Advice on the BICE

By Stephen P. Wilkes and Livia Q. Aber

Introduction

On April 8, 2016, the U.S. Department of Labor ("DOL") released a fiduciary "package" consisting of final regulations relating to fiduciary investment advice[1] ("DOL Fiduciary Rule") and several new and amended prohibited transaction exemptions[2] ("PTEs"), including Prohibited Transaction Exemption 2016-01 ("PTE 2016-01") also called the Best Interest Contract Exemption ("BICE").[3] Beginning April 10, 2017, advice given to a retirement plan, plan participant or individual retirement account ("IRA") owner by broker-dealer firms and their registered representatives, registered investment advisors ("RIAs") and their individual advisory representatives ("IARS") or insurance companies and their agents with respect to almost any investment product or relating to the management of certain investment products will constitute *fiduciary investment advice*, assuming the new rule is not repealed or suspended. In order to continue receiving variable compensation after April 10, 2017, including commissions and third party payments, financial institutions and their advisors on whom fiduciary status is imposed must meet the requirements of a PTE, such as the BICE.

Many firms are well on their way to complying with the new standards by the April 10, 2017 applicability date. The DOL Fiduciary Rule impacts many current business models and practices, especially commissions and revenue sharing practices. Significant resources have already been devoted to creating "best interest" contracts and disclosures, developing and adopting compliance procedures to mitigate conflicts of interest, and training advisors with respect to grandfathering rules. Furthermore, compensation structures have been reviewed and levelized in order to minimize the need for exemptive relief.

ERISA counsel have gleaned much insight in these several months working with financial institutions preparing for compliance. This article will focus on practical advice for the financial institution and advisor in order to avoid traps for the unwary.

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Definition of Fiduciary Investment Advice

1975 - 2016

The impetus for the DOL Fiduciary Rule was the DOL's belief that the existing definition was outdated, resulting in many investment professionals having no obligation to adhere to the fiduciary standards or prohibited transaction rules under the Employee Retirement Income Security Act of 1974, as amended (ERISA). This arguably outdated definition was established in 1975 prior to the advent of participant-directed 401(k) plans, the widespread use of IRAs and rollovers of plan assets. The 1975 regulations significantly narrowed the scope of the fiduciary investment advice definition by creating a five-prong test. Under this test, an individual is viewed as rendering investment advice if, for a direct or indirect fee or other compensation, (i) advice is rendered as to the value of securities or other property, or as to the advisability of investing in, purchasing or selling securities or property (ii) on a regular basis, (iii) pursuant to a mutual agreement, arrangement or understanding with the plan or a plan fiduciary that (iv) would serve as a primary basis for investment decisions with respect to plan assets, and (v) is individualized based on the particular needs of the plan.

In order to continue receiving variable compensation after April 10, 2017, including commissions and third party payments, financial institutions and their advisors on whom fiduciary status is imposed must meet the requirements of a [prohibited transactions exemption], such as the BICE.

This definition requires that each of the five prongs be met before an advisor can be treated as a fiduciary. It is not difficult to avoid one or more of them. Providing advice on a one-time basis, for example, gives advisors an "out" to disclaim fiduciary status. From the DOL's perspective, the existing definition allows too many advisors to provide advice without having to answer to the fiduciary standards of care under ERISA.

DOL Fiduciary Rule

Fiduciary Recommendation

Under the new DOL Fiduciary Rule applicable on April 10, 2017, fiduciary investment advice is only rendered if there has been a "recommendation" for a fee or other direct or indirect compensation. There are two types of recommendations that constitute fiduciary investment advice. The first is a recommendation as to the *advisability* of investing in a security or other investment property.[4] The second is a recommendation as to the *management* of securities or other property.[5] Unlike the five-part test promulgated by the 1975 regulations, the hurdles to fiduciary status are fairly easy to overcome. Consequently, the DOL Fiduciary Rule greatly broadens the scope of advisors who will be deemed to be fiduciaries.[6]

