Everything You Wanted to Know About BICE but Were Afraid to Ask

The best-interest contract exemption (BICE)—formally known as Prohibited Transaction Exemption (PTE) 2016-01—is part of a large regulatory package with quickly approaching deadlines for compliance. Issued by the U.S. Department of Labor (DOL), BICE is designed to (among other things) protect retirement investors from costly or conflicted investment advice. Under the rule, service providers that give investment advice to participants and plan sponsors now will have to follow the fiduciary standard of conduct under the Employee Retirement Income Security Act (ERISA). BICE rules are important to plan sponsors and something they need to start considering in their interactions with plan vendors. This article is designed to heighten awareness in order to assist plan sponsors, as employee benefit plan sponsors or fiduciaries, in fulfilling their duties.

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Author's note: In May, the Department of Labor announced that the Fiduciary Rule and BICE would become applicable on June 9, 2017, at which time a "phased implementation period" would begin. During this transition, which ends on January 1, 2018, the only requirement for relief under BICE is compliance with the impartial conduct standards discussed within. While we have made every effort to ensure the accuracy of this article, we encourage you to speak with counsel, since dates and congressional priorities may have changed. That said, the broader themes of the article remain the same and should be helpful to human resources professionals and plan sponsors as they consider this unsettled landscape of fiduciary issues.

With quickly approaching deadlines for compliance, employee benefit plan sponsors and fiduciaries are bound to have a number of questions on what the new fiduciary regulations mean for them and their plan participants. Last spring, the U.S. Department of Labor (DOL) published a new regulation that expands the situations in which someone provides investment advice as a fiduciary under the Employee Retirement Income Security Act (ERISA), as amended. There are a number of exemptions to these rules, including the best-interest contract exemption (BICE), which many financial institutions and their advisors are expected to make use of if they intend to continue with current compensation practices. While much of the rule is aimed at financial advisors who provide retirement investment advice and recommendations to retirement investors (including plan participants and beneficiaries, individual retirement account (IRA) owners and plan fiduciaries), plan sponsors and fiduciaries will have items to cross off their to-do list as well. And so, without further ado, here is everything you wanted to know about BICE but were afraid to ask.

What Is BICE?

BICE is part of a large regulatory package issued by DOL designed to (among other things) protect retirement investors from costly or conflicted investment advice.

Does *BICE* Sound Like *Mice?*

Yes, it does. And some believe there are "critters" running through the current of thought of this regulatory package. Critics of the new fiduciary rule argue that DOL may have exceeded its regulatory authority. Further, others in the retirement plan industry have taken strong exception (through legal actions and otherwise) to some of the regulatory requirements. Nevertheless, DOL firmly stands behind these rules, so the fundamental concepts underlying the rules are likely to be something the industry will have to deal with for years to come, in evolved and evolving forms. This being the case, let's start with what we know now.

What Does BICE Stand For?

BICE stands for best-interest contract exemption, formally known as Prohibited Transaction Exemption (PTE) 2016-01. BICE was granted in connection with the publication by DOL of the final fiduciary rule, which broadened the definition of *fiduciary* when providing investment advice to retirement investors such as plan participants and beneficiaries, IRA owners and plan fiduciaries. BICE is designed to promote the provision of investment advice that is in the best interest of retirement plan investors. BICE provides an exemption to financial institutions and their advisors, affiliates and related entities to continue many compensation and fee practices as long as they take steps to minimize conflicts of interest with respect to the provision of retirement investment advice and adhere to basic fiduciary standards that ensure advice is in the best interest of retirement plan investors.

What Is the New Fiduciary Rule?

On April 8, 2016, DOL released its final regulation defining *fiduciary*. The regulatory package provides for new exemptions from the rule as well as certain amendments to existing class exemptions. BICE is one of these exemptions.

Why Does This Matter to Me?

Under the rule, service providers that give investment advice to participants and plan sponsors now will have to follow the fiduciary standard of conduct under ERISA. This means that those service providers must give advice in the best interests of the plan and its participants and beneficiaries—without considering commissions and fees. They also will be required to disclose possible conflicts of interest. If they don't comply with the standard, they face the threat of litigation and penalties under ERISA and the Internal Revenue Code (the Code).

