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September 24, 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 D.C. 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 are writing to supplement the views of State Farm Mutual Automobile Insurance Company and its subsidiaries (collectively, "State Farm") in response to comments submitted and statements made at the public hearings 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").[1]

The administrative docket contains thousands of comment letters that raise complex issues regarding the Proposal. DOL, as a matter of rational rulemaking and as

[1] State Farm submitted initial comments during DOL's first comment period on July 21, 2015. We use "Proposal" to refer, collectively, to the notices of proposed rulemaking referenced above.

required by the Administrative Procedure Act ("APA"), must fully consider these comments and the issues they raise before determining how to act on the Proposal.

After reviewing the comment file and proceedings, State Farm remains concerned that the Proposal is unworkable in its current form and that its effects will run counter to DOL's objectives. Specifically, State Farm is concerned that it will reduce options for all savers, but especially for savers with modest amounts to invest. Part I of the attached comments discusses our concerns, including our continuing concern that DOL does not have the necessary authority to promulgate this Proposal. State Farm continues to believe that, instead of moving forward with the Proposal, DOL should engage in a concerted effort with multiple functional regulators, the financial services industry, and consumer stakeholders to preserve choices for investors. However, in the event that DOL determines to move forward, Part II suggests specific improvements that must be adopted for providers to implement the Proposal.

State Farm appreciates 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

SUPPLEMENTAL 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

September 24, 2015

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EXECUTIVE SUMMARY: PART I
CONCERNS REGARDING THE POSITIONS OF COMMENTERS

The totality of the record, consisting of letters, studies and statements submitted in hearings, establish that the proposed new regulations would reduce investment options, offerings and advice for middle- and modest-income individuals. While State Farm has been assured by DOL that its intention is not to eliminate options for savers or to favor one investment assistance model over another, the Proposal as drafted does both. The Proposal would effectively prohibit differentiated commission-based compensation and the use of proprietary products because of the onerous and impractical administrative burden imposed by the BIC Exemption. This Proposal will leave many small retirement investors without needed services, and without guidance from investment professionals as to the necessity of retirement saving. The Proposal fails to recognize that most firms that charge for services based on assets under management ("AUM"), which DOL apparently favors, typically serve only customers with larger amounts to invest. Investors should have choices, and the Proposal will remove choices from the market.

As a result, the Proposal will actually cause more under-saving in the nation. Numerous well-informed bodies and professionals, including the U.S. Chamber of Commerce and the Small Business Administration, have warned that the Proposal will have this effect, or at the very least, that DOL has not carefully assessed the consequences of this likely result. Nor has DOL adequately considered other costs and disadvantages of the Proposal, including the lost time and confusion caused to investors by a rule change that affects their relationships with their current advisers. No regulation that limits access and options and engenders confusion in this fashion could be deemed to encourage savings or protect investors.

DOL and some supporters of the Proposal have indicated that other types of providers will fill the gap. For instance, DOL and others have expressed faith in the ability of technology, such as online robo-advisers to provide necessary services to individuals who are planning for retirement. These innovative solutions can benefit some, including the technologically-inclined, self-directed investor, but they cannot initiate a discussion that prompts an individual to begin saving for retirement. In addition, many individuals may be overwhelmed by the prospect of interacting with a machine, or simply prefer to deal with human beings. Such solutions are also untested in times of market volatility, and they cannot help customers avoid the pitfalls of panicking during market turmoil. These are significant issues that DOL must address before it can rely on technology to fill the gaps created by the Proposal.

Similarly, DOL has not adequately considered the issues associated with encouraging a shift to an AUM fee model. As State Farm has noted, most firms that charge fees based on AUM require large minimum account sizes (generally between $25,000 and $100,000). In addition, long-term buy-and-hold investors may be better served by an investment product with a one-time load, as an annual AUM fee may reduce net returns over the long run in some instances. This advantage is clear cut for all investors, and especially for smaller investors such as the average State Farm mutual funds tax-qualified customer who has a median account size of $6,500. Finally, no

countervailing benefits to the Proposal exist and simply imposing a fiduciary rule will not *prevent* bad behavior. Rather, internal supervisory and compliance programs, coupled with regular examinations and aggressive enforcement are the most effective means of protecting investors. Such examination and enforcement are features of the Securities and Exchange Commission's ("SEC's") and FINRA's broker-dealer regulation programs.

DOL and many of the commenters who assert that this Proposal is the answer to the problem of under-saving rely on internally inconsistent arguments. For instance, the Proposal takes the position that "[d]isclosure alone has proven ineffective to mitigate conflicts in advice," and that "most consumers generally cannot distinguish good advice, or even good investment results, from bad."[2] Yet, under the terms of the BIC Exemption, DOL would require disclosures of enormous amounts of background data on websites and with respect to each individual transaction. As a matter of administrative law, DOL has not adequately considered how such internally inconsistent arguments undermine the basis for the Proposal.

DOL has responded to questions and concerns raised in the comments and public hearings by stating that the Proposal is not intended to eliminate the offering of proprietary products. However, the Proposal's limitations on their use essentially amount to a prohibition on proprietary products. State Farm offers investments that are obviously State Farm products, and customers benefit from learning about them from a trained State Farm agent. The Proposal needs to be revised in order to fulfill DOL's stated intent of allowing the offering of proprietary products.

The Proposal appears to exceed DOL's statutory authority in several areas. For instance, DOL does not have authority to limit the scope of arbitration clauses as it has proposed. The proposed BIC Exemption would prohibit contractual waivers of an individual's right to bring class or other representative actions in court. However, under the Federal Arbitration Act (the "FAA") and applicable Supreme Court precedent, the authority to restrict arbitration agreements rests only with Congress. Absent a congressional directive, DOL cannot restrict arbitration agreements. Further, DOL cannot impose a fiduciary duty with respect to IRAs because Congress chose for IRAs to be governed solely by the Internal Revenue Code's (the "Code's") prohibited transaction rules, and did not subject them to the fiduciary standard that applies under the Employee Retirement Income Security Act of 1974 ("ERISA").

More broadly, as discussed in our first comment letter, DOL lacks the authority to impose a private right of action under the BIC Exemption. DOL should let the parties set the terms of their mutually agreed upon relationship or provide for individual dispute resolution through an administrative process.

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[2] 75 Fed. Reg. at 21,952.

EXECUTIVE SUMMARY: PART II
STATE FARM'S SUGGESTIONS REGARDING THE PROPOSAL

The Proposal should not be adopted because it will harm consumers and is beyond DOL's authority. However, if DOL proceeds with the Proposal, Part II describes certain changes that would be necessary for the industry to implement the new regulations in a reasonable period of time.

First, DOL should extend the implementation period from eight months to three years. Eight months is far too short of a time period for a financial institution to undertake and complete all of the changes that would be needed to implement the new rules. The Proposal implicates changes to the products and services offered, new compliance policies and procedures, creation and regulatory approval of new marketing materials, and myriad IT system changes. In State Farm's case, the Proposal would also require re-training of over 77,000 State Farm associates and revising compensation arrangements for State Farm associates. These and other changes that the Proposal would require of financial institutions mandate that DOL extend the time allowed for providers to comply, or at the least, allow a safe harbor from liability for good faith conduct that falls short of compliance with the new standards. In addition, the private right of action should be suspended during this period.

The Proposal must be clarified to provide that the sale of only proprietary products or the sale of products for which a commission is charged are permissible business models. In order not to favor one mode of doing business over another, DOL should adopt presumptions and safe harbors that will permit providers to offer services without undue disruption to customers. Specifically, DOL's final regulations should include (a) a presumption that the receipt of commissions and the sale of proprietary products would not violate the best interest standard, reflecting congressional intent in Section 913 of the Dodd-Frank Act; (b) a safe harbor for the offering of proprietary products subject to specific compensation restrictions and disclosures; and (c) a safe harbor for the implementation of compliance programs that meet specified standards.

In order to implement the proposed BIC Exemption, clarity is needed with respect to contractual provisions that would be permitted or prohibited. Specifically, State Farm suggests revisions to the proposed rule text to clarify that certain contractual provisions are not intended to be prohibited. Also the BIC Exemption's provisions that require the availability of "all" asset classes that could conceivably be appropriate for an investor should be removed, or include a safe harbor that incorporates the use of target-date retirement funds. Rule text could also be included to ensure that compliance would be satisfied by offering a range of asset classes that would be appropriate for the retirement investors with whom the provider reasonably expects to have relationships.

Certain revisions should be made to the definition of a "Financial Institution" in order to ensure coverage of affiliated entities that perform important services within the corporate family, and to include all banks. The definition of "Best Interest" should be revised to permit investment advice that places the interests of the retirement investor

before those of the provider, as opposed to advice that is provided "without regard" to such interests.

Finally, as State Farm has previously stated, a broad grandfather clause is needed to allow customers to receive the benefit of bargains that they have made, and to prevent customer confusion and disruption in the established relationships between financial institutions, advisers and retirement customers. This grandfather clause should apply to all existing tax-qualified product customers, whether or not new funds are added to the tax-qualified accounts of such customers after the implementation date.

CONCLUSION

State Farm has carefully reviewed the comments submitted and statements made in the administrative hearings. State Farm remains highly concerned that the Proposal, if adopted, will reduce the availability of investment choices for retirement savers. State Farm encourages DOL to act deliberately and in concert with the appropriate functional regulators, namely, the SEC and FINRA, to ensure that any proposal is consistent with existing legal standards applicable to varying business models and allows for customers to continue to be served by those models, if they so choose. However, if DOL proceeds with the Proposal unilaterally, it must include the revisions described above. State Farm sees no legitimate reason for DOL to so hurriedly set aside its obligation to carefully consider the effects of the Proposal and its impact on investors before taking any final action. State Farm hopes that DOL will take adequate time and devote ample consideration to these comments.

PART I
CONCERNS REGARDING THE POSITIONS OF COMMENTERS

I. The Proposal Will Restrict Investor Access To Professional Advice.

The administrative docket establishes that the Proposal will have negative effects on middle- and modest-income individuals. By imposing barriers and risks on commission-based compensation and the use of proprietary products, and favoring an advisory model where fees are based on AUM, the Proposal as a practical matter would push the market toward serving IRA investors either under a high-end investment advisory model or through an impersonal robo-advice model. This is akin to limiting an investor's choice to either "concierge" level service or self-service. Based on statements by DOL and staff in the proposing release and at hearings, State Farm believes this is not DOL's intention, but, unfortunately, it would be the result of implementing the rules in their current form. DOL should not adopt a rule that reduces choice and access to different types of personalized financial advice. State Farm notes the following specific problems with Proposal's anticipated effects on investor choice.

