Stephen McManus, CPCU®, CLU®, ChFC®
Senior Vice President and General Counsel
Ph [redacted] Fax [redacted]
[redacted]

One State Farm Plaza
Bloomington, Illinois 61710-0001

August 21, 2017

Via Email to: rule-comments@sec.gov

U.S. Securities and Exchange Commission
100 F Street, NE
Washington DC 20549-1090
Attn: Chairman Jay Clayton

Re: Standards of Conduct Applicable to Investment Advisers and Broker-Dealers

Ladies and Gentlemen:

State Farm Mutual Automobile Insurance Company, with its subsidiaries (collectively "State Farm"), writes at the invitation of Chairman Jay Clayton of the Securities and Exchange Commission (the "SEC") regarding the on-going regulatory initiatives to define a standard of conduct applicable to broker-dealers and investment advisers. State Farm appreciates the opportunity to comment on this critical issue for the financial services industry, especially in light of the Department of Labor's (the "DOL") rules that fundamentally alter the regulation of individuals and firms that advise on or offer tax-advantaged accounts.[1]

In its 95 years of business, State Farm has been proud to help individuals across the United States manage the risks of everyday life, recover from the unexpected, and realize their dreams. In many cases, serving the needs of State Farm customers means providing retirement advice incidental to the transaction and otherwise serving tax-advantaged accounts. Since the proposal and then adoption of the DOL's rule defining "fiduciary" under the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), and adoption of the Best Interest Contract Exemption (the "BIC Exemption") (together, the "Fiduciary Rule"), State Farm has fundamentally reconsidered its business and the way it provides its products and services to its customers.

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

As State Farm has emphasized in comment letters to the DOL dated July 21, 2015, September 24, 2015, April 14, 2017, July 20, 2017, and August 4, 2017, the Fiduciary Rule creates ambiguity and increases the burdens and risks of providing cost-efficient services to its customers.[2] The Fiduciary Rule thereby undermines the ability of State Farm to serve customers according to their needs and deprives those customers of choices with regard to the investment guidance they may receive.

We therefore support Chairman Clayton's call for public comment on standards of conduct for investment advisers and broker-dealers. In addition, we applaud the Chairman's emphasis on regulatory coordination:

> I believe clarity and consistency — and, in areas overseen by more than one regulatory body, coordination — are key elements of effective oversight and regulation. We should have these elements in mind as we strive to best serve the interests of our nation's retail investors in this important area.[3]

State Farm emphatically agrees. Federal regulations on standards of conduct should be coordinated across agencies to bolster efficiency and efficacy in consumer protection and should be consistent with Congressional intent as set forth in Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd Frank Act").

As the regulatory body tasked with the enforcement of the federal securities laws, the SEC has a primary role in the development and implementation of standards of conduct for the financial services industry. State Farm has previously requested that the DOL rescind the Fiduciary Rule during the pendency of the SEC's review of these critical issues. State Farm maintains that the functional product regulators, like the SEC, should be the leader in establishing any standard of care utilized in both tax-advantaged and non tax-advantaged accounts. Should the DOL maintain its desire to implement regulations imposing standards of care for tax-advantaged accounts, it should do so consistent with the SEC and only after the SEC has carried out its congressional charge as set forth in the Dodd Frank Act.

State Farm reiterates its view that the SEC should promptly address the appropriate standard(s) of conduct for securities industry participants in a manner which not only seeks to protect consumers but also ensures regulatory consistency across relevant regulators. As it does so, the SEC should consider the concerns discussed in the remainder of this letter.

I. Any standard of conduct should reflect the clear Congressional intent that neither (i) the receipt of a commission or fee in connection with the sale of investment

[2] Please refer to the comment letters previously submitted by State Farm dated July 21, 2015 (available at: https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/public-comments/1210-AB32-2/00646.pdf), September 24, 2015 (available at: https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/public-comments/1210-ZA25/00359.pdf), April 14, 2017 (available at: https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/public-comments/1210-AB79/01255.pdf), July 20, 2017 and August 4, 2017.

[3] Statement of Chairman Clayton, *Public Comments from Retail Investors and Other Interested Parties on Standards of Conduct for Investment Advisers and Broker-Dealers*, June 1, 2017.

products nor (ii) the sale of proprietary products constitute a violation of a unified standard of conduct.