What Was the Previous Standard?

Before the rule became applicable in June, many advisors were held to the lower standard of *suitability*. This meant they could recommend products—for example, an investment fund lineup for a 401(k) plan—that fit their customer's overall financial objectives and risk tolerance and were permitted to receive greater compensation than they would had they suggested other comparable products with lower fees.

How Does BICE Fit Into All of This?

BICE is DOL attempting to balance the need to protect retirement plan investors from investment losses caused by conflicted advice while at the same time providing advisors the flexibility and discretion to design compensation structures and practices unique to their business, so long as they adhere to impartial standards of fiduciary conduct and implement procedural safeguards to mitigate conflicts of interest with respect to the provision of such investment advice. Financial institutions and investment advisors that avail themselves of the strictures of BICE will be permitted to accept variable compensation or payments from third parties—such as commissions, 12b-1 fees and revenue-sharing payments. The purpose of the exemption is to create a situation in which any possible conflicts of interest are alleviated by the obligations of the exemption, with the goal of protecting the participants from excessive and undisclosed fees and poor investment advice. A conflict of interest exists (for purposes of BICE) when an advisor "has a financial interest that a reasonable person would conclude could affect the exercise of its best judgment as a fiduciary in rendering advice" to a retirement investor.

What Are They Trying to Get At?

As stated in the Executive Summary to BICE, "advisers can always give conflict-free advice. But if they choose to rely upon conflicted payment structures, they should be prepared to make an enforceable commitment to safeguard investors from biased advice that is not in the investor's best interest." So BICE is intended to protect retirement investors from receiving conflicted investment advice while at the same time providing financial institutions and their advisors the flexibility to maintain a wide range of current compensation practices.

What Requirements Must an Advisor Meet in Order to Rely on BICE?

In general, financial institutions must (1) acknowledge fiduciary status with respect to the provision of investment advice; (2) adhere to impartial standards of fiduciary conduct, which include providing advice that is in the best interests of the investor and his or her personal and financial objectives, without regard to the financial interests of the advisor; (3) implement policies and procedures designed to prevent violations of fiduciary standards; (4) adequately disclose fees, compensation and material conflicts of interest with respect to investment recommendations; and (5) retain records of compliance for DOL and retirement plan investors.

Is There an Actual Contract Requirement?

Advisors of IRA owners and non-ERISA plans must enter into a written contract to comply with BICE. Given that IRAs generally are not covered by ERISA as a matter of law (unless the IRA is part of a savings incentive match plan for employees (SIMPLE) IRA plan or simplified employee pension plan), its protections and remedies are not available to IRA investors. With this contract requirement, DOL is providing a mechanism for enforcement through a claim of breach of contract should an advisor fail to comply with the exemption. The contract requirement for advisors of IRA owners and non-ERISA plans is sometimes referred to as *full-blown BICE*.

The contract must be signed by both the advisor and the recipient of investment advice, and the best-interest standard of care must be incorporated into the contract. Advisors must disclose their compensation, and information on fees or other variable compensation must be provided on request. In addition, conflicts of interest must be disclosed along with compliance policies for avoiding and mitigating possible conflicts. The contract can allow for mandatory arbitration but cannot prohibit class action litigation or impose an unreasonable venue. The parties should enter into the contract prior to or at the same time as the execution of the recommended transaction. The contract may not include exculpatory provisions that disclaim or limit the liability of the advisor for violating the contract.

There is no separate contract requirement for investors covered by ERISA plans. However, the financial institution must comply with the acknowledgment requirement described below.

What Is the Acknowledgment Requirement?

The advice provider is required to affirmatively acknowledge in writing its status as a fiduciary under ERISA or the Code or both, with respect to the investment advice subject to the contract. In the case of an ERISA plan, the provider must acknowledge the status with respect to any investment advice regarding the plan or participant or beneficiary account.

What Is the Impartial Conduct Standards Requirement?

