State Farm®

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April 14, 2017

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-AB79: Definition of the Term "Fiduciary"; Conflict of Interest Rule--Retirement Investment Advice; Best Interest Contract Exemption (Prohibited Transaction Exemption 2016-01); Class Exemption for Principal Transactions in Certain Assets Between Investment Advice Fiduciaries and Employee Benefit Plans and IRAs (Prohibited Transaction Exemption 2016-02); Prohibited Transaction Exemptions 75-1, 77-4, 80-83, 83-1, 84-24 and 86-128

Ladies and Gentlemen:

State Farm Mutual Automobile Insurance Company and its subsidiaries (collectively, "State Farm") write with respect to the Department of Labor's (the "Department") final regulation defining the term "fiduciary" (the "Rule") under the Employee Retirement Income Security Act of 1974, as amended, and the Best Interest Contract Exemption (the "BIC Exemption"), in each case issued by the Department on April 8, 2016 (together, the "Fiduciary Rule"). In its proposal to delay the effective date of the Fiduciary Rule by 60 days, the Department invited commenters to respond to the questions raised in the Memorandum of President Trump to the Secretary of Labor dated February 3, 2017 (the "President's Memorandum") and more generally on questions of law and policy concerning the Fiduciary Rule.

In response, State Farm wishes to reiterate its belief that the Fiduciary Rule will reduce consumers' access to retirement services and investment information without offering commensurate benefit. Thus, State Farm urges the Department to rescind the Fiduciary Rule and collaborate with the US Securities and Exchange Commission (the "SEC") to adopt a unified fiduciary standard applicable to the financial services industry.

In the event the Department maintains the Fiduciary Rule, State Farm believes that the Department should review the rule in light of the many adverse effects that have been catalogued by State Farm and other financial industry participants, including in the comment letters dated

July 21, 2015[1] and September 24, 2015[2] submitted by State Farm following the rule's proposal. At a minimum and as explained in the attached comments, State Farm believes that the:

- BIC Exemption should be eliminated or substantial modifications should be made to its requirements to remove certain vague and overly burdensome requirements.

- Private right of action provided for in the BIC Exemption should be eliminated.

- Fiduciary Rule should be revised to reflect the clear Congressional intent that neither (i) the receipt of a commission or fee in connection with the sale of investment products, nor (ii) the sale of proprietary products constitute a violation of the "best interest" standard articulated in the Fiduciary Rule.

- Department should provide for an implementation period following the delayed effective date of the Fiduciary Rule of not less than 18 months.

State Farm encourages the Department to carefully consider the direction provided in the President's Memorandum and to further delay implementation of the Fiduciary Rule if the Department determines to propose revisions to the Fiduciary Rule instead of an outright rescission. The applicability date of June 9, 2017 recently adopted by the Department and the accompanying narrative does not allow for, and does not reflect, the thorough analysis called for in the President's Memorandum.

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

Sincerely,

Stephen McManus
Senior Vice President and General Counsel

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Attachment

[1] Comment letter available at: https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/public-comments/1210-AB32-2/00646.pdf

[2] Comment letter available at: https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/public-comments/1210-ZA25/00359.pdf

COMMENTS OF STATE FARM MUTUAL AUTOMOBILE INSURANCE COMPANY AND ITS SUBSIDIARIES ON RULES OF DEPARTMENT OF LABOR REGARDING DEFINITION OF THE TERM "FIDUCIARY," CONFLICT OF INTEREST RULE – RETIREMENT INVESTMENT ADVICE, BEST INTEREST CONTRACT EXEMPTION (PROHIBITED TRANSACTION EXEMPTION 2016-01), CLASS EXEMPTION FOR PRINCIPAL TRANSACTIONS IN CERTAIN ASSETS BETWEEN INVESTMENT ADVICE FIDUCIARIES AND EMPLOYEE BENEFIT PLANS AND IRAS (PROHIBITED TRANSACTION EXEMPTION 2016-02), AND PROHIBITED TRANSACTION EXEMPTIONS 75-1, 77-4, 80-83, 83-1, 84-24, AND 86-128

April 14, 2017

SUMMARY

Since April 20, 2015, State Farm Mutual Automobile Insurance Company, with its subsidiaries (collectively, "State Farm"), has made an enormous commitment of resources to analyzing its business in light of the Department of Labor's (the "Department") proposed and then final rule defining "fiduciary" under the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), and the Best Interest Contract Exemption (the "BIC Exemption") (together, the "Fiduciary Rule").