TIP ▶ Solicitation Agreements. The DOL Fiduciary Rule, the BICE, and the DOL's Frequently Asked Questions issued on October 27, 2016 ("DOL FAQs") will affect solicitation arrangements, but the extent of the impact is unclear at this time. In the preamble to the DOL Fiduciary Rule, the DOL responded to commenters' concerns about the fact that consultants, attorneys and other professionals are often looked to for referrals to other service providers, including investment advisors, by stating that it "does not believe a specific exclusion for 'referrals' is an appropriate way to address this concern." Whether the referral by the solicitor is a fiduciary recommendation is determined on a "facts and circumstances" basis depending upon the content, context, and manner of presentation of the referral. This puts the solicitor in an uncertain position where the line between fiduciary and non-fiduciary status can be easily crossed. To avoid fiduciary status, the solicitor should be tightly scripted and stick with neutral statements. The solicitor's position can be bolstered by the addition of an acknowledgment signed by the client stating that the

client agrees and understands that it is merely an "introduction" and not a referral or recommendation, and that nothing that has been said during conversations with the solicitor could reasonably lead the client to conclude the solicitor is suggesting that the financial advisor in question be hired. If the solicitor avoids making a fiduciary recommendation, the receipt of the solicitation fee is not a prohibited transaction and, thus, not in need of exemptive relief, such as the BICE.

However, where a client could reasonably think a solicitor has recommended hiring the investment advisor in question, a fiduciary recommendation will have been made and the solicitor will need exemptive relief if the referral fee is not a level amount that does not vary with the recommendation. In such cases, the solicitor will need to comply with the BICE, whose requirements depends upon the nature of the client (i.e., whether the client is a non-ERISA plan or IRA, or an ERISA plans)

If the referral fee is level, no exemptive relief may be necessary, but the answer is not clear in light of the DOL FAQs. The definition of "Third-Party Payments" under the BICE includes solicitation and referral fees. While not entirely clear, in Q&A-18 of the DOL FAQs, the DOL seems to be taking the position that third-party payments, including solicitation fees, are by nature variable and make it necessary to satisfy the BICE, even if only for a single recommendation. This seems to be a draconian result, especially for independent, unaffiliated solicitors who may not have the resources to comply with the onerous requirements of the full BICE (discussed in greater detail below).

Exclusions from Fiduciary Investment Advice

In recognition of the broad scope of the DOL Fiduciary Rule, the DOL created several exclusions from its new definition of "investment advice." The exclusions from the "recommendation" definition include platform-related information from defined contribution plan recordkeepers, investment education as well as general communications.[10] Other excluded parties include sellers of investment products to institutional fiduciary representing plan clients, swap counterparties, as well as employees of plan sponsors.[11] So long as a communication or transaction falls under one of the excluded categories, it will not be deemed to be a fiduciary recommendation.

TIP ▶ "Hire Me" and Marketing Statements. The DOL has clarified that the fiduciary advice definition is not intended to include marketing-related statements that an advisor might make when promoting its own services. In other words, an advisor that makes a "hire me" recommendation to a plan or IRA client will not be viewed as providing fiduciary advice.[12] Without this exception, an advisor's "hire me" recommendation could potentially be viewed as conflicted advice in violation of the prohibited transaction rules.

However, the consequences of making an investment recommendation while explaining one's services and fees are unclear. In the preamble to the DOL Fiduciary Rule, the DOL stated that *"…when a recommendation to "hire me" effectively includes a recommendation on how to invest or manage plan or IRA assets (e.g., whether to roll assets into an IRA or plan or how to invest assets if rolled over), that recommendation would need to be evaluated separately under the provisions in the final rule."*[13] The meaning of this sentence has been called into question. Some have interpreted the combination of a "hire me" marketing statement with an investment recommendation consists of three separate events: (1) the "hire me" recommendation, i.e., the recommendation of oneself; (2) the incidental advice that occurred at the marketing "meeting" before a formal engagement is entered into with the advisor, and (3) the investment recommendation provided after the client is engaged. A hard-line position would be that the second of the three events above violates prohibited transaction rules that cannot be avoided by virtue of that fact that a flat fee was later charged with respect to the ongoing advice. If this is the case, compliance with the BICE would be necessary. Such a position would emphasize the importance of refraining from making a fiduciary recommendation while promoting one's own services.