When providing investment advice, an advisor must provide investment advice that is, at the time of the recommendation, in the best interests of the investor. Although one would think this would always be the case, the requirement makes this law, which is actionable if breached.

When Is Advice in the Best Interests of the Participant?

The advice must meet the prudence requirements under ERISA. That is, it must reflect the care, skill, prudence and diligence under the circumstances that a prudent person acting in a similar capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims. This is based on the investment objectives, risk tolerance, financial circumstances and needs of the investor. The advice must be without regard to the financial or other interests of the advisor or any other party. In addition, compensation paid to the advisor must be reasonable and conspicuously disclosed, and the advisor must not make any misleading statements about the investments of the plan.

What Is the Policies and Procedures Requirement?

The advisor is required to warrant that it has adopted and will comply with anticonflict policies and procedures reasonably and prudently designed to ensure that advisors adhere to impartial conduct standards.

The policies and procedures must provide that the advisor will not use or rely upon anything that would reasonably be expected to cause recommendations not in the best interests of the investor. In other words, the policies and procedures should unambiguously discourage advisors from recommending investment products or courses of action contrary to the investor's best interests. Such items at issue include quotas, bonuses, contests, special awards and differential compensation. However, differential compensation is allowed as long as the policies and procedures and incentive practices are reasonably and prudently designed to avoid a misalignment of the interests of advisors with the interests of investors when viewed as a whole. For example, the exemption allows that different compensation can be provided to account for the difference in services inherent in different products. The policies also must designate a person (identified by name, title or function) responsible for addressing conflicts and monitoring adherence to the standards of impartial conduct.

While DOL has stated in the preamble to BICE that it covers "commissions paid directly by the plan or IRA, as well as commissions, trailing commissions, sales loads, 12b-1 fees, revenue sharing payments, and other payments by investment product manufacturers or other third parties" to advisors, these forms of compensation still may be problematic. The mere presence of these forms of compensation suggests to many that the advisor has his or her own financial interests in mind. Future guidance from DOL will be needed on this issue.

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What Are the Disclosure Requirements?

To rely on BICE, a written disclosure, either as part of the contract or separate from it, must be provided at or shortly before the execution of the recommended transaction. The disclosure must state the best-interest standard of care and must describe how the investor pays for services, i.e., whether it is paid directly or through a third party. It must also describe any material conflicts of interest, disclosing any fees or charges imposed on the investor as well as stating the type of compensation that might be received from third parties associated with the recommended investments. The disclosure should inform investors that they may receive a copy of the advisor's written description of its policies and procedures, along with the specific costs, fees and other compensation—including third-party payments—connected with the recommended transactions. These can be described in dollar amounts, percentages, formulas or any other means that are reasonably designed to give accurate disclosure to the investors so that they may make informed decisions about the costs of the transactions as well as the severity and significance of any conflict. These disclosures must be provided free of charge. If requested after a transaction takes place, the disclosure must be provided within 30 days of the request. The disclosure also should include a link to the advisor's website, and it should inform the investor that the disclosures are updated on a quarterly basis, as needed, and that the policies and procedures are available free of charge on the website. The disclosure must state whether or not the advisor offers proprietary products or receives third-party payments with regard to the recommended investments and must disclose any limitations on the advisor due to the proprietary products. In this regard, a mere statement that the advisor may limit the recommendations to proprietary or third-party-generating investments would not suffice. Lastly, the disclosure must describe whether the advisor will monitor the investments and, if so, how often, and it must provide contact information so that investors can ask questions about the advice or any statements received. In short, the concept is that the investor must receive the type of information that any reasonable investor would consider when agreeing to a recommended investment transaction.

Aren't They Just Going to Point Me to Their Website?

Probably, at least in part. The regulation has detailed requirements for website disclosures. The website should be freely accessible, updated at least quarterly and contain a discussion of the investor's business model along with the conflicts of interest associated with the model. Along with a schedule of typical fees, the website should provide a sufficient description of the advisor's policies so that retirement investors can assess the strength of the advisor's protections against potential conflicts. The website also should disclose all third-party payment arrangements between the advisor and investment product manufacturers and a description of those arrangements, including whether or not they impact advisor compensation and any benefits the advisor provides to the manufacturers. Lastly, the website should describe the compensation and incentive arrangements between the financial institutions and their affiliated advisors, including any incentives for recommending specific proprietary investment products or investment products offered by another institution.

