February 2, 2011

Office of Regulations and Interpretations
Employee Benefits Security Administration
United States Department of Labor
200 Constitution Avenue, NW., Room N–5655
Washington, DC 20210

Attn: Definition of Fiduciary Proposed Rule

Response to Proposed Rule Expanding the Definition of Fiduciary

We are the National Association of Certified Valuation Analysts (NACVA), the largest business valuation credentialing organization in the country. We are responding to the Department of Labor (DOL) proposed new regulations expanding the definition of who will be considered a fiduciary (29 CFR 2510 the "Proposed Regulation").

We understand the DOL's concern to insure that valuations of private company stock for the purposes of an Employee Stock Ownership Plan and Trust (ESOP) are both accurate and reliable. The DOL has issued the Proposed Regulation because in its opinion there is a problem with the quality and accuracy of ESOP stock valuations. As a result, the DOL is proposing the expansion of the full spectrum of fiduciary responsibilities to include appraisers.

Brief History of Valuations for Tax Related Purposes

The Department of the Treasury and its tax-collecting gatekeeper the Internal Revenue Service (IRS) has long had a vital interest in accurate appraisals of stock in private companies for compliance with regulations relating to the taxation of applicable property as legislated by the Federal Government. The IRS is the final arbiter of valuations for tax related purposes, generally understood to include assignments for gifting, estates, and ESOPs.

If the DOL is concerned with the accuracy of appraisals for the purposes of ESOPs, the Proposed Regulation is the first indication that there is a widespread problem. We question why the DOL is undertaking this initiative without an apparent consultation with the IRS, which has a long history, trained staff and the resources to be effective in the rather narrow discipline of ESOPs. The IRS has the oversight responsibility for the large universe of tax related valuations including gifting and estate taxes. Involving the IRS in this discourse seems to us to be an essential element of the spirit of regulatory compliance if the issue is really a matter of poor quality valuation reports.

Historically the IRS response regarding the quality of valuation reports has been to emphasize training and experience. Recently the IRS was instrumental in having Federal legislation enacted relating to gifting. For gifting purposes, we have an understanding of who is a qualified appraiser and what are the qualifications consistent with being a qualified appraiser. The penalties for non-compliance with these regulations are very severe for the appraiser. The penalties range from substantial fines to being prohibited from providing tax related valuations. Such a prohibition could seriously damage an appraiser's reputation and their valuation business.

Major Flaws with the Proposed Regulation

We are concerned that the DOL is apparently willing to rush into classifying appraisers as fiduciaries without a thorough analysis of the essence of the problem and other more effective alternative solutions.

Conflict with Existing Regulations. The Proposed Regulation imposes fiduciary responsibilities in direct conflict with existing tax regulations. Currently the IRS mandates that the appraiser must be "independent" (26 U.S. Tax Code 401(a)(28)(C)). This standard of behavior is supported by a 30-year history of court citations and enforcement actions by both the IRS and DOL. There is substantial documentation and logic for this standard of independence.

The Proposed Regulation would directly conflict with this well established regulation by making the appraiser a fiduciary to the ESOP. A fiduciary has many stated obligations to the ESOP including such things as undivided loyalty to the plan, acting in the exclusive best interests of the plan participants, and maximizing plan assets.

Clearly, these fiduciary obligations are beyond the scope of activity of an independent appraiser. The Proposed Regulation will make the appraiser a fiduciary to the fullest extent of the law. The appraiser will be personally liable for a full range of activities bearing no relation to the stock value including such things as compliance with plan documents, investing plan assets, duty to correct prior mistakes, etc.

We seriously question why the DOL is proposing regulations that are in direct conflict with long established regulations governing appraisals promulgated by other Federal agencies, primarily the IRS. We think it is reasonable expectation that the regulatory environment be coordinated between agencies to lessen the needless uncertainty of trying to comply with rules that are in direct conflict with one another.

Failure to Maintain Valuation Standards. The DOL purports to make appraisers fiduciaries without defining the standards they are to be held to. The DOL issued 29 CFR Part 2510 Regulation Relating to the Definition of Adequate Consideration, Notice of Proposed Rulemaking, 1988. Those proposed rules have never been finalized. Since the issuance of the proposed rules, there have been a host of valuation issues that the appraisal industry has addressed in concert with applicable organizations and the IRS. We have worked in partnership to provide leadership in this area. In spite of repeated requests, the DOL has been silent in such important matters. We think it is irresponsible for the DOL to propose such far ranging responsibilities without having a clearly defined understanding of how the fiduciaries are to be evaluated.

The DOL has not participated to any material degree in the development of valuation standards and protocols. There is virtually no history of valuation orientation in a public arena. It is unclear who is coordinating the valuation discipline within the DOL, and their level of training and experience for such a key initiative. Again, we are concerned that the IRS has apparently been excluded from DOL discussions.