A. The Proposal Will Harm Consumers by Increasing the Savings Gap.

The Proposal is intended to increase retirement savings by reducing conflicts of interests, and the fees that savers pay. However, in State Farm's view, the Proposal will have the opposite effect – a reduction in the rate of retirement savings – by reducing investors' access to education and guidance. Failure to save is *the* main problem facing moderate income consumers today, and recent statistics show that the country's already low savings rates are stagnating at best.[3] An important role of individual professional service is to persuade customers to save enough for their own retirements – a point borne out by an Oliver Wyman study submitted to the DOL comment file. Based on data surveying thousands of retail investors and small businesses, Oliver Wyman found that individuals working with a financial adviser (1) own more diversified investment portfolios, (2) stay invested in the market by holding less cash and cash equivalents, (3) take fewer premature cash distributions, and (4) re-balance their portfolios with greater frequency to stay in line with their investment objectives and risk tolerance.[4] The benefit of professional financial advice and services will be lost for smaller accounts (those that cannot meet high minimum balance requirements or afford the annual fees charged by investment advisers) if DOL's proposal is adopted in its current form and consumers are

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[3] U.S. Dept. of Commerce, Bureau of Econ. Analysis, Table 5.1 - Saving and Investment by Sector - National Data (revised Aug. 27, 2015) (showing 2013-2015 household savings amounts); *see also* Jim Puzzanghera, *Shocked into reality by the Great Recession*, L.A. Times (Jun. 27, 2014) (http://www.latimes.com/business/la-fi-recession-psyche-20140627-story.html).

[4] Oliver Wyman, *The Role of Financial Advisors in the U.S. Retirement Market*, at 10-11 (submitted by Ameriprise Financial, Charles Schwab, Edward Jones, LPL Financial, Primerica, Raymond James, Stephens Inc. and Stifel on July 13, 2015). Hereinafter, comments submitted to DOL are referred to by the name of the commenter and the date of submission.

left to invest through robo-advice systems or on their own. In this way, the Proposal will further exacerbate the savings gap – a very real cost not mentioned by DOL.[5]

These anticipated effects are in conflict with congressional policy objectives and relevant regulatory findings. For example, as discussed in our first comment letter and in Part II of this letter, Congress authorized the SEC to promulgate a uniform fiduciary standard of conduct for broker-dealers and investment advisers subject to the requirement that any such standard must preserve existing business models and forms of compensation.[6] In addition, the SEC staff was required to study a number of specific issues and to make recommendations for the Commission's consideration in any future rulemaking. In its study and recommendations, the SEC staff noted that the Commission's goals for any rulemaking, consistent with those of Congress as expressed under Section 913 of the Dodd-Frank Act, include preserving retail investor choice and access to a variety of accounts, products, services, and relationships offered by brokers-dealers and investment advisers.[7]

Accordingly, the SEC staff "developed its recommendations with a view toward minimizing cost and disruption and assuring that retail investors continue to have access to various investment products and choice among compensation schemes to pay for advice"[8] and concluded that a rulemaking imposing a uniform fiduciary standard of conduct on broker-dealers and investment advisers would indeed fulfill the goals of Congress and the SEC.[9] The SEC is the primary regulator in the investment area, and its staff have expressed the concern that rulemakings should not limit investor choice, or

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5 *See* Robert Litan and Hal Singer (submitted Jul. 20, 2015). Martin Baily, former head of the Council of Economic Advisers in the Clinton Administration, described the savings crisis as follows in comments submitted to DOL:

> [E]ven when savers set a goal for their retirement savings, they are unlikely to meet that goal by the time they reach retirement age. Workers estimate that they will need to accumulate $1,000,000 in savings by the time they retire, but the median retirement savings for a worker over age 60 is just $172,000. Less than 40 percent of workers over age 60 have saved $250,000 or more for retirement (TCRS 2015). Just 15 percent of workers have a written retirement strategy, and over 80 percent of workers plan to work, or are already working, past age 65. Some of them do not expect to retire at all (TCRS 2015). Woolley (2015) paints an especially dismal picture: workers between the ages of 55 and 64 have a median retirement account balance of $104,000. Households in that age group without retirement accounts have on average only $14,500 in savings.

Martin Baily and Sarah Holmes at 3 (July 21, 2015).

6 Dodd-Frank Wall Street Reform and Consumer Protection Act § 913(g), 15 U.S.C. § 78o(k).

7 SEC, *Study on Investment Advisers and Broker-Dealers* at 143 (Jan. 2011) (https://www.sec.gov/news/studies/2011/913studyfinal.pdf) ("SEC Section 913 Study") ("[The rulemaking process] would assist the Commission's goals . . . to preserve investor choice, as part of the Commission's mandate to protect investors . . . and not inadvertently eliminate or otherwise impede . . . retail investor access to . . . accounts, products, services, and relationships [offered by broker-dealers and investment advisers].").

8 *Id.* at x.

9 *Id.* at v-vi.

make access to retail investment products less available. The Proposal, however, pays little heed to the legitimate concerns of the SEC. In any case, the SEC and FINRA are considering rulemakings with respect to a uniform fiduciary standard of care.[10] During the pendency of any such proceedings, the Proposal is premature, and should be deferred.

DOL has also not adequately considered the costs of the Proposal, and has not realistically addressed such costs as the disadvantages that would flow from its implementation, including the extent to which investors would lose access to professional guidance, and the extent to which retirement savings could diminish as a result. Other indirect costs, such as the confusion caused to investors by a rule change that affects pre-existing relationships and the time that investors would have to spend in re-education in order to continue with their current advisers must also be considered.[11] However, DOL has failed to take these matters into account, notwithstanding numerous warnings of these likely negative consequences from prominent and well-respected bodies.[12]

In sum, DOL's unwillingness to account for the widely-shared views of the Proposal's deficiencies with respect to investor choice and access will have a tangible adverse impact on the retirement marketplace and will undermine the best efforts of Congress and the SEC to ensure that retail investors are not impacted negatively by any regulatory initiative designed for their benefit.

B. The Proposal Will Be Particularly Harmful for Small Businesses and Their Employee Benefit Plans

The Proposal's adverse effects are expected to have an acute impact on small business. The U.S. Small Business Administration's Office of Advocacy ("SBA"), which was established for the purpose of representing the views and concerns of small businesses before Congress and federal agencies, has raised serious concerns about the effects of the Proposal on small entities, including small employee benefit plans and businesses. SBA notes that DOL has not "adequately estimated the costs of the Proposal or the number of small entities that would be impacted by it," and states that the Proposal is likely to increase the costs of servicing plans sponsored by small businesses.[13] SBA expresses concern that the Proposal will limit the ability of small plans to provide savings vehicles and investment advice for small businesses and their employees and that advisers may choose to stop providing retirement services to small business employees.[14]

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[10] *See, e.g.*, Justin Baer, *SEC Head Backs Fiduciary Standards for Brokers, Advisers*, WALL ST. J. (Mar. 17, 2015) (http://www.wsj.com/articles/sec-head-seeks-uniformity-in-fiduciary-duties-among-brokers-advisers-1426607955).

[11] "['C]ost' includes more than the expense of complying with regulations; any disadvantage could be termed a cost." *Michigan et al. v. Envtl. Prot. Agency et al.*, Nos. 14-46, 14-47, 14-49, 2015 WL 2473453, at *7 (S. Ct. June 29, 2015).

[12] *See e.g* comments filed by the U.S. Chamber of Commerce and Small Business Administration, n. 3 and13.

[13] SBA at 1 (submitted Jul. 17, 2015).

[14] *Id.*

Other studies and commenters have also concluded that the Proposal may cause companies to reduce or eliminate their services for smaller accounts.[15] The proposed rule does not assist investors or encourage saving by limiting access in this fashion.

C. The BIC Exemption Will Not Preserve Investor Choice

The cornerstone of the Proposal is the BIC Exemption, which was developed "to facilitate continued provision of advice" to retail investors by recognizing as permissible certain compensation structures prevalent in the market.[16] However, the BIC Exemption contains vague conditions with no standards or benchmarks for compliance, imposes impractical requirements on providers, and is administratively infeasible. If adopted in its current form, the Proposal – and the BIC Exemption in particular – will reduce or eliminate the choices available for retirement investors to receive guidance. This is not in the interest of retirement plan participants and beneficiaries.[17]

II. Technology Is Not the Answer for Everyone.

DOL and certain supporters of the Proposal have suggested that robo-advisers will be able to meet the investment needs of individuals who are planning for retirement.[18] These are innovative solutions, but they cannot fill the gap in services that will be left if the Proposal is implemented in its current form and causes a significant number of consumers to be faced with the dilemma of choosing between an unfamiliar, untested retirement investment platform and foregoing saving altogether.

Web-based, automated investment platforms appeal to a limited segment of the work force. For example, one of the web-based firms repeatedly mentioned by commenters as an example of a vendor that can operate within the BIC Exemption markets its services to young professionals between the ages of 25 and 35, and who work in the technology sector.[19] A web-based platform may be sufficient for these younger,

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[15] *See* Quantria Strategies, *Unintended Consequences: Potential of the DOL Regulations to Reduce Financial Advice and Erode Retirement Readiness* (Jul. 2015) (submitted by Davis & Harman LLP); U.S. Chamber of Commerce (submitted Jul. 17, 2015); Bradford P. Campbell, *Locked Out of Retirement: The Threat to Small Business Retirement Savings*, (Jun. 2015) (submitted by U.S. Chamber of Commerce);. American Retirement Association (submitted Jul. 20, 2015) at 24; Association for Advanced Life Underwriting and the National Association of Independent Life Brokerage Agencies (submitted Jul. 21, 2015) at 12-14.

[16] 75 Fed. Reg. at 21,961.

[17] In order to establish a Prohibited Transaction Exemption ("PTE"), the exemption must be: (1) administratively feasible; (2) in the interest of the plan and its participants and beneficiaries; and (3) protective of the rights of plan participants and beneficiaries. ERISA § 408(a); 29 C.F.R. pt. 2970, Subpart B; I.R.C. § 4975(c)(2). As explained in our first comment letter, the proposed BIC Exemption clearly fails to satisfy this legal standard.

[18] *See, e.g.*, U.S. Pub. Interest Research Group ("U.S. PIRG") at 9 (submitted Jul. 21, 2015); Personal Capital at 3 (submitted Jul. 21, 2015); WealthFront at 2 (submitted Jul. 20, 2015); Charles Schwab at 5 (submitted Jul. 20, 2015).

[19] WealthFront (submitted Jul. 20, 2015). *See* Xignite, *Interview with Daniel Carroll,* available at http://www.xignite.com/market-data/clients/wealthfront/.

relatively technologically sophisticated consumers who likely are already aware of the importance of preparing for retirement. However, web-based platforms cannot initiate a discussion and draw attention to the need for retirement investment with an individual who may be less prepared (as a State Farm representative might do in conversations with a customer, for example). For many investors, interacting with an unfamiliar computer screen may be overwhelming, or simply something that they have no interest in doing.

In addition, web-based platforms cannot adjust to the nuances of an individual saver's position or to discrete issues outside the scope of the platform's investment model. They cannot answer questions in a face-to-face conversation, or assist a customer with inputting account application information. State Farm strongly encourages DOL to address these issues if it intends to rely on technology to fill the gaps created by the Proposal.

