



FLASHPOINT SUPPLEMENT: BEST INTEREST CONTRACT EXEMPTION (BICE)

This information is a supplement to the Ferenczy FlashPoint: The New Fiduciary Regs: A Practical Review – Part II, that discusses the BICE and the more accessible version of the BICE that is available to level fee advisors. Terms are used in this supplement that are defined in the FlashPoint. We recommend you review the referenced FlashPoint for that information. It is available [here](#).

A Financial Institution (FI) or Advisor that is a fiduciary under the new DOL regulations is subject to ERISA prohibitions on self-dealing. The self-dealing rules prohibit the fiduciary from providing advice that, if followed, will increase the fiduciary's compensation. They also prohibit receipt of compensation from third parties on account of the fiduciary advice to the plan.

The DOL has issued a prohibited transaction exemption to permit the FI or Advisor to receive increased compensation or third party payments under certain circumstances. The DOL intends this exemption, called the Best Interest Contract Exemption or BICE, to produce an environment where the self-dealing potential is mitigated by requirements and limitations to ensure that the participant's interests are protected. In particular, an FI's or Advisor's Material Conflicts of Interest—defined in the BICE to be a financial interest of the FI or Advisor that a reasonable person would conclude could affect the FI's or Advisor's judgment in rendering investment advice—are identified and their effects eliminated to the extent possible.

As you will see from the description below, compliance with the BICE will not be easy. In addition, compliance involves not only the Advisor who is giving the advice to the plan or participant, but also the FI, its Affiliates, and its Related Entities. The DOL has assured the retirement plan industry that it will be provided significant additional guidance before the BICE becomes effective. Ferenczy Benefits Law Center LLP will continue to provide information to its clients and friends as the situation develops.

BICE Requirements

To take advantage of the BICE, the FI and Advisor must meet six requirements:

1. Contractual requirements;
2. Fiduciary acknowledgement;
3. Impartial Conduct Standards;
4. Policies and procedures requirements;



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5. Disclosure requirements; and
6. Record retention requirements.

A variation of the BICE, being called “BICE Lite” by industry members, is available for certain level fee fiduciaries, particularly with regard to rollover transactions. The BICE Lite exemption permits those who qualify for it to meet only the second and third requirements listed above. BICE Lite is discussed in the Ferenczy FlashPoint available [here](#).

Both the BICE and the DOL fiduciary rules published concurrently with the BICE apply to both qualified employer retirement plans and Individual Retirement Accounts (IRAs), although the details of the BICE requirements are slightly different. We are assuming below that the plan at issue is an employer plan, unless otherwise noted. If you are an Advisor to IRAs and want more information about the requirements that apply to you, let us know.

#1: Contractual Requirement

The BICE requires that FIs and Advisors to IRAs be subject to a written contract promising to comply with the exemption. The written contract requirement applies only in relation to advice to IRA holders. This is because fiduciaries to employer plans are legally obligated to comply with these rules by ERISA, and ERISA gives plan participants an avenue for enforcement of these obligations via the DOL and the courts. Because IRAs are not subject to ERISA, these obligations and remedies are not available to IRA holders. Therefore, the contract requirement requires FIs and IRA Advisors to promise to comply with the BICE rules and gives the IRA holder an enforcement mechanism through the courts (i.e., for breach of contract).

The contract must be signed before or at the same time as the first recommended transaction to which the BICE will apply. This is an improvement over the proposed exemption, which required that the contract be provided before the advice was to be given.

Important to *both* IRA Advisors and Advisors to qualified plans, however, are the provisions the contract (or any other writing that the qualified plan advisor is using to outline its duties and the limitations thereon) may *not* include:

- The contract may not reduce or eliminate the Advisor’s liability for violating the contract terms (or, for ERISA plans, the fiduciary requirements of ERISA).
- The contract may not require the plan or Investor to waive or qualify rights to participate in a class action, nor may it provide for liquidated damages for a breach of fiduciary duty or a BICE violation. The contract may waive punitive damages or rescission rights, and can require mediation or arbitration of claims against the Advisor, so long as the venue is not too distant and the rules for mediation or arbitration do not unreasonably limit the plan’s or Investor’s ability to assert claims against the Advisor.

#2: Fiduciary Acknowledgement Requirement



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The FI must affirmatively acknowledge in writing its and the Advisor's status as fiduciaries with respect to the investment advice provided.

#3: Impartial Conduct Standards (ICS) Requirement

The DOL requires compliance with the ICS to structure a safe environment for recipients of investment advice. Under this section, the FI must affirmatively adopt the ICS and adhere to those stated standards.

Under the ICS:

- The investment advice given must be in the Best Interest of the Investor;
- Compensation paid to the FI and Advisor in relation to the advice must be reasonable; and
- The Advisor and the FI may not make misleading statements about plan investments.