Best Interest Contract Exemption ("BICE")

Grandfathering Relief

Before discussing the BICE requirements, it is useful to recall that the BICE includes a "grandfathering" provision, called the Exemption for Pre-Existing Transactions, which permits financial institutions and their advisors to continue receiv-

ing variable compensation earned on investment products *acquired before April 10, 2017*. In order for grandfathering relief to be available, the pre-April 10, 2017 recommendation

- Cannot be made under an agreement that has expired or come up for renewal;
- Must not have been in violation of the prohibited transaction rules of ERISA and/or the Internal Revenue Code of 1986, as amended (the "Code") in the first place;
- Can only generate compensation that is reasonable;
- Must be made pursuant to an arrangement that was entered into prior to April 10, 2017 and that has not expired or come up for renewal after that date;
- Does not result in the retirement client's investment of additional amounts in a grandfathered investment product after April 10, 2017 except in certain narrow circumstances;[14] and
- Complies with the best interest standard discussed below.

This means that additional purchases that are recommended after April 10, 2017 for an investment product acquired prior to April 10, 2017 will generally not be grandfathered. For example, if a variable annuity contract was sold to a retirement client prior to April 10, 2017, and additional deposits under the same contract are recommended after this date, any commissions generated by this new recommendation would not be grandfathered and the new advice would need to satisfy the BICE requirements. However, grandfathering does apply to a recommendation to invest additional amounts if it involves exchange investments within a mutual fund family or variable annuity contract pursuant to an exchange privilege or rebalancing program that was established prior to April 10, 2017, so long as the recommendation does not result in more compensation to the firm or the advisor than otherwise would have been the case before April 10, 2017.[15] Note also that investment recommendations that are part of a systematic purchase program established before April 10, 2017 are grandfathered as well.[16]

TIP ▶ Firm and Platform Changes. If the advisor *changes advisory firms* after April 10, 2017, this may trigger the loss of grandfather status on investments made prior to this date. As noted, one of the conditions for grandfathering is that the variable compensation to which grandfather relief applies be received pursuant to an agreement entered into prior to April 10, 2017 and that this agreement not have expired or come up for renewal after that date. This requirement will disqualify an advisor from grandfathered treatment if he/she changes firms because in establishing a relationship with the new firm, the advisor must necessarily enter into a new client agreement. This same rationale may apply to *platform changes* as well. In both cases, compliance with BICE may be required.

Four Alternative Forms of BICE

The BICE consists of four alternative sets of requirements depending on the type of retirement investor to whom the fiduciary advice is given and the type of compensation received by the advisor. The four types of BICE include: (1) Transition BICE; (2) Full Blown BICE, available when advice is rendered to a non-ERISA plan or IRA owner; (3) Disclosure BICE, when advice is rendered to ERISA-covered plans; and (4) Streamlined BICE, when fiduciary advice is rendered in three discrete circumstances by a level-fee fiduciary advisor.[17] In all cases, the advisor must adhere to certain Impartial Conduct Standards. The Impartial Conduct Standards consist of three components, one of which is the Best Interest Standard, the cornerstone of the BICE. This standard incorporates ERISA's traditional notion of prudence enhanced by attention to the retirement client's particular needs and a disregard of the advisor's own financial interests.

Transition BICE

The BICE provides transition period relief, which we will call Transition BICE.[18] Transition BICE is the least onerous of the four types of BICE, and is available regardless of the type of retirement investor to whom fiduciary advice is given and the type of compensation received by the advisor. During the period from the April 10, 2017 applicability date to December 31, 2017 (the "Transition Period"), Transition BICE users may continue to receive variable compensation so long as the relaxed Transition BICE requirements are met.

In addition to adhering to the Impartial Conduct Standards, an advisor must provide a written statement of fiduciary status and make conflict of interest disclosures.[19] This information may be provided electronically or by mail.[20] Firms must also designate a person or persons (the "BICE Officer") responsible for addressing material conflicts of

interest and monitoring individual advisors' adherence to the Impartial Conduct Standards. The BICE Officer must be designated by April 10, 2017.[21]

TIP ▶ BICE Committee. The responsibilities relating to addressing material conflicts of interest and monitoring adherence to the Impartial Conduct Standards may be more than one individual can handle. Accordingly, a committee vested with these responsibilities could be the more prudent approach. A committee charter identifying detailed oversight responsibilities (such as training advisors on the DOL Fiduciary Rules creating a recordkeeping and document retention system, ensuring differential compensation is based on neutral factors, etc.) should be created.