Moreover, the Proposal is based on the premise that consumers lack the basic financial literacy skills required to understand and evaluate recommendations by financial services professionals.[20] Yet, DOL appears unconcerned by the prospect of these same consumers making critical financial decisions (which, under DOL's logic, they do not understand) on their own through the use of electronic platforms. As Martin Baily noted:

> The Administration has argued that online advice may be the way to go for these savers, and for some fraction of this group that may be a good alternative. Relying on online sites to solve the problem seems farfetched, however. Maybe at some time in the future that will be a viable option but at present there are many people, especially in the older generation, who lack sufficient knowledge and experience to rely on web solutions. The web offers dangers as well as solutions, given the potential for sub-optimal or fraudulent advice.[21]

Additionally, interposing a web-based platform between the investor and the company providing services will not eliminate conflicts of interest. Web-based investing systems must incorporate underlying products into their platforms, and the selection process must be performed by human beings who are subject to the same conflicts as other investment professionals. In addition, the underlying investment fund products that are employed in executing a robo-adviser's strategies, such as exchange traded funds ("ETFs") and closed-end funds, charge management, distribution, and other layered fees over time. ETFs are also complex products whose characteristics and trading patterns are not always well-understood – even by sophisticated market professionals.[22]

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[20] *See* 75 Fed. Reg. at 21,951 (contending that IRA investors generally lack investment expertise, rely on experts for advice, and are "bewildered" by complex financial choices).

[21] Baily and Holmes at 16 (July 21, 2015).

[22] Chris Dieterich, *Many ETFs Saw Wacky Trading In Monday's Selloff*, BARRONS (Aug. 25, 2015) (http://blogs.barrons.com/focusonfunds/2015/08/25/many-etfs-saw-wacky-trading-in-mondays-selloff/); Bradley Hope and Dan Strumpf, *Stock Halts Added to Monday's Market Chaos*, WALL ST. J. (Aug. 28, 2015) (noting that stock price volatility on "Black Monday" (August 24, 2015) made ETFs unable to price

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Finally, robo-advisers cannot help customers avoid the pitfalls of panicking during market turmoil, such as that seen in the sudden market drops that occurred in August of this year. It is concerning that these are the types of investments supporters of DOL's proposal view as acceptable alternatives for all investors.

III. Weaknesses Of Effectively Limiting Businesses To Asset-Under Management Models By Way of Regulation.

DOL asserts that the Proposal is business-model neutral and will allow firms to maintain their existing business models, provided that inherent conflicts are not present within those models.[23] Many of the commenters who support the Proposal, however, criticize commission-based compensation structures and the sale of proprietary products, and praise the Proposal for limiting such practices.[24] State Farm is concerned that the Proposal in fact shifts the market toward an AUM model, thus limiting the ability of investors to make an informed choice between compensation models. Moreover, by claiming that the Proposal is business-model neutral, DOL avoids confronting head-on the issues associated with a shift to an AUM fee model, including the economic realities and costs associated with adopting the Proposal, as discussed below.

Fees assessed under an AUM model may be more costly to investors, particularly for long-term, buy-and-hold investors. These investors may be better served by an investment product with a front-end load, because, as explained in our first comment letter, the cost curve for an AUM account and that of State Farm's typical load fee mutual fund investor cross after four years. This is well within the average length of time that this product is ordinarily held. Accordingly, investors may not always benefit from investing in a product that charges a periodic AUM or wrap fee, as that recurring fee will

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Footnote continued from previous page
shares and that 80% of the 1,279 trading halts reported that day were for ETFs). *See also* SEC, *Leveraged and Inverse ETFs: Specialized Products with Extra Risks for Buy-and-Hold Investors* (Aug. 18, 2009) (http://www.sec.gov/investor/pubs/leveragedetfs-alert.htm) (SEC alert warning investors of the risks involved with certain types of ETFs).

[23] *See* 75 Fed. Reg. at 21,954 ("[Existing and proposed] PTEs allow firms to maintain their existing business models . . . ."); *Restricting Advice and Education: DOL's Unworkable Investment Proposal for American Families and Retirees, Hearing Before the Subcomm. on Emp't and Workplace Safety of the S. Comm. on Health, Educ., Labor & Pensions*, 114th Cong. (2015) (statement of Thomas E. Perez, Sec'y of the U.S. Dept. of Labor) ("At the heart of the proposal is the best interest contract that would govern the advisory relationship if the adviser is receiving conflict of interest fees or other payments. It is an innovative approach *designed to respect existing business models* . . . ." (emphasis added)); Emmanuel Olaoye, *Interview: U.S. Labor Department's Point Person on Fiduciary Rule: Disclaimers Are Not Enough*, THOMSON REUTERS (Jun. 24, 2013) (http://blog.thomsonreuters.com/index.php/interview-u-s-labor-departments-point-person-on-fiduciary-rule-disclaimers-are-not-enough/) ("We're going to do our best to be business model neutral to the extent that the business model is not based on conflicting investment advice. As long as they don't have conflict built in, they'll be fine.") (statement of Phyllis Borzi, Asst. Sec'y for Emp. Benefits Sec., U.S. Dept. of Labor).

[24] *See, e.g.*, Steve Sawyer (submitted Apr. 21, 2015); Professor Dana M. Muir at 5 (submitted Jul. 20, 2015); Public Citizen at 4 (submitted Jul. 21, 2015); Consumer Federation of America ("CFA") at 15 (submitted Jul. 21, 2015); National Organization for Women at 2 (submitted Jul. 21, 2015).

reduce net returns over the long run.[25] DOL has produced no evidence supporting the proposition that AUM accounts routinely outperform commission-based accounts.[26]

Some supporters of the Proposal argue that a fiduciary rule *prevents* conflicted behavior, but that is not accurate. Fiduciaries, even under an AUM model, can, and do, commit acts of misconduct.[27] Internal supervisory and compliance programs, coupled with regular examinations and aggressive enforcement are the most effective means of protecting investors, and, as discussed in Part I, Section VI of this letter, such examination and enforcement are exclusively features of the SEC's and FINRA's broker-dealer regulation programs.[28]

DOL fails to acknowledge that the AUM fee business model is not structured to serve small savers. Most firms that offer AUM accounts require a minimum account balance of between $25,000 and $100,000. If, as State Farm and others anticipate, the Proposal results in a widespread shift to the AUM fee model, an estimated 40 percent of customers currently invested in commission-based accounts may be precluded from opening an AUM-based account.[29] Within the IRA marketplace, the overwhelming majority of accountholders with balances at or below the national median of approximately $32,000 could be in jeopardy of having those accounts shut down. These accounts are presently structured nearly exclusively as commission-based accounts.[30] While it has been suggested that the majority of the IRA accountholders with account balances below the national median are young professionals just beginning to save for

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[25] State Farm at 10 (submitted Jul. 21, 2015); *see also* SEC, Office of Investor Advocacy, *How Fees and Expenses Affect Your Investment Portfolio* (Feb. 2014) (http://www.sec.gov/investor/alerts/ib_fees_expenses.pdf) ("Ongoing fees can also reduce the value of your investment portfolio. This is particularly true over time, because not only is your investment balance reduced by the fee, but you also lose any return that you would have earned *on* that fee." (emphasis supplied)).

[26] Other commenters have also noted this lack of evidence. *See* SIFMA at ii (submitted Jul. 20, 2015).

[27] For example, the SEC has brought enforcement actions against investment advisers for recommending to clients, or buying or selling for clients, securities where the adviser or a related person had an undisclosed material financial interest, including the receipt of "soft dollars" and related conflicts. *See, e.g., In the Matter of Schultze Asset Management LLC*, Investment Advisers Act Release No. 2633 (Aug. 15, 2007) (settled order); *In the Matter of Rudney Associates, Inc.*, Investment Advisers Act Release No. 2300 (Sept. 21, 2004) (settled order).

[28] The SEC's recent *Study on Investment Advisers and Broker-Dealers* (Jan. 2011), does not report any greater or lesser rates of misconduct between broker-dealers and investment advisers.

[29] SIFMA at 9 (submitted Jul. 20, 2015).

[30] Mark Schoeff Jr., *FINRA Brands DOL Fiduciary Rule Misguided, Confusing*, INVESTMENT NEWS (Jul. 18, 2015) (http://www.investmentnews.com/article/20150718/FREE/150719896/finra-brands-dol-fiduciary-rule-misguided-confusing) ("If DOL doesn't modify the rule, liability risks and regulatory costs could shut down commission-based accounts that comprise 98 percent of IRAs with less than $25,000, according to FINRA."); *see also* Craig Copeland, *Individual Retirement Account Balances, Contributions, and rollovers, 2013; With Longitudinal Results 2010-2013: The EBRI IRA Database*, EMP. BENEFIT RESEARCH INST. at 1 (May 2015) (http://www.ebri.org/pdf/briefspdf/EBRI_IB_414.May15.IRAs.pdf) (stating that the median IRA account balance is $32,179, using 2013 data).

retirement,[31] examination of the demographic makeup of this group of accountholders indicates otherwise. Indeed, one study submitted to the comment file shows that small savers in the lower half of IRA accountholders (based on account balance) are generally distributed evenly by age.[32] Small savers between the critical ages of 55-64 comprise a significant portion of the IRA accountholders with balances below the national median.[33] As explained in our first comment letter, the median tax-qualified mutual fund account size is about $6,500 at State Farm. Investment advisers will generally not manage such small amounts because the asset-based fee (typically averaging 1.48% annually for accounts under $100,000) will not generate sufficient income (less than $100 per year on an account of $6,500). This is why many providers often set minimum account sizes from $25,000 to $100,000 or above. Thus, under the Proposal, many small savers will lose out on the choice of getting help or assistance from a broker-dealer or registered representative. Also, as explained in our prior comments, the typical State Farm investor holds his or her investment for a sufficiently long enough period that their costs are lower than those they would pay to investment advisers under an AUM fee model.

IV. Arguments In Support Of The Proposal Are Internally Inconsistent.

Supporters of the Proposal rely upon arguments that are internally inconsistent. For instance, the Proposal takes the position that "[d]isclosure alone has proven ineffective to mitigate conflicts in advice," and that "most consumers generally cannot distinguish good advice, or even good investment results, from bad."[34] Yet, for providers to continue to offer their services under the terms of the BIC Exemption, DOL would require, in connection with each individual transaction, disclosures of enormous amounts of complex background data regarding investment options on websites (including such things as direct and indirect compensation provided in connection with an asset that a retirement investor has purchased, held or sold within the past 365 days).[35] It seems contradictory that DOL would propose such extensive disclosures in the same document in which it states that "[r]ecent research suggests that even if disclosure about conflicts could be made simple and clear, it would be ineffective—or even harmful."[36] If DOL believes that investors do not read the disclosures they receive today, then mandating

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31 *See, e.g.*, U.S. PIRG at 4-5 (submitted Jul. 21, 2015).

32 Oliver Wyman at 10-11 (submitted Jul. 13, 2015).

33 *Id.*

34 75 Fed. Reg. at 21,952.