Advice is in the Best Interest of the participant if:

- The advice meets ERISA's prudence requirements. This means that the Advisor must act with the same care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims;
- The advice is based on the investment objectives, risk tolerance, financial circumstances, and needs of the Investor; and
- The advice is without regard for the financial interests of the Advisor, FI, Affiliates, Related Entities or any other party.

As will be discussed below, the BICE obligates the FI and the Advisor to take specific actions to ensure compliance with these standards.

#4: Policies and Procedures Requirement

The FI must provide the Investor with a warranty that it has adopted policies and procedures reasonably and prudently designed to ensure that its Advisors meet the ICS. In other words, the DOL is looking for FIs to create a top-down structure under which these standards become the way business is conducted.

The policies and procedures must include:



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- A specific identification and documentation of the FI's Material Conflicts of Interest;
- The adoption of measures reasonably and prudently designed to prevent Material Conflicts of Interest from causing the Advisor to violate the ICS;
- The designation of one or more persons (who can be identified by name, function, or title) charged with the responsibility of addressing Material Conflicts of Interest and monitoring ICS adherence by Advisors;
- A requirement that neither the FI nor any Affiliate or Related Entity use or rely upon quotas, appraisals, bonuses, contests, special awards, differential compensation, or other actions or incentives that are intended or reasonably expected to cause Advisors to give financial advice that is not in the Investor's Best Interest.

The BICE clarifies that the last requirement does not prevent the FI, Affiliates, or Related Entities from "providing advisors with differential compensation ... based on investment decisions by Plans, participant or beneficiary accounts, or IRAs, to the extent that the Financial Institution's policies and procedures and incentive practices, when viewed as a whole, are **reasonably and prudently designed to avoid misalignment of the interests of Advisors with the interests of the Retirement Investors they serve as fiduciaries.**" (Emphasis added.) The exemption further explains that different compensation can be provided, for example, to account for the difference in services inherent in different products.

Nonetheless, this requirement likely goes to the heart of the compensation structure of just about any sales-based organization. The Preamble to the BICE states that, "The exemption is intended to cover a wide range of current compensation practices ... Rather than flatly prohibit compensation structures that could be beneficial in the right circumstances—such as commission accounts for investors that make infrequent trades—the exemption permits Financial Advisors and related Financial Institutions to receive commissions and other common forms of compensation, provided that they implement appropriate safeguards against the harmful impacts of conflicts of interest on investment advice." The Preamble also notes that the DOL "confirms that this exemption provides relief for 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 Advisers and Financial Institutions."

It is unclear, however, how these types of variable compensation can be provided while not being viewed as incentivizing Advisors to act in their own financial interest. For example, must an FI be able to demonstrate differences in service for two investment offerings to pay an Advisor different types or amounts of compensation? Consider an Advisor who is marketing an investment fund selection to its retirement plan client. If the Advisor recommends that the Investor select either Large Cap Fund A or Large Cap Fund B, and those two funds offer the Advisor sales commissions, is it a violation of BICE if the two commissions are different? What if the Advisor recommends the more expensive fund? Is this not "differential compensation" that is prohibited by the last of the above warranties?

What is the bottom line? It appears that these rules permit variable compensation methods so long as no one is motivated by them ... at least, to the extent that they forget the Investor's Best Interest. On a practical basis, does this



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really mean that Advisors must pinkie-swear to care about their clients, as if they wouldn't do so without these rules (or that the bad actors that exist will be compelled to be more honest by this process than they are currently)? Needless to say, additional guidance is needed to understand how this exemption is supposed to work.

#5: Disclosure Requirements

Several disclosure obligations apply if the BICE is to be relied upon. Notwithstanding the DOL's acknowledgement that disclosure documents are generally unsuccessful at putting the participant on notice about conflict of interest issues, the BICE requires:

- **Written disclosure.** A written disclosure, separate or part of the written contract, provided prior to the execution of the recommended transaction that clearly and prominently:
 - States the Best Interest standard of care and describes whether the Investor will pay for the FI's and Advisor's services directly or through third party payments;
 - Describes Material Conflicts of Interest, discloses fees or charges imposed by the FI or Advisor on the Investor, and states the type of compensation that the FI, Affiliates, Related Entities, or the Advisor expect to receive from third parties in relation to the recommended investments;
 - Tells the Investor that he or she may get copies of the FI's written description of the policies and procedures described above, as well as the specific costs, fees, and compensation (including third party payments) in relation to the recommended investments. The compensation may be described in dollar amounts, percentages, formulas, or any other means reasonably designed to present an accurate disclosure of their scope, magnitude, and nature in sufficient detail so as to permit the Investor to make an informed judgment about the transaction costs and the magnitude and severity of the Material Conflicts of Interest. This part of the disclosure also should tell the Investor that this information may be requested and provided before the transaction is entered into and that, if requested after the transaction, must be provided within 30 days;
 - Includes a link to the FI's website, which is discussed further below. The disclosure must also advise the Investor that model contract disclosures that are on the website are updated as needed on a quarterly basis and that the description of the policies and procedures is available free of charge on the website;
 - Discloses whether the FI offers proprietary products or receives third party payments with regard to the recommended investments. If the Advisor's recommendations are limited, in whole or in part, to the proprietary products or those that generate third party payments, the Investor must be notified of those limitations. A mere statement that the Advisor "may" limit investment recommendations to proprietary or third-party-generating investments is not sufficient for this purpose;



