INSTITUTE OF BUSINESS APPRAISERS
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TO: Employee Benefits Security Administration

The Institute of Business Appraisers is pleased to comment on the Proposed Rule relating to the Definition of the Term "Fiduciary" that was released by the Employee Benefits Security Administration (EBSA) of the Department of Labor and published in the Federal Resister on October 22, 2010 (the "Proposed Rule").

The Proposed Rule would more broadly define who is included under the definition of fiduciary by reason of providing investment advice to an employee benefit plan or a plan's participants.

In explaining the rationale for the issuance of the Proposed Rule, the EBSA stated the following:

> The financial marketplace also has changed significantly, and the types and complexity of investment products and services available to plans have increased. With the resulting changes in plan investment practices, and relationships between advisers and their plan clients, the Department believes there is a need to re-examine the types of advisory relationships that should give rise to fiduciary duties on the part of those providing advisory services. In this regard, we note that recent Department enforcement initiatives indicate there are a variety of circumstances, outside those described in the current regulation, under which plan fiduciaries seek out impartial assistance and expertise of persons such as consultants, advisers and appraisers to advise them on investment-related matters. These persons significantly influence the decisions of plan fiduciaries, and have a considerable impact on plan investments. However, if these advisers are not fiduciaries under ERISA, *they may operate with conflicts of interest that they need not disclose to the plan fiduciaries who expect impartiality and often must rely on their expertise, and have limited liability under ERISA for the advice they provide* (Emphasis added). Recent testimony by the Government Accountability Office noted an association between pension consultants with undisclosed conflicts of interest and lower returns for their client plans.

In the new conference announcing the Proposed Rule, the EBSA stated in response to the question of who would be affected by the Proposed Rule:

> In 1976, the Department issued guidance that said that appraisers that were providing valuations for ESOPs were not fiduciaries under ERISA, this regulation would change that and the reason is that the appraisers who give a valuation for an ESOP transaction are clearly providing advice that they know everyone is going to rely on, that's why they are hired, and there have been many, many examples of abusive transactions in this regard where the appraisal is faulty, where they overvalue the employer's stock.

With respect to the Proposed Rule as it applies to appraisers who prepare a valuation for ESOP purposes, the problems have been well documented in the public comments submitted by the National Center for Employee Ownership on December 8, 2010, the American Institute of

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Certified Public Accountants on January 19, 2011, and the ESOP Association on February 2, 2011. The Institute of Business Appraisers has reviewed these comments and supports them.

While the Institute of Business Appraisers applauds and supports the EBSA's efforts to curb the perceived abuses in ESOP valuations, there are less draconian measures that the EBSA can undertake that would better address the issue of abuses in ESOP valuations.

With respect to the perceived abuses in ESOP valuations, we believe that the EBSA should consider establishing a task force consisting of representatives of the Department of Labor, the Internal Revenue Service, the valuation accreditation organizations, and the ESOP community. The Task Force could consider alternatives such as the following:

- Establish rules with respect to the *qualifications of an ESOP trustee*. Raising the qualifications of the ESOP trustee would enable them to be better able to properly review the valuation report, which would eliminate or reduce the number of transactions in which the ESOP trustee is not qualified to exercise his/her fiduciary obligation with respect to the advice provided by the ESOP appraiser;

- Establish rules with respect to the definition of a *qualified appraisal* and a *qualified appraiser* for ESOP purposes similar to the rules established by the Internal Revenue Service with respect to these items in its regulations under Internal Revenue Code §170. This would raise the quality of the appraisers preparing valuations for ESOP purposes;

- Finalize the proposed *Regulation Related to the Definition of Adequate Consideration* and consider issuing additional guidance on valuations for ESOP purposes or, alternatively, establishing a task force/committee of interested parties to do so. This would provide authoritative guidance on ESOP valuation issues;

- Require the review of valuation reports prepared by an ESOP appraiser by an independent review organization composed of qualified appraisers on a periodic basis or as deemed appropriate by the Trustee or named fiduciary. In effect, this *peer review* process, similar to that which applies to Certified Public Accountants performing attestation engagements, would provide a mechanism where the Trustee or named fiduciary could have the report reviewed by an independent review appraiser and would help eliminate or curb perceived abuses in ESOP valuations. Alternatively, require that the ESOP valuation firm undergo a peer review of its processes, procedures, and reports by an independent review organization on a periodic basis; and/or

- Require that appraisers who prepare valuations for ESOP purposes cannot provide other services, such as analysis of the feasibility of an ESOP and the structuring and execution of the transaction, to the company, the selling stockholder(s), or employees. Many of the conflicts of interest that arise in the marketplace today result when the appraiser provides services other than the preparation of ESOP valuations. Additionally, require the full disclosure of any relationships and/or conflict of interests between ESOP valuation firms and other parties/advisers to the transactions.

Each of the four organizations which offer certifications in business valuation currently requires the completion of a certification to accompany each valuation. These certifications address issues of potential pre-disposition or bias. We would not object to a broadening, for purposes of ESOP engagements, of the form of that certification to mandate a specific disclosure of all prior relationships between the appraiser and the parties to the ESOP transaction.

These are just some of the alternatives that we believe the DOL should investigate and consider. We believe that if the Department of Labor, the Internal Revenue Service, the professional valuation community, and the ESOP community work together to address the perceived abuses in ESOP valuations, the result would be preferable to that of the Proposed Rule and would have fewer undesirable consequences.

Finally, any revised regulation must reflect the fact that valuation is an inexact practice. Honest and thoughtful appraisers considering identical securities can have material differences of opinion. In order to ensure that qualified appraisers continue to provide services to ESOPs and their sponsoring companies, the regulations must clearly distinguish between legitimate differences of opinion and gross negligence indicative of a true breach of fiduciary responsibility.

Respectfully submitted,

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The Institute of Business Appraisers is the oldest professional society devoted solely to the appraisal of closely-held businesses. Established in 1978, the Institute is the pioneer in business appraisal education and professional accreditation.