Since 1922, State Farm has been proud to help individuals across the United States manage the risks of everyday life, recover from the unexpected, and realize their dreams. As State Farm has emphasized in comment letters dated July 21, 2015 and September 24, 2015, the Fiduciary Rule undermines the ability of State Farm to serve customers according to their needs and deprives those customers of choices with regard to the investment advice and guidance they can receive. These impacts have the greatest effect in traditionally underserved markets of low and moderate income households.

In light of these concerns, the Department should rescind the Fiduciary Rule and collaborate with the US Securities and Exchange Commission (the "SEC") to adopt a unified fiduciary standard applicable to the financial services industry.

In the event that the Department maintains the Fiduciary Rule, the Department should make substantial revisions to the Fiduciary Rule, including those discussed in the remainder of these comments. State Farm encourages the Department to carefully consider the direction provided in the President's Memorandum and to further delay implementation of the Fiduciary Rule if the Department determines to propose revisions to the Fiduciary Rule instead of an outright rescission. The applicability date of June 9, 2017 recently adopted by the Department and the accompanying narrative does not allow for, and does not reflect, the thorough analysis called for in the President's Memorandum.

Commentary

1. The BIC Exemption should be eliminated or substantial modifications should be made to its requirements to remove certain vague and overly burdensome requirements.

The Fiduciary Rule is one of the most significant regulatory actions ever imposed on the financial services industry. However, in adopting the Fiduciary Rule, the Department itself recognized that it lacks the ability to enforce the sweeping changes it seeks.[3] Instead, through the BIC Exemption, the Department has established a framework which will compel firms to enter into a contract with customers incorporating the Department's requirements as substantive contractual terms, including making warranties that in effect expand the application of ERISA fiduciary duties without Congressional action.

[3] For example, a Department of Labor official was quoted as describing the BIC Exemption as the Department being "creative to try to find a way to make the . . . fiduciary responsibility [in ERISA] . . . enforceable in the IRA context." *See* Nick Thornton, *Who will enforce the DOL rule?*, Benefits Pro (June 1, 2016), http://tinyurl.com/goobyjk.

State Farm sharply disagrees with this approach. As discussed in more detail in the following section, the only way such a framework can be enforced is through private litigation, with all of its attendant uncertainty, costs and disruptions. More fundamentally, however, State Farm objects to the way in which the BIC Exemption alters the relationship that State Farm has with its customers, effectively depriving its customers of the option to pay only for services they want. Such an intrusion into an already highly regulated relationship is unwarranted and will lead directly to increased costs and diminished access for American retirement investors. The Department, therefore, should reconsider the use of a compulsory contractual framework to achieve its goals.

In addition to these core objections, the BIC Exemption as written is impractical, overly burdensome and prohibits contractual terms that are customary, reasonable, and appropriate for contracts between institutions and customers.

The Fiduciary Rule and the BIC Exemption require industry participants to adhere to a vague and open-ended "best interest" standard that is difficult to apply in the context of the common customer interactions the Department seeks to regulate. In addition, this standard may differ from other regulatory obligations applicable to these same interactions (e.g., FINRA's "suitability standard"). To some degree, these concerns could be addressed by incorporating into the BIC Exemption clear standards of conduct that would give financial institutions and advisors a roadmap to ensure compliance. In our previous comment letters, we provided suggestions for safe harbors that we believe would help achieve this end. In its current form, the BIC Exemption's more opaque requirements will come to be more clearly defined only after years of litigation.