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Finally, the DOL imposes a record-keeping requirement on Transition BICE.[22] The financial institution must maintain for a period of six years the records necessary to demonstrate that conditions for the exemption have been met with respect to a transaction occurring during the Transition Period. Failing to do so will result in the loss of the exemption with respect to the transaction for which the records are missing or have not been maintained.

Use of the Transition BICE is optional and it will be most often employed in circumstances where firms may not be prepared to comply with other forms of the BICE by April 10, 2017. However, as explained below, it may make strategic and protective sense to employ the Transition BICE regardless of the firm's readiness to comply with the other types of BICE.

Full Blown BICE

As its name implies, the requirements of Full Blown BICE are the most onerous of the four forms of BICE and they apply when fiduciary investment advice is provided to a firm's non-ERISA plan or IRA clients.[23] Unlike the other forms of BICE, Full Blown BICE requires a written contract enforceable under state law between the fiduciary advisor and the client. For new clients, the contract will likely be in the form of an advisory agreement and must be executed prior to or contemporaneously with execution of the recommended transaction.[24] For existing clients, the written contract will likely be in the form of an amendment to the parties' existing advisory agreement, and its execution on the part of the client can be accomplished by negative consent, with a 30-day period within which the client may terminate its relationship with the firm. [25] If the retirement investor does not respond within 30 days, the contract amendment is treated as effective. [26] For new clients, it can be executed by written or electronic signature.[27]

The written contract must contain certain mandatory provisions and warranties acknowledging the fiduciary status of the financial institution and advisor and promising to adhere to the Impartial Conduct Standards, including the new Best Interest Standard of care. The contract must also include a warranty that the firm has adopted written compliance policies and procedures designed to ensure adherence to the Impartial Conduct Standards and mitigation of material conflicts of interest.[28]

In addition, the contract must include general disclosures concerning the advisor's compensation and any related material conflicts, including the receipt of third-party payments and whether advice is limited to proprietary products. Specific information on compensation and other matters relating to any recommended investment products must be provided upon the client's request.[29]

TIP ▶ Third-Party Payments. The definition of "Third-Party Payments" under the BICE includes, among other things, 12b-1 fees and revenue sharing payments.[30] While not entirely clear, in Q&A-18 of the DOL FAQs, the DOL seems to take the position that third-party payments are by nature variable and thus, cannot be levelized. This means that Third-Party Payments, if received by the firm or the advisor, will

need exemptive relief in all cases and must be disclosed by users of Transition BICE, Full Blown BICE, and Streamlined BICE.

The appointment of a BICE Officer is also required under Full Blown BICE.[31] A BICE Officer is the responsible person or persons at the financial institution charged with addressing conflicts of interest and monitoring the firm's advisors' adherence to the Impartial Conduct Standards. This will include oversight of a supervisory structure established to ensure that advisors adhere to the Impartial Conduct Standards and, therefore, extends to the consideration and incentives of branch managers and supervisors and their potential effect on advisor recommendations. The written contract required under Full Blown BICE must also include a warranty that a BICE Officer has been appointed.[32]

The contract can include a mandatory arbitration provision with a reasonable venue for the client, but it cannot limit the client's right to participate in class action lawsuits. The contract can also include a waiver of the right to obtain punitive damages.[33]

The Full Blown BICE contract requirement is controversial because it extends the DOL's regulatory authority to matters seemingly beyond its jurisdiction. As a practical matter, the written contract requirement under Full Blown BICE creates a private right of action for non-ERISA and IRA clients that did not previously exist.[34] In this context, the Impartial Conduct Standards will be contractually enforced by the tort bar when an IRA or non-ERISA plan believes its advisor has recommended an investment product that is not in its Best Interest, or receives conflicted compensation.

TIP ▶ Employ Transition BICE as Risk Mitigation for 2017. Financial institutions should consider utilizing the Transition BICE approach during the Transition Period despite the fact that they may have Full Blown, Disclosure and Streamlined BICE documents in place and ready by the April 10, 2017 applicability date. Doing so has the practical effect of eliminating the potential for private rights of action being brought with respect to investment advice provided during the Transition Period. Experienced litigators point out that they prefer to bring suit only after the passage of a significant amount of time in order to allow for a greater accumulation of damages and, therefore, the potential for a larger recovery. Be that as it may, using Transition BICE may be a worthwhile protective measure during the Transition Period.

