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Testimony of the
AMERICAN SOCIETY OF APPRAISERS
To the
Employee Benefits Security Administration
Hearing On Its
Reproposed “Fiduciary” Regulations

Presented by
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Ladies and Gentlemen:

Good morning. My name is Jeff Tarbell and I'm testifying on behalf of the American Society of Appraisers (ASA). ASA is a multi-discipline, non-profit professional appraisal organization which teaches, tests and credentials highly qualified appraisers of businesses and business interests, real estate, personal property and machinery and equipment. By way of personal background, I'm employed at Houlihan Lokey, an investment bank that, among other things, provides valuation and fairness opinion services related to Employee Stock Ownership Plans ("ESOPs") and other employee plans under ERISA. I have more than 25 years of experience performing valuations and fairness opinions, many of them related to ESOPs. I'm an accredited senior appraiser credentialed by ASA in business valuation and I also hold a Chartered Financial Analyst (CFA) credential.

ASA appreciates the opportunity to testify at today's hearing on EBSA's proposed Conflict of Interest Rule. My testimony is limited to the valuation provisions of the rule, most importantly, issues governing the fiduciary status of individuals who provide appraisals, fairness opinions and other valuation services to ESOPs, IRAs, 401(k)s and other plans under ERISA. Our written comments in response to the proposal were submitted several weeks ago.

ASA greatly appreciates EBSA's decision to amend its 2010 Proposal by carving out from the current proposal's definition of "fiduciary", appraisals and fairness opinions of employer securities provided to ESOPs. These valuations are typically provided pursuant to ERISA reporting requirements and, for the major valuation firms, constitute the largest number of valuation engagements for ESOPs. Their exclusion from fiduciary requirements is a welcome development and a noteworthy example of EBSA's willingness to carefully consider stakeholder concerns and respond to them constructively.

We're hopeful that this same open-mindedness continues with regard to the current rulemaking, because while it's a significant improvement over the 2010 Proposal, we are troubled by the fact that it continues to apply fiduciary requirements to an important category of valuations and fairness opinions – specifically, those involving the purchase, sale or exchange by ESOPs and other plans of all assets other than the securities of companies with ESOPs. While there are no hard data on the total numbers of these individual transactions and on the specific types of property purchased, sold or exchanged by plans, we do know they're a common occurrence that most often involve the valuation of real property or privately held securities in the portfolios of non-ESOP ERISA plans. These transactions are important to plan participants and to the appraisers who value the assets involved.

Our members – and I would expect, the entire community of professional appraisers – strongly oppose what can be characterized as a "carve out from the carve out" in the proposed rule. We do not believe there is any reasonable public policy rationale which supports EBSA having two separate and distinct appraisal policies: one involving the valuation of employer securities held by ESOPs and another involving all other assets that a plan might purchase, sell or exchange. EBSA should have one appraisal policy governing the valuation of plan assets, not two. Accordingly, we urge that the proposed rule be amended by excluding from the definition of "fiduciary" appraisals and fairness opinions not just of ESOP securities but of all assets held by ESOPs and other ERISA plans; and that EBSA address its valuation concerns in a separate initiative.

EBSA's decision not to exclude all property categories from appraisal fiduciary requirements resurrects the many substantive reasons ASA, the community of professional appraisers and many companies with ESOPs strongly opposed the 2010 rule. I want to discuss several of those reasons this morning because they are fully relevant to the many valuations that will still be subject to fiduciary requirements under the rule, as proposed:

First, appraisers firmly believe that an unavoidable conflict exists between the ethical and legal obligations of appraisers to be independent of all parties to a financial transaction and the ethical and legal obligations of fiduciaries to act solely in the interests of plan beneficiaries. Notwithstanding EBSA's dismissal of this concern, we believe the "conflicting duties" issue is real and troubling. We think it will be raised by plan fiduciaries or other parties to plan transactions when the purchase, sale or exchange of property for investment purposes underperforms or otherwise goes wrong; and someone believes the appraiser who valued the property has violated his or her legal obligation to make decisions that are in the interest of plan beneficiaries. Moreover,, when the asset involved in an individual transaction is real estate related and the opinion of value is challenged, the appraiser could be subject to disciplinary action by his or her state appraiser licensing agency because it believes the appraiser failed to act independently of plan beneficiaries and all other parties.

This concern is not ours alone. We're confident it is shared by the entire community of professional appraisers, including The Appraisal Foundation; and, very likely by other plan stakeholders.

We respectfully disagree with the Department's view that the legal duties of professional appraisers to be independent of all parties and the legal duties of fiduciaries to safeguard plan interests are not only not in conflict, but are actually in perfect sync. If the final rule includes appraisers within the fiduciary definition for any plan-related valuations, we think it's inevitable that this issue will have two adverse consequences: it will be a major source of confusion among ESOP appraisers trying to reconcile and balance these two obligations; and it will give rise to disputes - some of which will end up in litigation - between appraisers and the plan trustees.

