosure for Asset-Backed Securities Required by Section 943 of Dodd-Frank Wall Street Reform and Consumer Protection Act, 76 Fed. Reg. 4489 (Jan. 26, 2011) (deferring compliance with SEC rule by municipal issuers of asset-backed securities for four years); Press Release, Federal Trade Commission ("FTC"), FTC Extends Enforcement Deadline for Identity Theft Red Flag Rules (May 28, 2010), *available at* https://www.ftc.gov/news-events/press-releases/2010/05/ftc-extends-enforcement-deadline-identity-theft-red-flags-rule (announcing the FTC's three-year deferral of enforcement of a rule adopted in 2007); *see also* Money Market Fund Reform; Amendments to Form PF, 79 Fed. Reg. 47,736 (Aug. 14, 2014) (deferring compliance date with SEC rule for over two years).

tax-qualified customer relationship after the implementation date. State Farm has entered into hundreds of thousands of account and investment agreements with customers that apply to tax-qualified retirement vehicles. State Farm has also entered into thousands of contracts with independent contractor agents, which would be affected by the Proposal. Each one of those contracts would be drastically affected if the Proposal were approved and applied retroactively. We question the legality of retroactively changing the terms of hundreds of thousands of existing contracts, all of which were legally negotiated and executed in a manner fully consistent with federal and state laws.

If a complete grandfathering provision for all existing tax-qualified product customers is not adopted, firms will be required to fundamentally change the nature of their customer relationships involving existing tax-qualified accounts. In many cases, customers have paid an initial sales charge with an understanding that they would have access to additional investment advice for those purchases without incurring additional fees. For example, a customer nearing retirement may want advice on how to re-allocate his or her investments in order to match a changing risk profile. In the current environment, the registered representative would provide the customer with the advice without receiving any significant additional compensation. Without a comprehensive grandfather provision, it will be more costly for firms to provide advice to these customers and, as a result, may charge a fee for such services or reduce access to such advice. Clearly, this result is not in the best interest of the customer.

Further, the limited grandfathering clause in the Proposal for existing agreements with respect to the conditions of the proposed BIC Exemption would require that companies and their representatives or agents provide no "advice" to an existing account. The term "advice" is so broadly defined that it effectively precludes, before a contract is signed, all communications—oral or written—with the customer as to his or her existing accounts, or even responding to the most basic of customer questions about existing IRA investments. This will not serve the best interests of the customer. It is also hard to imagine how an agent could document, for purposes of compliance, that he or she did not provide "advice" during a conversation with a customer. A complete grandfathering of existing tax-qualified product customers is necessary to avoid extreme disruptions to communications between customers and agents, and to allow agents to demonstrate compliance.

VI. DOL Should Consider the Efforts of, and Coordinate With, Functional Regulators.

DOL's concerns regarding the financial security of American retirees are legitimate. But DOL must recognize that the Proposal could effectively result in many small investors receiving no advice at all and cause many people to ignore or postpone retirement saving.

This is not to say that cost savings cannot be realized in tax-advantaged retirement accounts, or that the interests of providers and investors cannot be more closely aligned. As noted earlier, the SEC has been working on the issues related to the appropriate standard of care for broker-dealers and investment advisers pursuant to the authority

granted under the Section 913 of the DFA. The SEC, as the regulator of investment advisers and broker-dealers, continues to focus on the complex task of determining proper standards of care. We believe the most efficient and effective method of constructing a cohesive framework for additional consumer protection is one that includes the coordinated efforts of all relevant agencies.

DOL must also consider how proposals advocated by the Securities Industry and Financial Markets Association (SIFMA) would change the suitability standard that currently applies to broker-dealers and their registered representatives with a best interest standard. Interested parties have also called for bipartisan legislation to establish a best interest standard, with workable rules that maintain access to investment assistance for low- and middle-income individuals and small businesses. Coordination with other regulators and consideration of the positions of other interested parties would also identify other potential solutions the Proposal omits, such as requirements for more clear and consistent disclosure practices that would better serve investors without threatening to disrupt the provision of services. In any case, State Farm would welcome the opportunity to work with DOL, the SEC, and FINRA in a collective effort on standards of care related to tax-qualified accounts.