Disclosure BICE

Disclosure BICE requirements apply when fiduciary investment advice is provided to a firm's ERISA plan clients.[35] Its conditions are identical to those of the Full Blown BICE except that a written contract is not required. In lieu of the contract, a disclosure document or notice must include all of the information that would otherwise be mandated in the contract. Unlike the other form of BICE, Full Blown and Disclosure BICE users must file a one-time notice by email to the DOL before they can rely on the proffered exemptive relief. The notice remains in effect until it is revoked in writing by the firm.[36]

Streamlined BICE

Streamlined BICE is for use by level-fee fiduciaries[37] who do not earn any variable compensation, and provide investment advice in three discrete situations.[38] They are recommendations to: (1) roll over plan assets to an IRA, (2) roll over from an IRA to another IRA, and (3) switch from a commission-based account to a level-fee arrangement.[39]

Streamlined BICE requirements are very simple. In the circumstances above, the level-fee fiduciary must document why the advice was considered to be in the client's best interest. In the case of a rollover from an ERISA plan, this includes documenting the consequences and alternatives to the recommendation, such as leaving money in the plan, the fees and the relative expenses associated with the plan and IRA, whether the plan sponsor pays some or all of the plan's administrative expenses, the different levels of service under the plan and IRA, and the range of investments available under each alternative. The firm must also provide the investor with a written statement that it and its advisor are acting as fiduciaries.

TIP ▶ Checklist Approach. Streamlined BICE requirements can be accomplished by taking a checklist approach for each of the three scenarios. Checking off boxes to document that particular factors were considered and discussed with the client will ensure that a

methodical and thoughtful approach was taken by the advisor when making his/her recommendation. At a minimum, the factors to consider should include those described above. Other factors may include estate planning considerations, required minimum distributions, and 10-year income averaging treatment available to 401(k) plan participants born before January 2, 1936. Checkboxes can also be used to evidence the advisor's thoroughness and document the fact that she requested and/or reviewed certain information such as Form 5500, participant fee disclosures under ERISA section 404(a)(5) and plan benefit statements. Finally, firms may want to consider adding signature blocks at the end of each checklist for both the advisor and the client to acknowledge that all relevant factors were considered and that both parties agree that the recommendation is in the retirement investor's best interest.

Note that where the advice from a non-level fee advisor is to roll over from an ERISA plan to an IRA, from another IRA, or to change from a commission- to fee-based arrangement under an IRA, the requirements of Full BICE must be satisfied. Consequently, the IRA client will have a private right of action under the written contract.

"BIC for A Day"

Unlike the four forms of BICE discussed above, "BIC for a Day" is not specifically addressed in the BICE. Instead, it is a concept that has taken shape as a result of ERISA practitioners working with the various forms of BICE and realizing that certain advice scenarios do not clearly fit under any single BICE. BIC for a Day provides exemptive relief for a recommendation to enter into a level-fee advisory program. It simply addresses the "one time" recommendation to enter into the level program, and does not cover the investment recommendations after the client has entered into the relationship for which the advisor is paid a level fee.

Early on, practitioners believed (and hoped) that BIC for a Day would be subject to the simplified Streamlined BICE requirements. However, Q&A 13 of the recently issued DOL FAQs in Q&A-13 clarified that the Streamlined BICE requirements apply to the three identified circumstances and nothing else. Consequently, BIC for a Day is a type of Full Blown BIC. The full array of Full Blown BICE requirements applies here but, because it merely addresses the entry into a level-fee advisory relationship and not the follow-on investment recommendations, transaction disclosures are not necessary.

Conclusion

The DOL's big picture policy goal is to impose a universal "Best Interest" fiduciary standard on all types of advisors to plan sponsors, participants and IRA owners which is accomplished primarily through the BICE. The BICE along with the DOL Fiduciary Rule imposes significant compliance costs on broker-dealers, insurance agencies and other firms. The DOL Fiduciary Rule, the BICE and the related PTEs are complex and many interpretive issues remain. It is not easy to prepare for compliance with the fiduciary package, but with the passage of time, ERISA practitioners are able to identify and avoid traps for the unwary.