Compounding this challenge is the burdensome requirement to enter into a separate BIC Exemption contract with each retirement investor. The Department's objectives could be met in a less costly and less disruptive way by adopting a framework of required disclosure that would provide retirement investors with the information necessary to evaluate their relationship with financial industry participants. If modeled on a plain-English framework, such a disclosure-based approach would create limited consumer confusion while meaningfully advancing the Department's objectives. [4]

Finally, if the Department does not opt for a disclosure-based approach, but instead retains the compulsory contract approach, the limitations on customary contractual provisions imposed by the BIC Exemption should be reconsidered. Such limitations are ill-conceived and will create long-running challenges in serving consumers under the exemption. For example, the BIC Exemption prohibits customary waivers of participation in class actions, which will dramatically

[4] For example, Prohibited Transaction Exemption 84-24—at least as in effect until June 9, 2017—contains clearly articulated standards. These standards now provide effective protection to investors as well as a clear path to compliance for financial institutions and advisers. However, alongside the Fiduciary Rule, the Department has promulgated substantial revisions to PTE 84-24 that will significantly increase the compliance burden for financial institutions. Though not the subject of the present comment letter, the amendments to PTE 84-24 are integrated with the Fiduciary Rule (as recognized by the Department in delaying their effectiveness together with the delay of the Fiduciary Rule). Like other aspects of the Fiduciary Rule, these amendments create similar uncertainties and will increase compliance costs with little commensurate benefit to investors. Therefore, the Department should use the input received from commenters with regard to the Fiduciary Rule as a basis for reverting back to the previous PTE 84-24 or to propose revisions to the amended PTE 84-24.

increase the number of abusive class action suits that have the potential to create significant disruption for financial services firms with little benefit to investors. Prohibiting such clauses will simply add costs to a financial institution's business that will ultimately be passed on to customers.

2. At a minimum, the private right of action provided for in the BIC Exemption should be eliminated.

As discussed in our earlier comment letters, the contractual terms imposed by the BIC Exemption create—by design—liability under state law that (at least in the case of individual retirement accounts) Congress has never granted the Department the power to impose. This private right of action is not a part of the statutory framework of either the Internal Revenue Code or "ERISA" and would empower the plaintiff's bar, rather than the IRS, to enforce the prohibited transaction rules. Moreover, the creation of a private right of action for violation of fiduciary duty will result in the application of multiple state laws in multiple jurisdictions. This result runs counter to the intent of Congress as expressed in Section 514(a) of ERISA, which provides that ERISA supersedes all state laws (presumably including BIC Exemption-based contractual claims) as they relate to any qualified employee benefit plan. It also adds great costs for consumers and regulated entities which are contrary to the standards of review in the President's Memorandum.

As a method of enforcement, the Fiduciary Rule's private right of action is a significant and serious flaw. Litigation leads to uncertainty and delay, and will increase costs for all financial industry participants. This harm is compounded by the fact that the Fiduciary Rule provides no (or ineffective) safe harbors clarifying what is and is not unlawful under the rule. What the Department claims is "flexibility" for companies (supposedly a benefit to industry participants), is actually impractical and represents a significant continuing burden on industry participants and ambiguity for consumers. The standards upon which a transaction will be litigated will vary from trial court to trial court and will then be subject to further review and interpretation through the appellate process in multiple jurisdictions. It will take years for the standards to be developed by case law, during which time, financial institutions, advisors and customers will lack guidance as to the standards applied to these transactions. In addition, consumers will not experience predictable and consistent outcomes in the courts.

The contention made by various parties in the comment process to the effect that the proposed Fiduciary Rule will not increase financial institutions' litigation risk is simply false. For example, the BIC Exemption contains numerous new requirements of contractual warranties, all of which form the basis for future causes of action. To suggest that the standards are clear because fiduciary standards are well established ignores the new obligations created in hundreds of pages of rulemaking. Undoubtedly, there will be differences of opinion regarding these new obligations and creative trial lawyers will make use of the private right of action to have these differences decided by courts. The effect will be increased costs for financial institutions and customers and an on-going drain on judicial resources.