Fiduciary Duties Poorly Considered. The Proposed Regulation will hold appraisers personally liable for a wide range of responsibilities and obligations having nothing to do with the valuation. This invites a regulatory quagmire with appraisers as "co-fiduciaries" with the ESOP Trustee and other possible fiduciaries who do have the full burden of responsibilities. We can imagine that the co-fiduciaries will be mired in negotiating indemnity agreements, defining duties, where the primary liability resides in the case of a challenged appraisal, and dealing with regulations that are unclear. There will be tremendous confusion under the Proposed Regulation because it is ill-considered. This will result in unnecessary litigation and involvement by the Federal Courts. While the struggle to define fiduciary responsibilities rages, it is likely that many valuation firms will withdraw from the ESOP valuation industry and they will not be replaced by other firms.

Failure to Consider Existing Valuation Standards. The DOL proposes extending fiduciary responsibilities to ESOP appraisers. Most business valuation organizations (AICPA, NACVA, IBA, and ASA) have reporting standards that require all professionals having material input into the valuation to either sign the report or be identified. In larger appraisal organizations it is common for several associates to collaborate in the preparation of complex valuations. If there are multiple associates participating in the valuation process, which is the fiduciary?

We understand that a fiduciary has potential unlimited personal liability under ERISA. Given that the fiduciary responsibilities are so broad, often have little to do with the stock price, and create great uncertainty among co-fiduciaries, it is easy to see that many firms will refuse such assignments with predictable results. Fewer firms facing uncertain and limitless personal liability will raise prices substantially, and ESOP candidates will have fewer and more expensive options.

Failure to Consider the IRS and their Responsibilities. The DOL asserts that the main problem with ESOP appraisers is that there are a number of flawed reports in the market leading to incorrect valuation conclusions. This appears to be an area of regulation most commonly associated with the rule making authority of the IRS. Extending fiduciary responsibility to appraisers seems unwarranted in light of the observations we have offered and the fact that the IRS has apparently not been consulted in this process.

Alternative Suggestions to Accomplish the Goals

We share the same overall goals with the DOL. We want the appraisals of ESOPs to be of consistent high quality. Our experience is that the better approach to attaining the higher ground regarding quality is to insist on training and education. There are a number of essential first steps in this venue. First, we suggest the DOL work with the industry and the IRS to identify the major quality issues. Once defined, a strategy to address any shortcomings will be delineated and corrective steps initiated to address the concerns. We have been a leader in developing national training in business valuation with the assistance of other valuation associations and with valuable input from users of the reports including the IRS.

Appraiser Training. The DOL should be a leader in developing the standards that govern ESOP valuations. ESOP Appraisers should be required to provide evidence of competence with regard to ESOP related valuation issues. For example, the industry consortium of appraisal organizations, IRS and other interested parties has been very successful in raising the quality of tax oriented valuations. In our experience, the first step is to establish clear appraisal standards. If the DOL believes the ESOP appraisals must meet specific discrete industry requirements, those attributes must be identified so that training and compliance can be measured. Once standards are met, appropriate training that meets the requirements of the IRS and DOL can be developed. With those requirements established, the business valuation community will be able to offer quality programs to bring expectations into alignment. NACVA has already demonstrated leadership in training by working with the IRS to establish valuation standards, train IRS associates, and train valuation professionals.

Fiduciary Training. Currently, virtually anyone may become a Trustee or fiduciary. While there is literature that details the responsibilities of a fiduciary, there is no acknowledged training program or certification for such responsibilities. Authorizing fiduciary training and perhaps having candidates attest in writing that such training has been taken and understood is one positive step in making sure ESOP valuations meet exacting quality standards. We think that trained fiduciaries are a best practice in promulgating industry quality.

We note that there are already a number of ESOP centric organizations that are very active in communicating fiduciary and Trustee responsibilities. Such initiatives by the National Center for Employee Ownership (NCEO), the Ohio Employee Ownership Center (OEOC) and The ESOP Association rely on voluntary compliance and attendance. Having specific fiduciary requirements sanctioned by the DOL and IRS will create the necessary focus to compel greater compliance with regulations. The clear benefit to training existing fiduciaries on ESOP based valuation requirements is that such individuals are already expected to bear that responsibility. Having those individuals attest to knowledge of their duties will help insure quality valuations.

Summary

We think the Proposed Regulations as drafted contain substantial flaws and should not be enacted. The Proposed Regulations will create unnecessary uncertainty within the appraisal community, impose unlimited personal liability that is ill-conceived, and fails to meet stated goals. There are better options. Comprehensive fiduciary and valuation training will help improve the quality of ESOP valuations. Training works for other tax related valuation reports, and ESOPs are no exception.

Respectfully submitted,

NACVA's Executive Advisory Board