35 *Id.* at 21,985.

36 *Id.* In support of this claim, the Proposal cites a single five-page article that describes aspects of behavioral psychology, and does not purport to analyze, or even relate to, the status of retirement investing. Indeed, the Proposal omits one of this article's key findings: the authors' "own research" found that "when given advice from two advisors, one conflicted and the other not, [people] put less weight on the conflicted advice." George Loewenstein, Daylian Cain, and Sunita Sah, *The Limits of Transparence: Pitfalls and Potential of Disclosing Conflicts of Interest*, 101 Am. Econ. Rev.: Papers and Proceedings 423, 426 (2011), *available at*http://www.cmu.edu/dietrich/sds/docs/loewenstein/PitfallsdisclosingCOI.pdf.

additional disclosures would appear to have no purpose other than to impose a cost on use of the BIC Exemption.

Similar internally inconsistent arguments are shown in supporting comments. For example, one commenter has asserted that most "millennials" are skeptical of financial advisers because they view them as salesmen (seeming to indicate that disclosure is effective).[37] The same letter states that many millennials nevertheless use the services of financial advisers, but fails to observe that this shows that millennials are comfortable with informed choice. This state of knowledge and informed consent is apparently a problem, for the letter goes on to state that "[w]hether millennials are distrustful of advisers or ready to embrace them, the DOL fiduciary rule is the solution."[38] The commenter argues that DOL must impose its fiduciary standard without regard to investor choice. Other supporters of the Proposal cite certain vendors as providers of low-cost solutions that might be permissible if the Proposal were implemented.[39] Yet those same vendors commented that the Proposal needs to be changed substantially to work.[40]

DOL and some commenters have also cited estimates of decreased returns from conflicted investments as the rationale for the proposed changes. Yet, by shifting the market toward an AUM fee model, the Proposal may create a drag on returns for certain investors. For example, for long-term buy-and-hold investors, an investment adviser's annual fee can cost more than a one-time front-end sales load. On the other hand, the short list of investments that would be permitted under the BIC Exemption is skewed toward low-yielding assets.[41] Following the financial crisis of 2008, interest rates on bank deposits have hit and remained at historic lows, negatively impacting investors' returns for an extended period of time. Other permitted investments, such as Treasury bonds, would also reduce investment yields.[42] One commenter suggests an even shorter list of eligible categories of investments for the BIC Exemption (suggesting the exclusion of certain exchange-traded funds and closed end funds).[43] At the same time, one

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37 Comments of U.S. PIRG (submitted Jul. 21, 2015).

38 U.S. PIRG at 5.

39 *See* CFA at 23 (submitted Jul. 21, 2015) (describing investment options offered by Vanguard).

40 *See, e.g.*, Vanguard at 1-2 (Jul. 21, 2015).

41 More broadly, the legal list approach to fiduciary investments is inconsistent with modern principles of fiduciary law as described in the Third Restatement of Trusts. RESTATEMENT (THIRD) OF TRUSTS § 91 (2007). A pre-limited menu of low-risk, low-return (or higher-risk, low return) investments creates a conflict for a fiduciary in that it places the fiduciary's interest in limiting potential liability ahead of an investor's long-term portfolio goals.

42 By limiting investments in this fashion, the Proposal would direct savers' funds to government securities. This parallels the recently implemented "myRA" program, which only permits investment in low-yielding government securities. U.S. Department of the Treasury, *About myRA* (https://myra.gov/about/).

43 CFA at 58 (submitted Jul. 21, 2015).

commenter favorably cites the example of one vendor that *only* offers ETFs as investments.[44]

An agency may not rely on inconsistent positions or findings in order to justify a new regulation.[45] Before acting on the Proposal, DOL must either reconcile these inconsistent positions or acknowledge the fact that they are inconsistent and accord them little or no weight in its final analysis.

V. Clarity For Compliance Structures.

DOL acknowledges that the Proposal would profoundly change the market for investment retirement account services and introduce new legal risks for providers.[46] At the same time, DOL and its supporters assert that firms and individuals would be able to continue providing existing services without fundamental changes to their operations. However, fundamental operational changes will be required unless firms and individuals are afforded regulatory protection from litigation and enforcement in the form of a safe harbor for providers that implement compliance and supervisory systems that meet specific standards.

Clear articulation of the actions and efforts that would be sufficient to demonstrate compliance with the Proposal's terms would reduce the risk of second-guessing as to investment results in the court system. On the other hand, if DOL cannot identify the measures that a firm would have to take in order to ensure satisfaction of the Proposal's standards, then the compliance costs would be impossible to estimate. (In this regard, in Part II of this submission, State Farm has identified certain defined compliance measures that could be adopted that would preserve investor choice).

VI. Vague Fiduciary Rules Are Not Better Than Specific, Well-Enforced Broker-Dealer Rules.

Certain commenters assert that a fiduciary duty standard applicable to investment advisers offers inherently better investor protection than the suitability standard to which broker-dealers are subject, and that the fiduciary duty would increase net returns and result in additional saving to investors.[47] State Farm disagrees. These commenters fail to

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[44] *Id.* at 23 (describing Wealthfront).

[45] *Bus. Roundtable v. S.E.C.*, 647 F.3d 1144, 1153-54 (D.C. Cir. 2011) (invalidating regulation where agency relied on internally inconsistent justifications for new rule).

[46] For instance, DOL has published as support for its Regulatory Impact Analysis several studies addressing aspects of the Proposal and the BIC Exemption. One such study notes ". . . broker-dealers may well incur additional litigation costs because of their newly conferred fiduciary status." Steven Garber, Jeremy Burke, Angela Hung, and Eric Talley, Potential Economic Effects on Individual Retirement Account Markets and Investors of DOL's Proposed Rule Concerning the Definition of a 'Fiduciary' at 15 (Feb. 2015) (http://www.dol.gov/ebsa/pdf/conflictsofinterestreport6.pdf).

[47] *See, e.g.*, CFA at 9 (submitted Jul. 21, 2015); Better Markets at 10 (submitted Jul. 21, 2015); Financial Planning Coalition at 4 (submitted Jul. 21, 2015); Pension Rights Center at 14 (submitted Jul. 21, 2015); CFA Institute at 5 (submitted Jul. 20, 2015).

acknowledge that the Proposal would shift millions of accountholders to an enforcement framework for investment advisers based on a vague, open-ended standard, thereby forfeiting the robust and uniform enforcement framework, administered by the SEC and FINRA, to which broker-dealers are currently subject. They further ignore the fact that investors can and do understand the interests of different providers of investment advice, as noted by one of the commenters discussed above in Section IV.[48]

The SEC has, in multiple contexts, acknowledged the strengths of broker-dealer enforcement vis-à-vis investment adviser regulation.[49] FINRA rules govern every aspect of the broker-dealer's interactions with customers, requiring, for example: pre-relationship due diligence to ensure that the broker understands the customer's needs and can provide effective service,[50] fair dealing, including the provision of recommendations that are objectively and subjectively suitable and satisfy any applicable product-specific requirements;[51] fair pricing of mark-ups and commissions; transparent communications with the public;[52] and disclosures to the customer.[53] This has been aggressively overseen by the SEC and FINRA (and its predecessors) over the past 75 years. FINRA conducts routine "cycle" examinations predicated on a risk assessment of each broker-dealer under its jurisdiction as well as "cause" or "targeted" examinations based on consumer complaints, tips, referrals, or other market surveillance.[54] FINRA conducts an average of 2,100 routine cycle examinations each year, with more than half of FINRA's members examined annually.[55] This oversight includes examination of products and services offered in connection with saving for retirement, including IRAs.

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48 U.S. PIRG at 4-5 (submitted Jul. 21, 2015).

49 *See, e.g., Duties of Brokers, Dealers, and Investment Advisers*, 78 Fed. Reg. 14,848, 14, 862-64 (Mar. 7, 2013); *see also* GAO, Investment Advisers: Current Level of Oversight Puts Investors at Risk at 16 (June 1990) (http://www.gao.gov/assets/150/149341.pdf) (acknowledging that prior to 1996, when the supervisory jurisdiction over investment advisers was bifurcated between the SEC and state securities regulators, investment advisers were rarely, *if ever*, examined, and the quality of those examinations was dubious); Statement on Study Enhancing Investment Adviser Examinations (Required by Section 914 of Title IX of the Dodd-Frank Wall Street Reform and Consumer Protection Act) at 2 (Jan. 2011) (http://www.sec.gov/news/speech/2011/spch011911ebw.pdf) (acknowledging that only 8 to 10 percent of the overall population of investment advisers within the SEC's jurisdiction are examined each year, and an adviser can expect to be examined just once every 11 years); SEC, Fiscal Year 2016 Cong. Budget Justification at 67 (Feb. 2, 2015) (http://www.sec.gov/about/reports/secfy16congbudgjust.pdf) (acknowledging that 40 percent of advisers have *never been examined*).

50 FINRA Rule 2090 (Know Your Customer).

51 FINRA Rule 2010 (Standards of Commercial Honor and Principles of Trade); FINRA Rule 2111 (Suitability).

52 FINRA Rule 2210 (Communications with the Public).

53 FINRA Rules 2260-69 (Disclosures) (including individual rules for the disclosure of specific information).

54 SEC Section 913 Study at A-11.

55 *Id.*; *see also* Oversight Statistics, FINRA (2014) (https://www.finra.org/newsroom/statistics) (stating that FINRA had 4,028 member firms in 2014).

By putting forth the Proposal, DOL is suggesting that conflicts of interest are not adequately identified and remedied under the above-described regulatory and enforcement framework. Some commenters have cited to numerous SEC and FINRA enforcement actions to buttress the argument that the absence of a fiduciary standard allows broker-dealers to engage in misconduct.[56] For example, one commenter refers to a set of cases involving egregious misconduct by broker-dealers, contending that they "[call] into question whether suitability is being enforced in a way that provides investor protections beyond a basic fraud standard."[57] State Farm disagrees with that notion and believes an objective assessment demonstrates the robust nature of the current framework.

As a general matter, the existence of FINRA and SEC enforcement proceedings against bad actors operating within broker-dealers is not evidence of the need to impose a fiduciary duty on broker-dealers. Instead, this body of proceedings demonstrates that regulators are aggressively policing broker-dealer conduct and protecting the interests of investors, including retirement plan and IRA holders. The fact is that the FINRA examination process uncovers acts of misconduct both large and small, and those bad acts are remedied appropriately through disciplinary proceedings and referrals. And investors are benefiting from this robust enforcement framework.[58] On the other hand, Investment Advisors are examined only once per 11 years on average, so there could be serious violations by Investment Advisors that have not yet been uncovered.

In addition, FINRA has bolstered its Suitability Rule by providing regulatory guidance interpreting the Rule to require "best interest" considerations during the course of a broker-dealer's mandated suitability analysis.[59] FINRA has also broadened the applicability of the Rule by, for example, requiring suitability analysis to be conducted in the context of recommendations to *hold* securities, not simply recommendations to transact in securities.[60] Furthermore, FINRA has launched a conflicts initiative, through which it has made clear that broker-dealers are expected to implement a strong enterprise-level conflicts management framework that includes the adoption of a "best

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56 *See, e.g.*, CFA at 10-13 (submitted Jul. 21, 2015) (citing cases).