What Is the Notification Requirement?

The advisor is required to notify DOL of its intention to use BICE prior to receiving any compensation in a related transaction. The notification remains in effect until revoked in writing by the advisor. It must be noted, however, that the notice to DOL need not identify the plan(s) or IRA(s) for which BICE applies, only that the financial institution intends to avail itself of BICE protection in general.

What Are the Record Retention Requirements?

The advisor must maintain records that show compliance for at least six years. The records must be reasonably accessible to plan participants, beneficiaries and fiduciaries as well as DOL and the Internal Revenue Service (IRS).

What Is BICE Lite?

It is not a beer, contrary to popular belief or your expectations. Rather, the regulation provides for a streamlined version of BICE—sometimes referred to as *BICE Lite*—for advisors who have level fees. Level fees are a fixed percentage of plan assets and do not vary depending upon a recommended investment. With level-fee arrangements, DOL believes the advisor's interests are more in line with investors' interests and, therefore, fewer restrictions are required. And with a large portion of financial arrangements today following this model, we anticipate many financial institutions will use BICE Lite, especially when dealing with rollovers and distributions.

What Are the Requirements for BICE Lite?

Advisors must provide a written statement of fiduciary status. They must comply with the impartial conduct standards, which include giving advice in an investor's best interests, reasonable compensation and not making misleading statements to investors. Lastly, advisors must document the reasons for their recommendations. There are additional requirements if the transaction involves a rollover that results in additional compensation to the advisor. The advisor must consider other alternatives (including leaving the assets where they are), the fees and expenses, whether the employer pays some of the fees, and the different levels of service and different investments available under each option. The advisor must document all of this, including the reasons that the transaction is in the investor's best interests.

Aren't Our Financial Service Providers Already Fiduciaries?

They might be and, to the extent that they already are subject to fiduciary status, they will remain so under the new fiduciary rule. The rule will bring an assortment of other financial advisors and service providers under the fiduciary standard. These service providers are currently undergoing a process of reevaluating their business models in light of the new regulations, including whether or not their current compensation practices could work under BICE. Some advisors may choose not to provide investment advice. In the past, these advisors may have provided plan sponsors and participants with informal assistance (in the form of providing investment education or plan-level information), and they likely will refrain from doing so in order to avoid fiduciary status with respect to the plan. If you or your employer relied on such assistance, as is the case when receiving a sample of investment lineups for a plan, it may be time to retain the help of an investment advisor.

Are There Any Steps to Take Now to Make Sure We're Prepared for the New Rules?

Employers, including the board of directors, management or any committees involved in making decisions for plans, already are considered fiduciaries and have to keep in mind the best and sole interests of participants when picking investments and service providers. Fiduciaries are potentially subject to personal liability under the law.

Human resource professionals, often on the front lines whenever there is a new regulatory rollout, must be aware that the relationship they have with financial advisors is changing. In the past, many financial advisors, broker-dealers, insurance agents and mutual fund representatives had not been held to the fiduciary standard. But now those advisors will be.

As a plan sponsor, you can expect that there will be disclosures to acknowledge and, in some cases, even contracts and other service agreements to sign. Further, you will need to be more aware of who is getting paid and how. And you will need to determine whether or not fees for providing financial advice are reasonable. You should begin to have conversations with retirement plan investment advisors, confirm their status as fiduciaries to the plan and request appropriate documentation. Failure to have these conversations could be deemed a breach of your own fiduciary duties under a breach-of-duty-to-monitor theory of liability.

Service providers that provide fiduciary functions may be changing their approach to complying with their duties. The terms of your arrangements with them may need to be renegotiated or updated.

What Should We Ask Our Service Providers?

You should know whether or not they are fiduciaries, whether or not they are using BICE (or relying on an alternative exemption), and whether or not you will need to sign any agreement to document compliance. FYI, there are alternatives to BICE and compliance with the new fiduciary rule, but they are beyond the scope of this article. If you currently work with a brokerage firm, bank or insurance company, consider speaking with a registered investment advisor (RIA) for comparison.