State Farm supports standards of conduct for broker-dealers and investment advisers which are consistent across applicable regulatory bodies and believes that such standards would provide clarity to both customers and industry participants. However, in imposing any standard, the SEC and other relevant regulators must take into account the fundamental differences between the services provided by investment advisers and broker-dealers.[4] Key among those differences are certain practices common to broker-dealers—such as the use of sales-based compensation and the sale of proprietary products—which are inappropriately disfavored by the Fiduciary Rule in contravention of clear statements of Congressional intent.[5]

(i) The receipt of sales based compensation should be explicitly permitted under any revised standard of conduct.

Any revised standard of conduct must continue to permit the use of sales-based compensation. Long a mainstay of the financial services industry, sales commissions are frequently preferred by middle-income consumers whose "buy-and-hold" strategy does not require the continuous investment advice that is more suited to a percentage fee based on assets under management. This preference also reflects the fact that the payment of commission-based compensation—tied as it is to a particular transaction—is easy for consumers to understand and, in many cases, represents good value for smaller or low-volume accounts. For example, JD Power's *DOL Special Report* found that 59% of investors who currently pay commissions responded that they "probably would not" or "definitely would not" stay with their current firm if required to switch to a fee-based arrangement.[6]

The importance of the commission model underlies the clear Congressional intent to preserve its use with retail investors through the enactment of Section 913(g) of the Dodd-Frank Act, in which 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 standard of conduct established by the SEC for broker-dealers. A primary objection to the Fiduciary Rule is that it does just the opposite—clearly disfavoring the use of commission payments in connection with the sale of investment products.

As the SEC considers possible approaches, it should recognize the valid and important role of commission-based compensation in serving investors. Any standard of conduct adopted by the SEC should expressly provide that the receipt of commissions and similar compensation by an adviser, financial institution, or affiliate or related entity of either the adviser or financial institution is not in and of itself a violation (or even evidence of a violation) of the standard. This approach

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[4] As a general matter, registered investment advisers provide advisory services, including continuous, discretionary advice to consumers in return for a fee based on a percentage of assets under management. In contrast, broker-dealers provide transaction specific services and provide only episodic, non-discretionary investment guidance to consumers. Broker-dealers are typically compensated in the form of commissions on the securities purchased or sold in connection with such transactions. The comment letter of the Securities Industry and Financial Market Association, July 21, 2017 recently filed with the SEC provides additional description of the differences between the two business models.

[5] Section 913(g)(1) of the Dodd-Frank Act**,** amending the relevant provisions of the Securities Exchange Act of 1934, 15 USC § 78o(k), with respect to transaction based compensation; Section 913(g)(2) of the Dodd Frank Act, with respect to proprietary products.

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

will help preserve business models that are relied upon by millions of investors and retirement savers, particularly those with modest account balances or who employ a buy-and-hold investment strategy.

(ii) The sale of proprietary products should also be specifically permitted under any refined standard of conduct.

Like many others in the industry, State Farm offers proprietary mutual fund and variable annuity products. These products are typically developed by institutions to be tailored to the needs of their particular client base. The Fiduciary Rule, however, calls into question the future of such products.[7]

Like transaction based compensation, the beneficial role played by proprietary products was also recognized by Congress in Section 913(g) of the Dodd Frank Act, which required that any industry wide standard of conduct allow for the sale of a proprietary or limited range of investment offerings to retail customers, provided that certain disclosure requirements are satisfied. Again, this clear intent was ignored in the Fiduciary Rule, which raised new hurdles for institutions offering such products. This approach is wrong and the sale of proprietary products should be specifically permitted in accordance with Section 913 in any revised standard of conduct developed by the SEC.

II. A disclosure requirement, not a compulsory contract, will provide better customer information in any unified standard of conduct.

Studies show that some degree of confusion may exist among a portion of investors as to the duties owed them by industry participants. It is worth also noting that details of the relationship, such as fees, may also be unclear to investors. One of the primary concerns identified by the SEC through the RAND study of investor perspectives in 2008[8] was that retail investors are confused about the type of professional or firm that is providing them with investment services. Notwithstanding, the study also indicated that investors are generally happy with services received from broker-dealers, and investors are not seeking a change in the manner in which broker-dealers conduct business. These are important points that should be fully considered by the SEC as a part of this process.