57 *Id.* at 13.

58 In 2014, FINRA conducted more than 4,500 examinations resulting in 1,397 disciplinary actions and approximately 700 referrals of fraud cases for prosecution by other authorities. *See* FINRA Oversight Statistics, *supra* n. 55.

59 FINRA Rule 2111 (Suitability) FAQ (https://www.finra.org/industry/faq-finra-rule-2111-suitability-faq#_edn3) ("In interpreting FINRA's suitability rule, numerous cases explicitly state that 'a broker's recommendations must be consistent with his customers' best interests.' The suitability requirement that a broker make only those recommendations that are consistent with the customer's best interests prohibits a broker from placing his or her interests ahead of the customer's interests.").

60 *See* FINRA Regulatory Notice 11-02, *Know Your Customer and Suitability* (Jan. 2011) (http://www.finra.org/sites/default/files/NoticeDocument/p122778.pdf) (stating that the Suitability Rule applies recommended investment strategies involving an explicit recommendation to hold a security or securities).

interests of the customer" standard within the firm's code of conduct.[61] In sum, due to the consistent, thorough examination and enforcement of broker-dealers by the SEC and FINRA, as well as the important regulatory enhancements adopted by FINRA, supporters of the Proposal are simply wrong to assert that a fiduciary standard provides consumers with more protection than broker-dealer regulation. Indeed, DOL's proposed rule would not result in a higher standard of care — but merely a different standard of care: one that adds significant costs and reduces choice, and that negatively impacts savers.

VII. Clarification As To Investment Education And Recommendations.[62]

Comment letters in the docket and statements in the public hearings raise concerns about the uncertainty created by the Proposal's broad definition of "advice" and its narrow definition of "investment education." It is encouraging that DOL recognized in its commentary on the Proposal and in public hearings that FINRA guidance "provides useful standards and guideposts for distinguishing investment education from investment advice under ERISA."[63] However, DOL must reflect this reliance on FINRA guidance definitively in any final rule. State Farm urges DOL to do so. Failure to harmonize the education exemption explicitly with FINRA guidance could have a chilling effect on educational material provided to the public, increase investor confusion, and result in unnecessary litigation and expense due to second-guessing by lawyers and courts.

VIII. Lack Of Clarity On Status Of Proprietary Products.

State Farm offers proprietary products, including mutual funds and annuities, that were developed to meet the needs of our customers. State Farm serves various types of customers, including those with limited amounts to invest, many of whom would not be served by advisers that charge AUM-based fees. In response to industry concerns raised in the comments and public hearings, DOL staff have stated it was not the intent of the Proposal to eliminate proprietary products.[64] However, certain aspects of the Proposal, principally the limitations on the counterparty carve-out and the conditions associated

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[61] FINRA Report on Conflicts of Interest (Oct. 2013) (http://www.finra.org/sites/default/files/Industry/p359971.pdf).

[62] State Farm reiterates its view that DOL should retain Interpretive Bulletin 96-1in order to allow investors to receive educational materials as they do today, without the establishment of a fiduciary relationship. *See* State Farm at 11 (July 21, 2015).

[63] 75 Fed. Reg. at 21,938; Transcript of Public Hearing at 993:1-5 (Aug. 12, 2015) ("[W]e tried very hard to, you know, define the trigger for fiduciary advice in the first place in a way that's aligned with the FINRA standard, a recommendation, a call to action. That's not a casual conversation.") (statement of T. Hauser, Deputy Asst. Sec'y for Program Operations, U.S. Dept. of Labor). *See also* FINRA Policy Statement 01–23.

[64] Transcript of Public Hearing at 253:5-10 (Aug. 10, 2015) ("Obviously in our [BIC] exemption we contemplate the sale of proprietary products.") (statement of T. Hauser); Tr. 343:1-7 (Aug. 10, 2015) ("Certainly, you know, it's quite plain both from the structure and the words in the exemptions and the rules that it does not mean you cannot get paid. I mean there's a whole section on reasonable compensation, as well as selling proprietary funds. Neither of those things make any sense if you can't be compensated.") (statement of T. Hauser).

with the BIC Exemption, create such high costs and risks for proprietary products that they essentially amount to a prohibition.

The offering of several important retirement products could be curtailed under the Proposal. For example, annuities are an ideal way to address the risk of outliving one's savings and therefore a particularly useful investment as part of a retirement plan. They are made available through networks of issuer-designated agents who are trained in the intricacies of the company's annuities products. Under State Farm's exclusive proprietary product model, it is obvious to investors that the agent or company is marketing a company product. Customers benefit from learning about a company's products from a trained agent who is well-equipped to answer customer questions. However, because the Proposal's text does not clearly affirm the permissibility of offering exclusively proprietary products, it creates uncertainty that may limit the ability of investors to obtain these useful products.

IX. Restrictions On DOL's Statutory Authority.

There are several statutory impediments to DOL's implementation of the Proposal as drafted, including Congress's clear policy articulated by statute favoring arbitration, and the DOL's lack of jurisdiction over IRAs. Several commenters urge DOL to make the Proposal even more burdensome.[65] The modifications urged by these commenters should bring these statutory flaws into even greater focus. More broadly, as discussed in our first comment letter, DOL lacks the authority to create a private right of action under the BIC Exemption.

A. Inability to Restrict Arbitration.

DOL has no authority to limit the scope of arbitration clauses as proposed. Under the BIC Exemption, DOL proposes to prohibit contractual provisions waiving an individual's right to bring class or other representative actions in court. However, the FAA[66] "establishes a national policy favoring arbitration when the parties contract for that mode of dispute resolution."[67] This policy has been applied and affirmed by the Supreme Court in the case of *Shearson / American Express, Inc. v. McMahon* in the context of arbitration agreements between securities broker-dealers and their customers.[68] Under the FAA and the above-described Supreme Court precedent, the authority to restrict arbitration agreements rests with Congress. Absent a congressional directive, DOL cannot restrict arbitration agreements. Instead of attempting to create this impermissible cause of action, DOL should enable the use of arbitration which better

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65 *See, e.g.*, 3ethos (submitted May 26, 2015); The Advisory Group San Francisco, LLC (submitted Jun. 19, 2015); Occupy the SEC (submitted Jul. 21, 2015).

66 9 U.S.C. §§ 1 *et seq.*

67 *Preston v. Ferrer*, 552 U.S. 346, 349 (2008) (citing *Southland Corp. v. Keating*, 465 U.S. 1 (1984)).

68 482 U.S. 220 (1987).

serves consumers by providing them with a forum to present their individual claim, a speeder adjudication of their claim, and a lower net cost to consumers.

B. Lack of Jurisdiction over IRAs.

Several commenters point to roll-over IRAs that receive proceeds from ERISA covered plans as supporting imposition of an ERISA-based fiduciary duty on IRAs.[69] Congress enacted ERISA and simultaneously created IRAs in 1974. Congress chose to subject employer-sponsored plans to the fiduciary standard defined under ERISA, but did *not* subject IRAs to the same standard. Instead, Congress chose for IRAs to be governed solely by the Internal Revenue Code's (the "Code's") prohibited transaction rules. Over the past four decades, Congress has amended ERISA and the Code on numerous occasions, including in 1992 to liberalize and encourage tax-free plan-to-IRA rollovers, and has not altered this framework.[70] Accordingly, DOL lacks the authority to extend ERISA's fiduciary standard to any IRAs.[71] DOL cannot obtain jurisdiction over IRA rollovers without congressional authorization.

DOL and several of the Proposal's supporters claim that plan-to-IRA rollovers expose investors to conflicted advice and the possibility of incurring significant fees.[72] The Proposal includes recommendations to take distributions from ERISA plan assets for the purpose of funding an IRA within the scope of covered investment advice.[73] Nothing in ERISA or the Code allows this. Further, this aspect of the Proposal is a complete reversal of DOL's long-standing opinion on this issue,[74] as well as a curious departure from DOL's original 2010 proposed rule, where it declined to extend ERISA to distribution or rollover advice precisely because of DOL's existing precedent to the contrary.[75]

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[69] *See e.g.*, Better Markets at 8 (submitted Jul. 21, 2015); National Active and Retired Federal Employees Association at 1-2 (submitted Jul. 17, 2015); Center for American Progress at 3 (submitted Jul. 21, 2015); CFA at 3-5 (submitted Jul. 21, 2015). When an ERISA plan participant leaves his or her employer, they may choose to "roll over" their assets to an IRA, leave them with the former employer's plan (if permitted), or cash out. Rolling over to an IRA may provide multiple benefits to the investor, such as a more diverse range of investment options, account consolidation, and access to higher levels of service.

[70] Unemployment Compensation Amendments of 1992, Public Law No. 102 - 318, 106 Stat. 290 (codified as amended in scattered sections of 5 U.S.C., 19 U.S.C., 42 U.S.C., and 45 U.S.C).

[71] *See* State Farm at 14-16 (submitted Jul. 21, 2015).

[72] *See* 75 Fed. Reg. at 21,947.

[73] 75 Fed. Reg. at 21,939.

[74] *See* DOL, Adv. Op. 2005-23A (Dec. 7, 2005).

[75] *See* Proposal at 21,939 ("Noting the Department's position in Advisory Opinion 2005–23A that it is not fiduciary advice to make a recommendation as to distribution options even if that is accompanied by a recommendation as to where the distribution would be invested, . . . the 2010 Proposal did not include this type of advice [within the scope of covered advice].").

Congress has not vested in DOL the authority to assert jurisdiction over a financial professional's recommendation to a client to take an otherwise permissible plan distribution for the purpose of investing in an IRA. However, the SEC and FINRA *are* vested with such authority and have consistently scrutinized rollover advice through their examination and enforcement of broker-dealers,[76] while also providing investors with educational tools to help them understand what to consider in evaluating a rollover recommendation.[77] Finally, even if DOL had authority to implement the Proposal, its issuance of rules that are inconsistent with the approaches taken by the SEC and FINRA will only confuse retirement investors and service providers.

C. Consequences of a Private Right of Action.

As discussed in our earlier comment letter, the DOL-imposed terms of the contract required by the BIC Exemption create liability (under state law, at least in the case of IRAs) that Congress has never granted DOL the power to impose. This private right of action, created under the BIC Exemption, conflicts with both the Code and ERISA and would allow the plaintiff's bar, rather than solely the IRS, to enforce the prohibited transaction rules.

As a method of enforcement, the Proposal's private right of action is a significant and serious flaw. Litigation will lead to uncertainty and delay, and will increase costs for all. The problem is compounded by the fact that the rule provides no safe harbors making clear what is and is not unlawful under the rule. At the point of sale, both the adviser and the customer will, via required disclosures, know the costs, fees and other requisite elements of the transaction. And yet, the Proposal still subjects advisers to the possibility of a lawsuit at a later date. In other words, a transaction entered into in the good faith belief that the investment is lawful can later be determined by a judge or jury to be unlawful. The uncertainty is made worse by the fact that the standards upon which the transaction is 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, both advisers and customers will be lacking guidance as to the standards to be applied to these transactions.