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- Provides telephone and email contact information for an FI representative that may be contacted with any concerns about the Advisor or service received and, if applicable, a statement explaining that the Investor may research the FI and its Advisors on FINRA's BrokerCheck database or the Investment Advisor Registration Depository; and
- Describes whether the Advisor and FI will monitor the Investor's investments and, if so, how often and reasons why the Investor will be alerted.
- **Website Disclosure.** The FI must maintain a website that is freely accessible to the public and updated not less frequently than quarterly. The website must contain:
 - A discussion of the FI's business model and the Material Conflicts of Interest associated with that model;
 - A schedule of typical account or contract fees and service charges;
 - A model contract or notice of contractual terms and the required disclosures needed for the BICE to apply, reviewed for accuracy quarterly and updated within 30 days of the review, if needed;
 - A written description of the policies and procedures related to conflict mitigation and incentive practice, sufficiently detailed and in a manner that permits the reader to make informed judgments about how strong the FI's protections are against conflicts of interest; also, a copy of the policies and procedures required under the Policies and Procedures section above;
 - A list of all product manufacturers and other parties with whom the FI maintains an arrangement providing for third party payments to either the Advisor or the FI, including a statement of how these arrangements impact Advisor compensation, and a statement on any benefits the FI provides to the product manufacturers or other parties in exchange for the third party payments; and
 - A description of the FI's compensation and incentive arrangements (on a dollar, percentage, formula, or other accurate and descriptive basis) with Advisors, including any incentives to Advisors for recommendations made for specific investments or to move from one FI to another or to stay at the current FI. Information about a specific Advisor's compensation is not needed.

If any of the financial information is provided in other disclosures (e.g., SEC, Form ADV part II, etc.), the FI can post those disclosures with an explanation and a link to where the specific information may be found.

- **DOL Notification.** The FI must also notify the DOL that it is using the BICE before it receives any compensation in relation to any recommended transactions for which it is relying on the BICE. This is a one-time notification and remains in effect until the FI revokes it in writing.



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#6: Record Retention Policies

The FI must retain the records needed to demonstrate that it has complied with the BICE. The records must be kept for at least six years, and must be reasonably accessible for examination by the DOL, any plan fiduciary engaged in a transaction covered by the BICE, any contributing employer or employee organization whose members are covered by the plan, or any participant or beneficiary (or their authorized representative) of the plan.

The BICE contains corrective measures or accommodations for errors made and documents lost due to circumstances beyond the FI's or Advisor's control.

Effective Dates

The DOL regulations were effective 60 days after publication in the Federal Register (which means that they were effective as of June 7, 2016). The regulations are not *applicable* until April 10, 2017. For all practical purposes, the pre-2016 regulations apply until that date.

The BICE is not effective until January 1, 2018. Therefore, between April 10, 2017, and January 1, 2018, the new fiduciary definition applies, but the new exemption technically is not yet available. Fortunately, a transition rule applies to this period. Under this rule, if certain conditions are met, an Advisor may receive compensation during the interim transition period that would normally be a prohibited transaction. These are:

- The Advisor and FI must adhere to the ICS;
- The FI must provide to the Investor prior to or at the time of the recommended transaction, in writing, by mail or email:
 - Affirmation that it and the Advisor are fiduciaries;
 - The Best Interest standard and their commitment to adhere to it;
 - Description of any Material Conflicts of Interest;
 - Disclosure of limitations on investment recommendations in relation to proprietary products or third party payments.
- The FI must designate someone by name or title to address and monitor the compliance with the Impartial Conduct Standards; and
- The FI must meet the BICE Record Retention Policies.



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The transition rule will not apply if:

- The plan at issue is an ERISA plan sponsored by the Advisor, FI, or any Affiliate, or the Advisor, FI, or Affiliate is a named fiduciary or plan administrator of the plan that was selected by a fiduciary who was not independent;
- The compensation received is in relation to a “Principal Transaction”—that is, one where the FI or Advisor is purchasing or selling an investment to or from the plan on its own account; or
- The Advisor has or exercises any discretionary authority or control in relation to the transaction.

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If you have any questions about this Supplement, the related Ferenczy FlashPoint (The New Fiduciary Regs: A Practical Review – Part II), or the DOL Fiduciary Regulations, please contact Ilene Ferenczy (Ilene@ferenczylaw.com; 678.399.6602) or Alison Cohen (acohen@ferenczylaw.com; 678.399.6604).