A simpler and more effective approach to address consumer confusion (than a compulsory contract) would be to adopt standardized, plain-English disclosure requirements as a part of a standard of conduct. A model for this kind of disclosure already exists for registered investment advisers under the framework of the Form ADV. For example, a simplified account opening disclosure could be coordinated among the SEC, the DOL and FINRA that includes the following:

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[7] In anticipation of the applicability of the Fiduciary Rule, State Farm made substantial modifications to its business to prohibit State Farm agents from engaging in direct sales activities with respect to State Farm mutual fund and variable insurance annuity products. At present, purchases of these products must be made by customers on a self-directed basis through a non-advisory call center operated by State Farm.

[8] *Investor and Industry Perspectives on Investment Advisers and Broker-Dealers*, Angela A. Hung, Noreen Clancy, Jeff Dominitz, Eric Talley, Claude Berrebi, Farrukh Suvankulov, Rand Institute for Civil Justice (sponsored by the United States Securities and Exchange Commission), at 19 (available at: https://www.sec.gov/news/press/2008/2008-1_randiabdreport.pdf)

- The type of relationship being entered into and specific duties owed to the consumer based on the services performed;
- The services available as part of the relationship, and information about applicable direct and indirect investment-related fees; and
- Information about material conflicts of interest that apply to these relationships, including material conflicts arising from compensation arrangements or proprietary products.

Disclosure of this type would provide more clarity to investors than the disclosures contemplated in the BIC Exemption.

This, however, is not the only objection with respect to the BIC Exemption. Though catalogued extensively with the DOL in prior commentary, State Farm wishes to summarize certain of its major objections to the BIC Exemption for the SEC. First, as a method of enforcement, the private right of action created by the BIC Exemption and the related prohibition on class action waivers constitute significant and serious flaws. Private state court litigation leads to uncertainty and delay, and will increase costs for all financial services industry participants and consumers. This harm is compounded by the fact that the Fiduciary Rule provides no (or ineffective) safe harbors clarifying what is not unlawful under the rule. The standards upon which a transaction will be litigated will vary from trial court to trial court and will then be subject to further review and interpretation through the appellate process in multiple jurisdictions. It will take years for the standards to be developed by case law, during which time, financial institutions, advisers and customers will lack guidance as to the standards applied to these transactions and the law may provide different consumer protections from state-to-state.

State Farm sharply disagrees with this approach. More fundamentally, however, the BIC Exemption alters the relationship that broker-dealers and their registered representatives have with their customers, effectively depriving customers of the option to not pay for services they may not want. Such an intrusion into an already highly regulated relationship is unwarranted and will lead directly to increased costs and diminished access for American retirement investors.

Moreover, the BIC Exemption's private right of action ignores the fact that regulatory examinations and enforcement are effective means to protect investors. Of course, as the DOL lacks any enforcement authority to police compliance with the requirements of the Fiduciary Rule and the BIC Exemption, the only option open for it was to create a private right of action. This fact alone suggests that the DOL is perhaps not the appropriate agency to undertake comprehensive regulation of the financial services industry. Unlike the DOL, the SEC and FINRA possess comprehensive regulatory and enforcement authority (including over tax-advantaged accounts) and should thus reject the DOL's approach in creating a burdensome and flawed private right of action.

III. The SEC should be the primary regulator of investment advice regardless of the type of account.

For over 75 years, the federal securities laws have protected investors of all types through the regulation of investment advisers, broker-dealers, and other market participants. Since their passage, these securities laws have been rigorously enforced by the SEC and other regulatory and self-regulatory agencies (including, for broker-dealers, FINRA). Today, these agencies comprehensively regulate broker-dealers and investment advisers, including those that serve tax-advantaged accounts. The DOL's Fiduciary Rule intrudes into this lengthy history of regulation, creating a stark regulatory divide between tax-advantaged accounts and other investment accounts. The inevitable result is confusion, reduction in service and/or increased costs that would be borne by investors and firms.

The SEC is, and should, remain the regulator with primary responsibility for establishing the standard of conduct for the provision of investment advice. Consistent with the basic tenant in SEC regulation that there is significant investor protection achieved through a disclosure-based regime, the unifying element in setting the appropriate standard of conduct should be disclosure of the role played and the duties applicable. State Farm therefore encourages the SEC to adopt a standard of conduct and a disclosure framework consistent with the clear intent of Congress as manifested in Section 913 of the Dodd Frank Act for all accounts and all investors.

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

Sincerely,

Stephen McManus

Stephen McManus
Senior Vice President and General Counsel