VII. The Proposal Fails to Address Costs to State Court Systems and the Impact on State Insurance and Broker Regulation.

The Proposal does not adequately address its federalism implications. As required by Executive Order 13132,[53] a proposing agency must provide to the Director of the Office of Management and Budget a federalism summary impact statement. The statement must describe the extent of the agency's prior consultation with state and local officials, summarize their concerns and the agency's position, and state the extent to which the concerns of state and local officials have been met.

Executive Order 13132 was issued in furtherance of the Unfunded Mandates Reform Act, of which one of the stated purposes is "to end the imposition, in the absence of full consideration by Congress, of Federal mandates on State, local, and tribal governments without adequate Federal funding, in a manner that may displace other essential State, local, and tribal governmental priorities."[54] Notwithstanding the certain interference with state insurance and securities regulatory programs, and the costs and impositions to state court systems of litigation over the BIC Exemption, DOL has dismissed any possibility of federalism implications, stating that it has "no implications for the States or the relationship or distribution of power between the national government and the States."[55]

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[53] Exec. Order No. 13132, 64 Fed. Reg. 43,255 (Aug. 10, 1999).

[54] 2 U.S.C. § 1501 *et. seq*. (1995).

[55] 80 Fed. Reg. at 21,956.

ESSENTIAL CHANGES TO MAKE THE PROPOSAL POTENTIALLY VIABLE

As described above, an effort at regulatory reform that is coordinated with functional regulators, more inclusive of the variety of established delivery models and more supportive of consumer choice is in the best interest of consumers and small businesses. However, in the event DOL disagrees and determines it should move forward independently with the Proposal, we strongly believe that certain changes are essential to make the proposed rules practicable and workable without undue disruption of the retirement investment market. Specifically, any final rules would be viable only if they were to:

- Adopt a broad seller's exception that includes non-fiduciary selling activity as originally contemplated in DOL's 2010 proposal;
- Preserve DOL Interpretive Bulletin 96-1 in order to allow investors to receive educational materials as they do today, without establishment of any fiduciary relationship;
- Make the proposed BIC Exemption more workable by:
    - Revising the timing for execution of a best-interest contract so that execution is required at the time of the sale of a product, not before having any discussions.
    - Maintaining existing enforcement regimes and not creating a private right of action for IRAs, to ensure consistency with Congressional intent and well-established understandings under current law;
    - Providing safe harbors, rebuttable presumptions and other objective standards so that financial institutions and advisers have clear guidance as to the behavior the rules are seeking to achieve;
    - Deleting the proposed requirement of making recommendations with respect to "all" asset classes;
    - Removing the additional requirements imposed on proprietary products and clarifying that, if properly disclosed, proprietary products do not constitute evidence of a violation of the best interest standard;
    - Revising the definition of a "financial institution" to include (i) all depository institutions, whether or not they have trust powers, and (ii) all entities within an insurance group that arrange for the marketing of insurance products;