We acknowledge that reasonable people can disagree on the inevitability of these adverse consequences. That is precisely what drives our deep concern that appraisers will get whip-sawed between two legal obligations that we and the entire professional appraisal community believe are in direct conflict; or, at best, will be thought by some to be in conflict. If there were a consensus or even near-consensus among reasonable people that no conflict exists between an appraiser's duty of independence and a fiduciary's duty of loyalty to plan beneficiaries, then a major reason for our objection to the "appraiser-as-fiduciary" concept would be withdrawn. But, no such consensus or anything close to one exists. To the contrary, there is a consensus on this issue, but in the opposite direction. Finally, our concerns about this matter are no less acute because under the proposed rule, these ethical and legal conflict issues will only affect valuations of property that do not involve the employer securities held by ESOPs. While individual transactions most likely represent a minority of ESOP and other plan valuation engagements, we believe they are of sufficient number and importance to put many providers of valuation services to ERISA plans in great jeopardy.

<u>Second</u>, including appraisers in the proposal's definition of "fiduciary" would substantially increase the costs of those appraisals covered by fiduciary requirements – costs that would be passed through to plan companies and/or to plan beneficiaries. This is because of two factors: Appraiser E&O insurance policies do not currently include claims based on fiduciary liability. Adding such coverage to existing policies would require appraiser E&O carriers to initiate a complex and time-consuming underwriting process to determine the costs, terms and conditions of such coverage (assuming that these companies would be willing to add a fiduciary feature which is far from certain). The resulting increased costs of E&O policies with fiduciary coverage and/or the additional liability exposure which derives from fiduciary requirements would inevitably increase the costs of these appraisals and reduce the number of appraisers willing to provide them.

<u>Third</u>, making appraisers fiduciaries is a wholly unproven way to ensure the reliability of plan appraisals; and, is inconsistent with the way all other federal agencies regulate appraisal practice. Given the fact that no federal agency (and no state agency) has ever regulated appraisal practice by imposing fiduciary status on appraisers, there is no empirical evidence that doing so will produce better valuations. DOL's proposal, if it were incorporated into a final rule, would be a case of first impression, an experiment that we believe would produce a series of negative consequences without any promise or even likelihood that appraisal reliability would be improved.

The most optimistic thing that can be said for the appraiser as fiduciary concept is that it will result in an outcome that is unknowable at this time. If there were no other way to increase assurances that ESOP appraisals are reliable (assuming that there is a demonstrable need for across-the board improvement, which we dispute), then such an experiment <u>might</u> be justified. But, there <u>are</u> other ways which are tried and true: the appraisal regulatory policies of other federal agencies, including IRS, that were adopted years ago and have proven effective.

<u>Finally</u>, the possibility of a separate EBSA regulatory initiative to address its concerns about appraisals adds weight to our position that all appraisals for ESOPs and other plans should be excluded from the current proposal. Commentary accompanying the valuation provisions of the proposal states that notwithstanding EBSA's decision to exclude valuations of ESOP employer securities from fiduciary requirements, it continues to have concerns about such valuations that it may want to address "in a separate regulatory initiative." Of course, we do not know the likelihood of such an initiative. But we think it would be extremely burdensome – and frankly unfair - for EBSA to require appraisers who value ERISA plan assets that are not carved out in the current proposal to adhere to its complex and costly fiduciary requirements and then subject them, shortly thereafter, to a fundamentally different set of requirements resulting from a separate regulatory initiative. Unfortunately, the unfairness inherent in such a development would exist even if the subsequent regulatory initiative produced a result our organizations supported. The easiest and most straightforward way to avoid such potential "double jeopardy" is by excluding all appraisals from the fiduciary provisions of the current proposal, and instead, covering them through an alternative process such as that underway for ESOPs or suggested in the rule commentary.

We hope EBSA agrees with our assessment that the reasons cited for our opposition to appraiser fiduciary requirements remaining in the proposed rulemaking are more than sufficient to justify their removal; and, we respectfully urge the agency to take this important step before finalizing its rule.

In the event that EBSA undertakes the separate rulemaking initiative suggested in the proposal's commentary, ASA would be pleased to work with the agency to fashion a regulatory approach that satisfies DOL's regulatory goals, is cost-effective and fair to appraisers. Given ASA's multidiscipline membership, we believe we're in a unique position to assist EBSA in connection with a future regulatory initiative that would involve valuations of a broad range of assets found in the portfolios of ESOPs and other plans.

I would be happy to answer any questions you may have about ASA's testimony.