The Department must confront the reality of these additional costs and burdens, and should take a realistic view of their magnitude. In its regulatory impact analysis, the Department estimated that the Fiduciary Rule would impose an aggregate annual cost to the industry of $1.5

billion, in addition to an estimated $5 billion in upfront costs.[5] We believe these cost estimates are too low, by several orders of magnitude for both financial institutions[6] and for customers.[7]

Moreover, these figures do not include any estimate for the costs of litigation as a result of the private right of action. In a recent report, Morningstar is forecasting that the industry is likely to incur between $70 million and $150 million in annual class-action litigation settlement costs, over and above the costs estimated in the Department's regulatory impact report. The report makes clear that these estimates do not even include attorneys' fees, and it acknowledges the well-settled truth that even meritless claims cost money to defend. Actionable conduct will, from time to time, occur by some financial institutions. Those harmed through such conduct should of course be compensated through existing and long established legal remedies. However, the Fiduciary Rule encourages meritless litigation and will greatly increase the expenses incurred in the provision of investment advice to retirement investors. This increase will in turn raise the overall cost of retirement and investment advice, likely limit access to financial services advice and products, especially for low and moderate income consumers, and thereby harm the very customers that the rule is intended to protect.

The Department's approach also ignores dispute resolution mechanisms that are more efficient and effective than traditional litigation.[8] The arbitration panels established and maintained by various self-regulatory organizations, notably FINRA, are designed to expediently and efficiently resolve disputes between participants. These arbitration forums provide an attractive alternative to traditional litigation, and an alternative that many in the industry, as well as many consumers, have embraced. At the very least, it would be preferable to establish a conference and administrative process where a dispute could be reviewed on the merits as a precondition to issuance of a right-to-sue certification. This would speed resolution of legitimate disputes and lessen the burden on our court systems.

The risk of increased litigation (and resulting costs) is a central concern of the President's Memorandum, which asks the Department to consider "whether the Fiduciary Duty Rule is likely to cause an increase in litigation, and an increase in the prices that investors pay to gain access to

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[5] *See* Regulatory Impact Analysis for Final Rule and Exemptions (April 2016) page 10.

[6] *See* State Farm Comment Letter, dated July 21, 2015 page 28 ("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.").

[7] As State Farm has previously described, the Department has also not sufficiently taken into account the costs that will be borne by customers. Perhaps most importantly, the Department failed to consider the extent to which customers, particularly those with middle or lower incomes, will lose access to professional investment guidance following the implementation of the Fiduciary Rule, and the amount by which retirement savings may diminish as a result.

[8] These concerns are accentuated by the fact that the multiple jurisdictions in which Fiduciary Rule disputes will be litigated will likely come to differing decisions resulting in inconsistent guidance regarding future conduct.

retirement services." It is very clear that the Fiduciary Rule, as adopted, will lead directly to these consumer harms.

3. The Fiduciary Rule should be revised to reflect the clear Congressional intent that neither (i) the receipt of a commission or fee in connection with the sale of investment products, nor (ii) the sale of proprietary products constitute a violation of the "best interest" standard articulated in the Fiduciary Rule.

State Farm has previously noted in its comment letters that the Fiduciary Rule ignored clear Congressional intent in a number of instances. Most significantly, the Fiduciary Rule clearly disfavors both the use of commission payments in connection with the sale of investment products and the sale of proprietary financial products by a financial institution and its advisors.

(a) Commission Payments

The payment of commissions has long been a mainstay of the financial industry. This reflects the fact that the payment of commission-based compensation—tied as it is to a particular transaction—is easy for customers to understand and, in many cases, represents good value for small, low-volume accounts. For example, JD Power's *DOL Special Report* found that 59% of investors who currently pay commissions responded that they "probably would not" or "definitely would not" stay with their current firm if required to switch to a fee-based arrangement.[9] It is therefore unsurprising that, as noted in our prior comments, Congress expressed its clear intent to preserve existing business models utilized by retail investors through the enactment of Section 913 of the Dodd-Frank Act.[10] In this provision, Congress mandated that the receipt of a commission, fee, or other standard form of compensation shall not, in and of itself, constitute a violation of any best interest standard of conduct established by the SEC.

Because these provisions, the product of a detailed legislative process in Congress, are meant to provide a workable regulatory framework for the provision of advice to *all* retail investors, including those investing for purposes of retirement, it is critically important that the Fiduciary Rule incorporate the Congressional recognition of the validity of commission-based compensation. The Fiduciary Rule could accomplish this by providing expressly that the receipt of commissions and similar compensation by an advisor, financial institution, or affiliate or related entity of either the advisor or financial institution will not be considered a violation of the impartial conduct standard. Such adjustments will help preserve business models that are relied upon by millions of investors and retirement savers, particularly those with modest account balances or a buy and hold investment strategy.