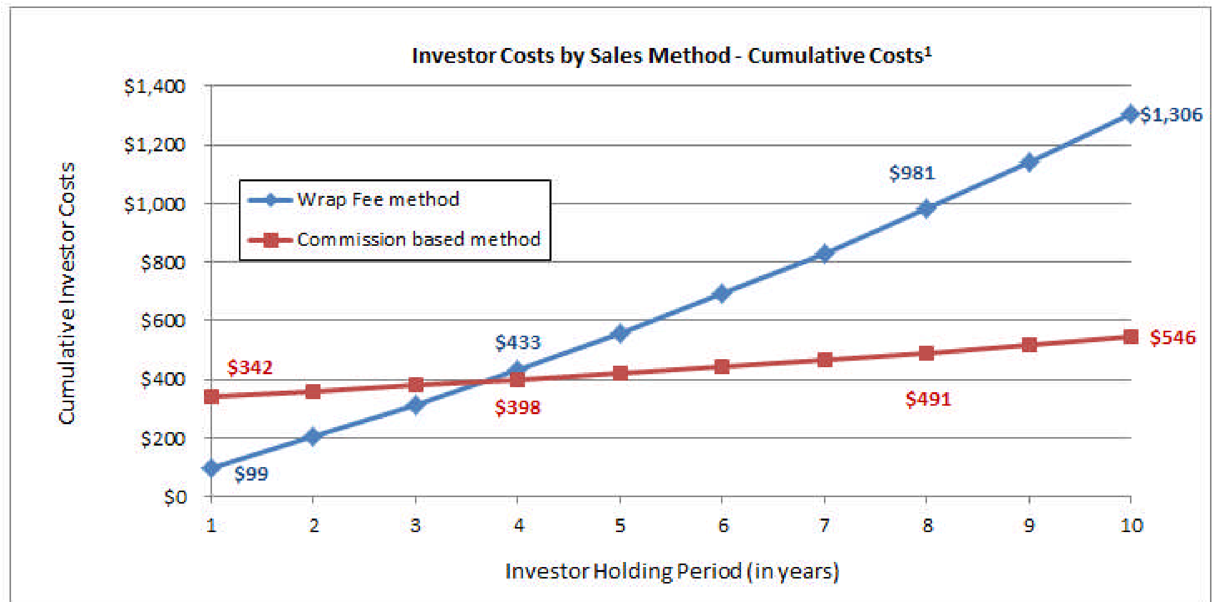
- Simplifying and reducing the burdens associated with disclosures required under the Proposal and coordinating new disclosure requirements with all governing agencies; and
- Preserving the choices that investors have today in determining the level of service and the fee structure they want, including the option of commission fee structures;

- Provide an implementation period of at least 3 years; and
- Provide complete grandfathering of all existing tax-qualified product customers (including ERISA plans and other tax-qualified accounts maintained at one financial institution but funded with a product from another financial institution), whether or not new money is added to such a tax-qualified customer relationship after the implementation date.

CONCLUSION

State Farm appreciates the opportunity to provide these comments to DOL, and further appreciates DOL's objective of protecting retirement investors. As we have explained in our comments, we believe the current Proposal is unworkable as a practical matter, and the anticipated effects of this particular Proposal run counter to DOL's desired objectives. We urge DOL, rather than moving forward with the Proposal, instead to engage in a collaborative and considered effort involving multiple functional regulators, the financial services industry, and consumer stakeholders. State Farm is prepared to participate in such a collaborative effort, and to provide the benefit of our experience and point of view to those similarly concerned about providing financial security to all Americans.

EXHIBIT A



The chart above illustrates 'Investor Costs by Sales Method' using the State Farm median account size of $6,500 and a range of holding periods. The average State Farm mutual fund shareholder holding period is longer than the industry average.

Please refer to the chart and note the following points:

1. In looking at only year 1 investor costs, it would appear that the commission-based[2] method is more expensive than the wrap fee[3] method ($342 vs. $99).

2. However, in looking at the longer 8-year and 10-year cumulative investor costs, the wrap fee method is actually much more expensive than the commission-based method.
   i. For the 8-year cumulative period, wrap fee method expenses are 2.0 times more expensive than the commission based method ($981 vs. $491).
   ii. For the 10-year cumulative period, wrap fee method expenses are 2.4 times more expensive than the commission-based method ($1,306 vs. $546).

3. Notably, during year 4, the wrap fee method begins to be more expensive for the investor ($433 vs. $398).

[1] Both methods assume 6% annual market growth on original investment amount; no additional contributions; and similar underlying fund expenses (excluding 12b-1 fees).

[2] State Farm front-load commission at $6,500 is 5.0%; costs also include 0.25% annual 12b-1 fee.

[3] Based upon data from Strategic Insight, the industry average wrap fee at all investment levels is 1.10%, while the industry average wrap fee for amounts below $100,000 is 1.48%.