ENDNOTES

* Stephen P. Wilkes advises a national client base of mutual funds, CIFs, private funds, registered investment advisers, insurance companies, broker dealers, wealth management firms, banks, trust companies, third party platform providers, plan sponsors on ERISA, tax, and related securities law issues. He provides advice with respect to retirement plan services agreements, investment management agreements, DOL regulations, SEC regulations, federal legislative activity, qualified employee pension plans, ERISA litigation, Collective Investment Funds, Offshore investment advisers, Sales and Marketing Distribution Agreements, Wrap-Fee Programs.

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[1] 81 Fed. Reg. 20946, 21002 (April 8, 2016).

[2] These exemptions also include PTE 2016-02 (also called the "Principal Transactions Exemption") and amendments and partial revocations of PTEs 84-24, 86-128, and 75-1, and additions to PTEs 77-4, 80-83, and 83-1.

[3] 81 Fed. Reg. 21002, 21085 (April 8, 2016).

[4] 29 C.F.R. 2510.3-21(a)(1)(i).

[5] 29 C.F.R. 2510.3-21(a)(1)(ii).

[6] Of course, an investment professional will also be deemed to be a fiduciary investment advisor if she represents or acknowledges that she is acting as a fiduciary; if the advice is rendered pursuant to a written or verbal agreement, arrangement or understanding that the advice is based on the

client's particular needs; or the advice is directed to a specific individual. 29 C.F.R. 251-.3-21(a)(2).

[7] 81 Fed. Reg. 20967, 20968 (April 8, 2016).

[8] Section VIII(q) of the BICE.

[9] The DOL stated that "[*t]hird party payments such as 12b-1 fees and revenue sharing payments, even if they provide the same amount or percentage for each investment offered, are transaction-based fees and vary on the basis of a particular investment because they are paid only for the particular investments that are included in the arrangement. If the adviser or financial institution is going to recommend products that generate third party payments, they need to comply with the more stringent provisions of the full BIC Exemption…*"

[10] 29 C.F.R. 2510.3-21(b)(2)(i)-(iv)

[11] 29 C.F.R 2510.3-21(c)(1)-(3).

[12] Preamble to Final Investment Advice Regulation, 81 Fed. Reg. 20968 (April 8, 2016).

[13] Preamble to Final Investment Advice Regulation, 81 Fed. Reg. 20968 (April 8, 2016).

[14] Section VII of the BICE.

[15] Section VII(b)(3) of the BICE.

[16] Section VII(b) of the BICE.

[17] The terminology "Full Blown," "Disclosure," "Streamlined," "Transition," and "BIC Officer" used to describe the various BICE requirements do not appear in PTE 2016-01 itself, but were coined by Marcia S. Wagner, Esq., Principal at The Wagner Law Group, A Professional Corporation.

[18] Section IX of the BICE.

[19] Section IX(d)(2) of the BICE.

[20] Section IX(d)(2)(v) of the BICE.

[21] Section IX(d)(3) of the BICE.

[22] Section IX(d)(4) of the BICE.

[23] Section II(a) of the BICE.

[24] Section II(a)(1)(i) of the BICE.

[25] New contractual obligations, restrictions or liabilities can be imposed by way of negative consent. Section II(a)(1)(ii) of the BICE.

[26] Section II(a)(1)(ii) of the BICE.

[27] Section II(a)(1)(i) of the BICE.

[28] Section II(d) of the BICE.

[29] Section II(e) of the BICE.

[30] Section VIII(q) of the BICE.

[31] Section II(d)(2) of the BICE.

[32] Section II(d) of the BICE.

[33] Section II(f) of the BICE.

[34] Presumably, this is intended to compensate for the fact that IRA owners and participants and beneficiaries in non-ERISA plans do not have an independent statutory right to bring suit against fiduciaries for violation of the prohibited transaction rules and that the DOL cannot sue on their behalf.

[35] Section II(g) of the BICE.

[36] The notice must be provided by email to *e-BICE@dol.gov*. Section V(a) of the BICE.

[37] A level fee is a fixed percentage of the value of assets or a set fee that does not vary with the particular investment recommended..

[38] Section II(h) of the BICE.

[39] Section II(h)(3)(i) of the BICE.