Didn't the 2016 Presidential Election Change All of This?

At the urging of the new administration, DOL postponed the applicability date of the Fiduciary Rule until June 9, 2017. Further, Congress has introduced legislation to postpone implementation for two years, perhaps with the goal of scrapping the rule altogether. There also have been some court cases challenging the legality of the rule. DOL could choose not to enforce the regulation, though that would not affect a participant's right to sue based on a breach of duty. Most practitio-

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ners believe, however, that there isn't enough time to "walk back" the rule before the applicability dates. In addition, investors' expectations have changed, and many advisors are trying to use their status as fiduciaries as a selling point.

What About In-House Staff?

In order to avoid fiduciary status with respect to the plan, in-house investment teams that provide investment advice to a plan investment committee may not receive any compensation for their recommendations over and above their usual compensation from the employer.

What About Our Human Resources Department?

If you have human resources professionals that provide recommendations to participants about plan investments and distributions, then the provision of investment advice should not be part of their job description. In addition, staff should not be licensed or registered under insurance or securities laws. Similarly, the advice given must not require any license or registration of this type. Lastly, the employee must not receive any fees (direct or indirect) or other compensation for the advice beyond their usual compensation from the employer.

Any communications from employees, such as human resources staff communicating information about plan distribution options, generally will be excluded from the definition of *fiduciary investment advice*. The same is true for recommendations regarding term life, health and disability insurance plans.

When Will BICE and the Regulations Go Into Effect?

The new fiduciary rule, though effective as of June 7, 2016, was not applicable until June 9, 2017. However, BICE compliance requirements don't go into effect until January 1, 2018. The time between June 2017 and January 2018 is a transitional period.

Will Anything Be Grandfathered In?

Yes, compensation earned on investment transactions made prior to the applicability date will be grandfathered in under the new regime.

Do Any of Our Rollover Forms, Distribution Forms or Investment Education Materials Need to Be Modified?

Yes. Before the applicability date, you should have reviewed your rollover and distribution forms and investment education materials to ensure that they reflect the new rules. Other materials that might need review include human resources procedures, manuals and call-center scripts.

What Should We Expect From Our Recordkeepers?

Many have suggested that recordkeepers and similar service providers may become more guarded in their interactions with your employees and plan participants about investment and distribution questions in order to avoid fiduciary concerns. Plan sponsors should communicate with their service providers, identify any new gray areas in the information and services offered to participants, and consider ways to clarify roles. Plan sponsors also should reevaluate their existing policies (or develop new ones) to monitor service providers and the interactions they are having with participants.

Should We Steer Clear of BICE?

It's probably too soon to tell if BICE will prove to be a valuable prohibited transaction exemption in the long run. Some consider BICE a bit risky and advise employers to be cautious when deciding whether to engage an advisor claiming cover under this exemption. Their argument is that it would be difficult for plan sponsors to continue in an arrangement that contains a conflict of interest if other options exist that don't rely on an exemption. Why sign a BICE agreement when you could hire an RIA who already is held to a fiduciary standard? However, such alternatives may be cost-prohibitive for plan sponsors, and BICE likely will allow some relationships to continue in similar ways as before.

In any event, the plan sponsor likely will have a fair amount of paperwork to sift through and digest as we work toward the implementation deadlines. Consultants, legal advisors and service providers should start communicating, if they haven't done so already, to begin to work on compliance.

Conclusion

As employee benefit plan sponsors and fiduciaries, you have an ERISA duty to monitor all vendors providing services to your plans, including those who become fiduciaries as a result of the new rules described above. If a vendor is faulted in a DOL investigation or in litigation, the plan sponsor and any other fiduciaries with a duty to monitor the vendor also will be faulted. Therefore, these rules are important to you and something you need to start considering in your interaction with plan vendors. This article is designed to heighten awareness in order to assist plan sponsors, as employee benefit plan sponsors or fiduciaries, in fulfilling their duties.