The contention by previous commenters who strongly support the Proposal that the Proposal will not increase financial institutions' litigation risk is simply wrong. 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 nothing new ignores the new

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[76] *See*, FINRA, 2015 Regulatory and Examination Priorities Letter (Jan. 6, 2015) (listing IRA rollovers as an enforcement priority); SEC, Examination Priorities for 2014 (Jan. 9, 2014) (SEC initiatives to examine for improper recommendations in connection with the movement of assets from an ERISA plan to an IRA).

[77] *See,* FINRA, Regulatory Notice 13-45, *Rollovers to Individual Retirement Accounts* (Dec. 2013), *available at* https://www.finra.org/sites/default/files/NoticeDocument/p418695.pdf; SEC, *Self-Directed Plans—Individual Retirement Accounts (IRAs), available at* http://investor.gov/employment-retirement/employment/self-directed-plans-individual-retirement-accounts-iras.

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.

Similarly, the BIC Exemption allows for differential compensation in the form of commissions, but only if certain requirements are met. Because the Proposal provides no meaningful guidance regarding how these requirements can be met, the BIC Exemption will inevitably lead to litigation as disagreements regarding what constitutes compliance arise.

Moreover, studies bear out that litigation is not an efficient or effective mechanism of dispute resolution.[78] This is particularly true given that the multiple jurisdictions in which these disputes are litigated will likely come to differing decisions resulting in inconsistent guidance regarding future conduct. DOL must confront the reality of these additional costs and burdens placed on consumers, advisers, and the courts of any shift toward adjudication of claims arising under the Proposal via the court system.

Commenters have also suggested that there is no meaningful risk of enhanced class action exposure from the Proposal because of the procedural hurdles and burdens associated with meeting the requirements of a class action. State Farm agrees that there are and should be significant hurdles associated with the class certification process in order to protect both putative class members and defendants from abuse of the class action mode of resolving disputes. Nevertheless, this does not mean that attorneys will not attempt to pursue class action relief as they identify novel issues that arise under the Proposal, including how particular requirements in the Proposal should be interpreted. Even unsuccessful class actions can be enormously costly to defendants as well as a drain on judicial resources. These costs must also be weighed against the long history of class actions as vehicles for producing plaintiff counsel fees and little significant relief for class members.[79]

In short, the Proposal will engender litigation. Resulting lawsuits will involve complex issues of first impression which will be determined, inevitably with inconsistent results, by trial courts across the country and then interpreted by appellate courts over a period of years, during which time the litigants are faced with uncertainty and the associated costs and risks of litigation. This will impose unnecessary complexity on

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[78] *See* Final Report of the Joint Project of the American College of Trial Lawyers Task Force on Discovery ("Task Force"); Institute for the Advancement of the American Legal System ("IAALS") (Apr. 15, 2009) (recognizing that the civil justice system is in serious need of repair and that there are serious problems in the system).

[79] *See* Adonis Hoffman, *Sorry, Wrong Number, Now Pay Up*, WALL ST. J. (Jun. 15, 2015) (http://www.wsj.com/articles/sorry-wrong-number-now-pay-up-1434409610).

customers and advisers and will impose additional strain on our already over-burdened court systems.[80]

In providing for enforcement through a private cause of action, the Proposal ignores more effective alternatives for dispute resolution. These include arbitration or administrative hearings before a self-regulatory organization. At the very least, it would be preferable to establish a conference and administrative process where the dispute could be reviewed on the merits as a precondition to issuance of a right to sue certification. This would provide a mechanism for prompt resolution of any legitimate disputes and lessen the burden on our court systems.

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[80] *See* Eric Magnuson, Steven Puiszis, Lisa Agrimonti, and Nicole Frank, *The Economics of Justice,* DRI (Jul. 17, 2014) (http://www.dri.org/Article/134) (noting that due to underfunding many state courts are unable to timely deliver justice).

PART II
STATE FARM'S SUGGESTIONS REGARDING THE PROPOSAL

The Proposal will harm consumers, is beyond DOL's authority, and should not be adopted. If, however, DOL nonetheless determines to move ahead with the Proposal substantially in the form proposed, State Farm believes that the following items must be changed in order to increase the likelihood that the industry could operationalize the Proposal.[81] Thus:

- The implementation period must be extended to at least three years;
- Clarifications must be made in order to meet DOL's stated goal of preserving specific business models, including a presumption based on Section 913 of the Dodd-Frank Act, and safe harbors for providers that offer proprietary products and commission-based sales, and for providers that implement specific compliance programs;
- Clarifications must be made to the prohibited contractual provisions;
- Clarifications must be made with respect to the requirements for offering "all" asset classes;
- Certain definitions must be revised; and
- Existing tax-qualified customers must be broadly grandfathered.

I. An Extended Implementation Period Is Needed.

An eight-month implementation period is grossly inadequate given the scale and complexity of the Proposal. Eight months is insufficient time to allow financial institutions to undertake and complete such major operational changes. State Farm is concerned that the limited time provided under the Proposal could lead to substantial disruptions in the marketplace. It will be logistically impossible for some firms (including some well-established large firms that serve millions of customers) to fully comply with such a complex rule in such a condensed period of time, especially in an industry that is so diverse in business models, compensation structures, and product line-ups. State Farm questions why, in the face of so many commenters raising this issue, the DOL remains fixed on an eight-month implementation period. State Farm is unaware of any economic or industry study, hearing testimony, or any rationale to support such a short time frame.

A compliance period of at least three years is necessary to ensure proper implementation without costly disruptions to consumers. Compliance periods of this length are not unusual for complex rules such as those proposed, as shown by many

[81] This listing does not detract from other essential changes, set forth in our first comment letter, but adds more detail and specificity as to certain ones that State Farm views as the most significant.

examples.[82] Many operational and customer-facing changes would need to be made before customers could be serviced under the proposed new rules. If there is not sufficient time to make and test these changes, customers may be harmed because they may be left in a situation where they cannot receive service.

State Farm has made a good faith effort to examine all components of this Proposal and determine what could reasonably and logically be completed within an eight month time frame after issuance of a final rule. However, there are so many sequential dependencies for implementation of the Proposal (if it is finalized) that it would be difficult, at best, to implement any portion of it within eight months.

One of the difficulties in determining the necessary time period relates to the fact that the Proposal has not yet been finalized. State Farm believes that DOL will carefully consider the points raised by commenters in letters and at hearings, and remains open to consideration of how the text of the proposed regulations could be revised in order to be consistent with DOL's stated intent of preserving business models. Before adopting an implementation plan, State Farm will have to thoroughly review any final rules.

In terms of operations, State Farm (and other similarly-situated firms) would have to create an implementation plan after assessment of any final regulations and a comparison with current operations. In this regard, State Farm will be subject to many new operational requirements, such as new IT systems, new compliance structures, and new compensation arrangements. IT system changes that will be required include compensation, audit, training, and oversight. Each IT system change will also require a series of underlying adjustments — including, for example, adjustment to vendor contracts, the development of new vendor relationships and the purchase, adoption, and maintenance of new software. Certain internally-developed software technologies will also have to be created or revised. If vendors are needed, State Farm will need to work through various Requests for Proposal ("RFPs"), view presentations, select vendors, and enter into contracts with such vendors. If, and to the extent, that any software system interacts with one or more others, State Farm will need to test the integration of the systems. State Farm estimates that implementation of IT-related requirements will take at least three years.

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[82] *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) (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).

State Farm would also need to create new sales literature and revise existing marketing materials, including hundreds of print and online marketing materials that contain discussion of ERISA/IRA accounts and non-ERISA/IRA accounts. The first step of the process would require State Farm to determine the impact of the final rules and then prioritize the revision of materials. Changes to these documents will have to be created and reviewed by counsel. The revised literature and materials will also require submission for approval or vetting with the relevant functional regulator, such as state insurance departments and FINRA. State Farm estimates that this process will take approximately 12 months. However, regulatory staffing may not be sufficient for the significantly increased industry demand if the Proposal is finalized in its current form, so the approval process may take longer.

Depending on the elements of any final rule, State Farm will have to consider how to implement compensation arrangements with over 18,000 independent contractor agents. State Farm agent compensation is managed on multiple inter-connected systems, all of which would have to be modified. In addition, State Farm would also likely have to adjust compensation for thousands of State Farm associates appropriately engaged in assisting customers. State Farm estimates the process will take 24 months for the drafting and implementation of appropriate arrangements, and for modifications to IT and systems capabilities to support the compensation arrangements so as not to have a period of disruption for both agents and customers during the period of transition.

A new training program will have to be developed. Special re-training sessions will have to be conducted for all personnel involved in investment distribution. For State Farm, this will involve over 77,000 total associates — over 18,000 agents, almost 57,000 employees of licensed agents, and over 2,000 internal State Farm employees responsible for carrying out internal functions and operations. An ongoing training program will also have to be implemented to train personnel as to new fiduciary responsibilities and related legal obligations. State Farm estimates that creation and implementation of this training program will require 36 months.

Likewise, State Farm estimates that it will take at least 36 months to build-out existing compliance frameworks across the enterprise in accordance with any final rules. This build-out includes developing an initial compliance framework, and then refining it to reflect other operational changes required by any final regulations.

State Farm expects that the drafting and implementation of the BIC contract for new customers will take at least 24 months and that it will take considerably more time for current customers (if they are not grandfathered under the final guidance in some way). State Farm will have to contact hundreds of thousands of existing customers, explain the necessity for new contracts and disclosures, and obtain signatures. Based on previous experiences, State Farm anticipates that this process will require many one-on-one meetings, and multiple efforts to explain the documents and remind customers to sign and return updated documents.

Finally, State Farm will have to create an all-new machine-readable website with data regarding investment offerings. This will require internal and external consultations

regarding content and programming, the selection and retention of IT consultants, and the development and integration of new software systems. Due to the numerous inputs that will be needed for each investment option, the new website will require extensive testing before going "live."

These tasks are only a sampling of those that will be required in order to implement the regulations if issued in a form similar to the current Proposal. Some areas or organizations may also find that they do not have sufficient capacity, and will have to retain consultants to design and implement compliant systems, structures and training modules in addition to those areas identified above. The process of retaining such consultants is in and of itself a time-consuming (and expensive) endeavor, similar to the RFP process described above.

For all these reasons, a minimum three-year implementation period is essential. And, while State Farm cannot speak for other financial institutions, State Farm expects many would require similar timeframes. The eight-month implementation ignores the realities of running a complex business organization, with sequential dependencies, multiple interdependencies, and current uncertainty about what exactly is to be implemented in just a few months from now.