(b) Proprietary Products.

In addition, Section 913 also requires any industry wide fiduciary standard to allow for the sale of a proprietary or limited range of investment offerings to retail customers, provided that certain disclosure requirements are satisfied. In order to fully implement Congressional intent and recognize the important and legitimate role that proprietary products play in the financial services

[9] http://www.jdpower.com/resource/wealth-management-fiduciary-roulette

[10] Dodd-Frank Act § 913(g); 15 U.S.C. § 78o(k).

industry, the BIC Exemption, if not eliminated in its entirety, should eliminate the specific additional requirements[11] imposed in the final Fiduciary Rule on the sale of such products. To the extent that a financial institution is otherwise complying with the BIC Exemption requirements, including the adoption and implementation of policies and procedures reasonably designed to ensure that retirement investors are provided with recommendations that are in their best interest, State Farm does not believe it is appropriate to impose additional burdens on institutions that offer proprietary products. In the case of State Farm, consumers know they are buying a State Farm product because these products are marketed exclusively through its proprietary agency system or on a direct basis.

4. For the reasons described above, the Department should reconsider the Fiduciary Rule and, in any case, provide for an implementation period following the delayed compliance date of the Fiduciary Rule of not less than 18 months.

Since its founding in 1922, State Farm has dedicated itself to serving the needs of its customers and State Farm is supportive of efforts to ensure the wellbeing of the people it serves. However, the Fiduciary Rule is one of the most significant (and adverse) developments State Farm has faced in almost a century of operation and as described in this letter and its previous submissions, State Farm does not believe it advances the interests of retirement investors. The Department should therefore take steps to reexamine the Fiduciary Rule from top to bottom. The harm to low and moderate income consumers and other investors of limited means is real because the rules make servicing these markets more expensive. These constituencies are already underserved today. This process would also be valuable if it took into account the views of industry participants—in the form of a request for comments—that have made significant investment over the past twelve months towards the implementation of the Fiduciary Rule.

Regardless of the Department's next steps in reviewing the Fiduciary Rule, as we and many industry participants have noted, the limited implementation period provided by the Fiduciary Rule was inadequate and burdensome given the scale and complexity of the rule and the changes to our business that needed to be made as a result. The Department should not repeat or compound this mistake. This is particularly the case if the Department adopts the significant changes to the Fiduciary Rule that we believe are necessary based on the additional analysis required by the President's Memorandum. Thus, State Farm proposes at a minimum an implementation period of at least 18 months and ideally 24 months from the compliance date of any modified Fiduciary Rule.

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[11] As set forth in Section IV of the BIC Exemption, these requirements include that the retirement investor is informed in writing that the Financial Institution offers proprietary products or receives third party payments with respect to the purchase, sale, exchange, or holding or recommended investments and that the retirement investor is informed in writing of any limitations placed on the universe of investable securities; the retirement investor is fully and fairly informed in writing of any material conflicts of interest that the Financial Institution and Advisor have with respect to the recommended transaction, including those that can arise out of the offer and sale of proprietary products; and the Financial Institution adopts, monitors, implements, and adheres to policies and procedures and incentive practices that meet the requirements of the Fiduciary Rule.

Conclusion

State Farm appreciates the opportunity to provide these comments to the Department. As noted in our previous comments and the discussion above, the Fiduciary Rule runs counter to the Department's objectives of protecting investors and is especially challenging to consumers of limited means who need some investment assistance. We encourage the Department to consider these comments in the context of the comprehensive review of the Fiduciary Rule initiated by the President's Memorandum, which offers the Department the opportunity to rescind the Fiduciary Rule and engage in collaborative efforts with other interested regulators towards a uniform fiduciary standard for the entire industry. Alternatively, such comprehensive review will at least provide the opportunity to make needed revisions, in order to reduce the unintended harms that will be caused by the rule's implementation. State Farm welcomes the opportunity to engage with the Department as it considers these critical questions.