If DOL refuses to recognize that the practical realities of implementation demand more time, and insists on a shorter implementation deadline, State Farm urges consideration of a safe harbor from any liability (including civil lawsuits) for providers that make reasonable efforts to implement and comply with the terms of the new rules but whose failure to comply with any portion of the final rules or exemptions is due to a good faith mistake or misjudgment.

II. Presumptions And Safe Harbors for Proprietary Products And Commissions.

The Proposal must be clarified to provide that the sale of only proprietary products or the sale of products for which a commission is charged are permissible business models. Any rule promulgated by DOL should be business-model neutral. During public hearings, DOL stated that it did not intend for the rule to end the availability of proprietary products and commission-based business models to plan and IRA customers. Now is the time for DOL to make very clear that proprietary products and commission based sales are permitted under the Proposal. State Farm suggests that DOL revise the Proposal to include the following presumption and safe harbors to protect these business models.

A. A Presumption Based on Section 913 of the Dodd-Frank Act is Essential.

As noted in State Farm's prior submission, Congress expressed its clear intention to preserve existing business models utilized by retail investors through the enactment of Section 913 of the Dodd-Frank Act.[83] Under Section 913, which addresses the SEC's

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

authority to promulgate rules governing the standards of conduct of brokers, dealers, and investment advisers when providing investment advice about securities to retail customers, 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. In addition, Section 913 requires any such 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.

Because these provisions, which were the product of thoughtful, lengthy negotiations between both chambers of 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 a Section 913-based presumption is added to the Proposal. Specifically, State Farm recommends the addition of a new sub-paragraph to Section II(e) (with existing paragraphs (e) and (f) redesignated as paragraphs (f) and (g)) of the BIC Exemption, as follows:

> (e) The following factors shall not, whether separately or in combination with other permissible conduct or activities, constitute a violation of the impartial conduct standards set forth in paragraph (c), or the warranties required by paragraph (d):
>
> (A) The receipt of compensation by the Adviser, Financial Institution or any Affiliate, Related Entity, or other party in the form of a commission, fee, or other compensation (such as commissions, trailing commissions, 12b-1 fees, revenue sharing arrangements, service fees, sales loads or other payments from parties, including Affiliates, providing investment products) in connection with the purchase, sale, or holding of an Asset; or
>
> (B) The offering by the Adviser or Financial Institution of only proprietary investments or a limited range of investment options, in accordance with the requirements established under Section IV(b).

Further, to keep the Proposal business-model neutral and to follow the intent of Congress, the additional requirements that are proposed to apply to those selling only proprietary products under Section IV(b)(1) should be entirely deleted. Financial institutions should not be required to make a "specific written finding" that offering a limited scope of investments, such as solely proprietary products, regardless of how broad the offering, does not prevent advisers from providing advice that is in the best interests of retirement investors.

The above adjustments will help carry out the clear intent of Congress by allowing for the preservation of business models that are heavily-relied upon by millions of retail investors and retirement savers, particularly those with modest account balances. In addition, these adjustments would be consistent with existing SEC and FINRA guidance and will mitigate the potential for conflict between the Proposal and any future best interest standard promulgated by the SEC or FINRA.

B. An Affirmative Safe Harbor for Sellers of Proprietary Products Should Be Added.

In addition to the Section 913 presumption discussed in Section A, above, in order to fully implement Congressional intent, the proposed BIC Exemption should contain an affirmative safe harbor for proprietary products if specified conditions are met. This safe harbor would allow sellers of proprietary products to have confidence that their sale of proprietary products with common compensation arrangements will comply with the best interest standard. This safe harbor could be implemented by adding the following at the end of "Section II – Contract, Impartial Conduct, and Other Requirements:"

> (h) *Proprietary Product Seller's Safe Harbor.* The written contract (including but not limited to the warranties required by Section II(d)) shall not be treated as having been breached, and the Retirement Investor shall have no cause of action, in connection with the purchase, sale, or holding of an Asset that is a Proprietary Product where the Financial Institution and its Advisers comply with the following requirements at the time any investment advice is provided to the Retirement Investor:
>
> > (1) The Financial Institution must disclose, at the time of sale, in writing to the Retirement Investor that the Financial Institution is a Seller of the Proprietary Products which may be recommended by the Adviser, that the Adviser is affiliated with the Financial Institution, and that the Financial Institution will benefit from the sale of Proprietary Products in ways that an unaffiliated seller would not benefit;
> >
> > (2) The Financial Institution must have adopted and implemented written policies and procedures that prohibit the use of quotas, bonuses, contests, special awards or differing commissions that (a) distinguish among products within a product type (i.e. variable annuity, mutual fund, deposit product, etc.) and (b) are designed in a manner which would reasonably be believed to encourage Advisers to make recommendations for Proprietary Products that are not in the Best Interest of the Retirement Investor; and
> >
> > (3) The Financial Institution must have adopted and implemented written policies and procedures requiring the Financial Institution and/or its Advisers to make a reasonable determination that any investment product recommended to a Retirement Investor is in the Best Interest of that specific Retirement Investor based upon its diligence with respect to the investment product and the information gathered with respect to such Retirement Investor by the Financial Institution and its Advisers.
>
> For purposes of this Proprietary Product Seller's Safe Harbor, an Adviser is considered to be affiliated with a Financial Institution if the Adviser is

an employee of the Financial Institution or any Affiliated or Related Entity of the Financial Institution, or is an independent contractor supervised by the Financial Institution or an Affiliated or Related Entity of the Financial Institution and exclusively or primarily acts on behalf of the Financial Institution or any Affiliated or Related Entity of the Financial Institution.

C. *An Affirmative Safe Harbor for Implementation of a Qualifying Compliance Program Should be Added.*

Financial institutions must have some level of certainty with respect to BIC Exemption compliance. Among other things, the Proposal's BIC Exemption is intended by DOL to allow providers that offer only proprietary products to continue to do so, and to allow certain common compensation arrangements (such as commissions, trailing commissions, 12b-1 fees, revenue sharing arrangements, service fees, sales loads and other payments from parties providing investment products) that would otherwise become impermissible under the revised definition of a "fiduciary." However, there can be no sure reliance on the BIC Exemption because it does not specify the circumstances which would qualify as compliance with its terms so as to establish a defense to a claim of a breach of the best interest standard.

Firms and individual advisers must be afforded regulatory protection from litigation[84] in the form of an affirmative safe harbor for providers that design compliance and supervisory systems that meet specific standards. This safe harbor, which would be available to sellers of proprietary products as well as to those who sell third-party products, could be implemented by adding the following at the end of "Section II – Contract, Impartial Conduct, and Other Requirements:"

> (i) *Compliance Program Safe Harbor.* The written contract (including but not limited to the warranties required by Section II(d)) shall not be treated as having been breached, and the Retirement Investor shall have no cause of action, in connection with the purchase, sale, or holding of an Asset where the Financial Institution has adopted and implemented a compliance program reasonably designed to ensure compliance with the terms of this Exemption that includes the following features:
>
> > (1) Written policies and procedures requiring the Financial Institution and its Advisers to undertake reasonable diligence with respect to any investment products recommended to any Retirement Investor and to reasonably determine that such investment products may be expected to be in the Best Interest of Retirement Investors with whom the Financial Institution reasonably expects to have relationships;

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[84] State Farm continues to question whether DOL has the authority to create a private right of action under the BIC Exemption.

(2) Written policies and procedures requiring Advisers, when making recommendations, to take into account, with respect to each Retirement Investor, (a) age, (b) anticipated or desired retirement date, (c) other assets and income and retirement assets outside of the account for which the recommendation is made, (d) experience in financial matters and investments, (e) desired risk tolerance or risk/return trade off, and (f) desired income or distribution from the account per year over a period of time;

(3) Written policies and procedures requiring Advisers to make a reasonable determination that any investment product recommended to a Retirement Investor is in the Best Interest of that specific Retirement Investor based upon the information identified in items (a) - (f) in item (2);

(4) Written policies and procedures requiring a written record evidencing the information collection and determinations required by the policies and procedures in items (1) – (3);

(5) Oversight of the operation of the compliance program by persons without responsibility for providing recommendations or selling investment products;

(6) Training to assist Advisers in the understanding and operation of the compliance program shall be conducted or offered by the Financial Institution periodically;

(7) The Chief Compliance Officer of the Financial Institution or a Related Entity shall annually certify to the Chief Executive Officer or the Board of Directors of the Financial Institution that the compliance program is reasonably designed to meet the requirements of this safe harbor and that all material compliance matters arising under such compliance program have been brought to the attention of the Chief Executive Officer or Board of Directors;

(8) An audit (by internal or external auditors) of the operation of the compliance program shall be performed no less frequently than annually; and

(9) Consequences for failure of Advisers to follow the compliance program, including but not limited to forfeiture of compensation, remedial training, enhanced supervision by the Financial Institution, or termination, shall be provided.

III. Clarification Regarding Prohibited Contractual Provisions.

The Proposal must be clarified as to how the prohibited contractual provisions are to be applied. The Proposal provides that certain contractual provisions prohibiting potential enforcement of contracts entered into pursuant to the BIC Exemption through class actions may not be included in a contract entered into pursuant to the BIC Exemption. The Proposal should clarify that certain provisions that could be included within the prohibited contractual provisions contained in the Proposal are not, in fact, intended to be prohibited. It should be permissible for contracts to contain a choice of law provision and a requirement to exhaust other reasonable remedies. Additionally, State Farm believes that such a clarification should tie into the safe harbors suggested above. State Farm recommends the revision of Section II(f) as follows:

> (f) *Prohibited Contractual Provisions.* The written contract shall not contain the following:
>
> (1) Exculpatory provisions disclaiming or otherwise limiting liability of the Adviser or Financial Institution for a violation of the contract's terms; and
>
> (2) A provision under which the Plan, IRA or Retirement Investor waives or qualifies its right to bring or participate in a class action or other representative action in court in a dispute with the Adviser or Financial Institution, provided that such prohibition shall not prevent the mandatory designation of forum, any requirement to exhaust other remedies prior to proceeding with a class action or other representative action in court, or an acknowledgement that the Financial Institution, as a matter of policy, makes a determination individualized to the client that the investment product recommended by the Adviser or Financial Institution is in the best interest of the Plan, IRA or Retirement Investor.

IV. Safe Harbor For Meeting BIC Exemption Requirement To Offer "All" Asset Classes.

State Farm remains concerned that the BIC Exemption's requirement that an adviser be prepared to offer recommendations with respect to "all of the asset classes reasonably necessary" to serve an investor's best interests is vague and inoperable.[85] The provision opens the adviser up to endless second-guessing by plaintiffs' attorneys and courts and exposes financial institutions to after-the-fact claims that the adviser should have recommended one or more asset classes that may not have even been offered by the adviser or as to which the adviser has no expertise or training. Use of the term "all" is overly broad and could pull in asset classes that are not customarily offered to retail investors, or that many investors find objectionable.

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[85] Proposed Best Interest Contract Exemption, Section IV – Range of Investment Options.

DOL should remove the requirement that an adviser offer "all" asset classes. The "reasonably necessary" language simply creates confusion when coupled with the reference to "all." No adviser could state with confidence that it offered *all* asset classes needed to meet the best interests of *all* investors unless the adviser carried *all* asset classes.[86] The simplest way to address this issue is to remove the word "all" from the text of the Proposal.

Additionally, State Farm recommends that the DOL create a "Target Date Retirement Fund Safe Harbor" under which advisers will be deemed to have satisfied the BIC Exemption's requirement, as revised below, if the adviser offers, at a minimum, a set of products which includes target date retirement funds ("TDFs") with target dates covering ten year increments over a period from current year retirement to anticipated retirement in 30 years. Due to their design including a mix of asset classes and a "glide path" that automatically changes that asset allocation as the retirement investor ages, DOL notes in its "Tips for ERISA Plan Fiduciaries"[87] that many plan sponsors use TDFs as their plan's qualified default investment alternative ("QDIA") under DOL regulations. State Farm agrees that TDFs constitute one appropriate way that retirement investors may receive the benefit of having available appropriate asset classes for investment, and that they form a good basis for a safe harbor. Offering TDFs helps assure that retirement investors have access to assets which have materially different risk and return characteristics and tend to minimize through diversification the overall risk in the customer's portfolio.

In addition, to clarify the otherwise general provision regarding "all of the asset classes reasonably necessary" to make a recommendation, the provision should incorporate a standard specifically requiring a financial institution to make a determination regarding investment products that may be expected to meet the needs of individuals with whom it reasonably expects to have relationships.

These revisions could be accomplished with the following changes to "Section IV – Range of Investment Options:"

> (a)(1) General. The Financial Institution offers for purchase, sale or holding, and the Adviser makes available to the Plan, participant or beneficiary account, or IRA for purchase, sale or holding, a range of Assets that the Financial Institution has reasonably determined may be expected to be in the Best Interest of Retirement Investors with whom the Financial Institution reasonably expects to have relationships, ~~that is broad enough to enable the Adviser to make recommendations with respect to all~~

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[86] Note, for instance, that investment fund research firm Morningstar tracks over 100 different categories of mutual funds. *The Morningstar Category Classifications* (http://corporate.morningstar.com/us/html/pdf.htm?../documents/MethodologyDocuments/MethodologyPapers/MorningstarCategory_Classifications.pdf).

[87] DOL, Employee Benefits Security Administration, *Target Date Retirement Funds – Tips for ERISA Plan Fiduciaries* (Feb. 2013).

~~of the asset classes reasonably necessary to serve the Best Interests of the Retirement Investor in light of their investment objectives, risk tolerance, and specific financial circumstances.~~

(2) Safe Harbor. A Financial Institution and Adviser shall be deemed to have satisfied Section (a) if the Financial Institution offers, at a minimum, a menu of investment alternatives that includes a suite of target date retirement funds, with target dates covering ten year increments over a period from current year retirement to anticipated retirement in 30 years.

V. Clarification Of Definitions.

State Farm believes that the Proposal will be substantially improved by making certain clarifications through the revision of two definitions.

The Proposal's existing definition of "Financial Institution" under the BIC Exemption is not reflective of the current marketplace for and distribution of financial products and services. The examples below illustrate our concern.

First, under the definitions proposed in Section VIII of the BIC Exemption, a company qualifying as a "Financial Institution," such as an insurance company, may market the products of a second financial institution through its representatives and agents. In these cases, an insurance company's marketing agreements are often entered into with an Affiliate of the insurance company. This affiliate would not itself be a "Financial Institution," under the current BIC Exemption. Second, the proposed definition includes banks and savings associations only to the extent that advice provided by these institutions is carried out through a trust department. Many banks, including State Farm Bank, do not have trust powers or separate trust departments. Due to the limited nature of these aspects of the definition of "Financial Institution," State Farm and numerous other institutions currently distributing financial products and services through a multitude of channels would, in certain respects, be unable to satisfy the requirements of the BIC Exemption.

Additionally, the Proposal's existing definition of "Best Interest" under the BIC Exemption requiring advisers to act "without regard to the financial or other interests of the Adviser, Financial Institution or an Affiliate, Related Entity or other party" is problematic and would benefit from revision. This language could be inappropriately construed to require that any advice provided wholly ignore the legitimate business goals that Advisers and Financial Institutions have to generate sufficient revenue to cover their costs and earn a reasonable profit.

Thus, State Farm believes the following amendments to Section VIII would be beneficial:

Section VIII—Definitions

(d) Investment advice is in the ''Best Interest'' of the Retirement Investor when the Adviser and Financial Institution providing the advice act with

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, ~~without regard to~~ and that places the interests of the Retirement Investor before the financial or other interests of the Adviser, Financial Institution or any Affiliate, Related Entity, or other party.

(e) "Financial Institution" means the entity that employs the Adviser or otherwise retains such individual as an independent contractor, agent or registered representative and that is:

. . .

(2) A bank or similar financial institution supervised by the United States or state, or a savings association (as defined in section 3(b)(1) of the Federal Deposit Insurance Act (12 U.S.C. 1813(b)(1)), ~~but only if the advice resulting in the compensation is provided through a trust department of the bank or similar financial institution or savings association which is subject to periodic examination and review by federal or state banking authorities~~;

(3) An insurance company qualified to do business under the laws of a state, or any Affiliate thereof, provided that such insurance company:

VI. "Grandfathering" Treatment For Existing Tax-Qualified Product Customers.

There must be complete grandfathering for all existing tax-qualified product customers (including ERISA plans and other tax-qualified accounts maintained at one financial institution but funded with, or holding, a product from another financial institution), whether or not new funds are added to the tax-qualified accounts of such customers after the implementation date. As discussed in our initial letter, broad grandfathering is necessary to allow customers to receive the benefit of bargains that they have made, and to prevent customer confusion and disruption in the established relationships between financial institutions, adviser and retirement customers. Customers who are happy with the terms of their existing relationship should be allowed to keep those terms. This could be accomplished by revising the terms of Section VII of the proposed BIC Exemption ("Exemption for Pre-Existing Transactions") as follows:

Section VII—Grandfathering ~~Exemption~~ for Pre- Existing Transactions, Advice and Customers

(a) In general. ~~ERISA and the Internal Revenue Code prohibit Advisers, Financial Institutions and their Affiliates and Related Entities from receiving variable or third-party compensation as a result of the Adviser's and Financial Institution's advice to a Plan, participant or beneficiary, or IRA owner.~~ Some Advisers and Financial Institutions were ~~did~~ not ~~consider themselves~~ fiduciaries within the meaning of 29 CFR 2510–3.21

before the applicability date of the amendment to 29 CFR 2510–3.21 (the Applicability Date). Other Advisers and Financial Institutions entered into transactions involving Plans, participant or beneficiary accounts, or IRAs before the Applicability Date, in accordance with the terms of a prohibited transaction exemption that has since been amended. This exemption grandfathers, under pre-Applicability Date law, all of a Financial Institution's and an Adviser's existing tax-qualified product customers (including ERISA plans and other tax-qualified accounts maintained at one financial institution but funded with, or holding, a product from another financial institution), whether or not new money is added to such a tax-qualified customer relationship after the Applicability Date. Nothing in the amendment to 29 CFR 2510–3.21 shall provide any inference as to the law in effect prior to the Applicability Date. ~~permits Advisers, Financial Institutions, and their Affiliates and Related Entities, to receive compensation, such as 12b-1 fees, in connection with the purchase, sale or holding of an Asset by a Plan, participant or beneficiary account, or an IRA, as a result of the Adviser's and Financial Institution's advice, that occurred prior to the Applicability Date, as described and limited below.~~

(b) Pre-Applicability Date Transactions and Advice. Whether a transaction entered into prior to the Applicability Date or advice rendered prior to the Applicability Date, or any and all compensation received by any person (whether received prior to, on or after the Applicability Date) in connection with such transaction or advice, results in a prohibited transaction under Section 406 of ERISA or Section 4975 of the Code shall be determined under the laws and prohibited transaction exemptions as in effect (subject to any amendments thereto effective prior to the Applicability Date and any grandfathering rules applicable thereto) as of the date of such transaction, advice or receipt of compensation, and in no event as in effect as of later than immediately prior to the Applicability Date. ~~Covered transaction. Subject to the applicable conditions described below, the restrictions of ERISA section 406(a)(1)(D) and 406(b) and the sanctions imposed by Code section 4975(a) and (b), by reason of Code section 4975(c)(1)(D), (E) and (F), shall not apply to the receipt of compensation by an Adviser, Financial Institution, and any Affiliate and Related Entity, for services provided in connection with the purchase, holding or sale of an Asset, as a result of the Adviser's and Financial Institution's advice, that was purchased, sold, or held by a Plan, participant or beneficiary account, or an IRA before the Applicability Date if:~~

~~(1) The compensation is not excluded pursuant to Section I(c) of the Best Interest Contract Exemption;~~

~~(2) The compensation is received pursuant to an agreement, arrangement or understanding that was entered into prior to the Applicability Date;~~

~~(3) The Adviser and Financial Institution do not provide additional advice to the Plan regarding the purchase, sale or holding of the Asset after the Applicability Date; and~~

~~(4) The purchase or sale of the Asset was not a non-exempt prohibited transaction pursuant to ERISA section 406 and Code section 4975 on the date it occurred.~~

(c) Post-Applicability Date Transactions With, and Advice Provided to, Persons Who Were Customers as of Immediately Prior to the Applicability Date. Whether a transaction entered into on or after the Applicability Date by a person with a Pre-Existing Customer or advice rendered by a person to a Pre-Existing Customer on or after the Applicability Date, or any and all compensation received by any person in connection with such post-Applicability Date transaction or advice (including transactions, advice and compensation in respect of funds added to the relationship post-Applicability Date by the Pre-Existing Customer), results in a prohibited transaction under Section 406 of ERISA or Section 4975 of the Code shall be determined under the laws and prohibited transaction exemptions as in effect as of immediately prior to the Applicability Date. A "Pre-Existing Customer" of any person means any tax-qualified product customer of such person (a tax-qualified customer includes but is not limited to, any Plan, participant or beneficiary account, or IRA funded with a product from a financial institution that is, or is affiliated with, such person) as of immediately prior to the Applicability Date.

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CONCLUSION

State Farm has carefully reviewed the comments submitted and statements made in the administrative hearings. State Farm remains highly concerned that the Proposal, if adopted, will reduce the availability of investment choices for retirement savers. State Farm encourages DOL to act deliberately and in concert with functional regulators, namely, the SEC and FINRA, to ensure that any proposal is consistent with existing legal standards applicable to varying business models and allows for customers to continue to be served by those models, if they so choose. However, if DOL proceeds with the Proposal unilaterally, it must include the revisions described above. State Farm sees no legitimate reason for DOL to so hurriedly set aside its obligation to carefully consider the effects of the Proposal and its impact on investors before taking any final action. State Farm hopes that DOL will take adequate time and devote ample consideration to these comments. Thank you for your consideration.