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Definition of Fiduciary Investment Advice 03-02-2011

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EMPLOYEE BENEFITS SECURITY ADMINISTRATION
PUBLIC HEARING:
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1 P R O C E E D I N G S

2 MS. BORZI: We're going to start in a couple
3 minutes. So if the first panel would just come up and
4 take their seats up here, that will save us a little
5 bit of time.

6 MR. DAVIS: Okay. The second day of our
7 definition of fiduciary hearing is called to order. We
8 have Panel No. 8, Mr. Goldberg, Ms. Carlisle, Mr.
9 Reilly.

10 Before we get started though, a couple of
11 administrative announcements. One, it's important that
12 everybody speaks into the microphone. It's really
13 important for the transcript person to be able to hear
14 clearly what everybody is saying so she can capture the
15 words correctly.

16 Secondly, we had a couple of issues yesterday
17 with people plugging their laptops into the sockets on
18 the wall and having the cord so that it traipsed across
19 the aisle. That's actually an OSHA violation and that
20 would not be a great story to have an OSHA violation at
21 the Department of Labor. So we would strongly
22 encourage you not to do that and power up --

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1 MS. BORZI: Plus, you'll be removed by our
2 OSHA people.

3 MR. DAVIS: So with those two administrative
4 announcements we will go ahead and get started. Mr.
5 Goldberg with the ESOP Association will start.

6 MR. GOLDBERG: Okay. Thank you.

7 I am Larry Goldberg and I'm here on behalf of
8 the ESOP Association. We're happy to have the
9 opportunity to get in front of you guys today to talk a
10 little bit about our comments on the regulations or
11 proposed regulations.

12 First, I'll just mention, the ESOP
13 Association is, as we say in our comments, an
14 organization that has over 1,000 members, largely
15 companies with ESOPs. About 50 percent of the members
16 of the Association are companies with less than 100
17 employees and those are companies who really hold the
18 key links to jobs in their local communities as well as
19 the larger companies; the same for the larger employers
20 in the Association.

21 The Association is really committed to
22 helping companies put in great ESOPs with great results

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1 for the participants as well as all the other parties
2 to the transaction. So we like the opportunity to be
3 able to talk to you guys about how to improve or
4 address problems that you see in the ESOPs area.

5 I have really three comments I'd like to --
6 or three points I'd like to make today to you.

7 The first one I'm going to talk about is just
8 the Association would be interested in some more
9 clarification about the problems that you've seen with
10 appraisals and I'll talk about that more.

11 And secondly, we would point out, we're not
12 sure the proposal really will solve the problems that
13 you've identified in the preamble and certainly we do
14 think there are some negative effects on ESOP
15 participants and ESOP formation from the proposal we'd
16 like to talk about.

17 And then, finally, we'd like to suggest some
18 alternative approaches that might better achieve your
19 goals and also promote ESOPs at the same time.

20 So in looking at the comment at the proposal
21 it seems like there's three stated reasons for the
22 proposal. First, that the market for retirement plans

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1 has changed over the years, in the last 30 years.

2 Second that there's some conflicts of interest in the
3 marketplace among service providers and then finally,
4 third, that there's incorrect valuations that you're
5 seeing of employer securities.

6 So with respect to the first point, there
7 are, as other speakers have said, lots of changes in
8 the marketplace. I'm not sure there's been that much
9 change in the ESOP marketplace. The relationship of
10 the trustee hiring an appraiser to perform an
11 independent valuation is actually much the same today
12 as it was back in the '70s when the regs were -- the
13 rules were in place.

14 As far as conflicts of interest go, I mean,
15 just in looking at our own membership and talking to
16 folks, we're not seeing that appraisers are suffering
17 from conflicts of interest with other parties to the
18 transaction so definitely we could look for some more
19 clarity from you guys on that.

20 I think where that leads us is to focus on
21 the last point, which is incorrect valuations and that
22 that's really the focus of the ESOP aspect of this.

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1 The term "incorrect valuations" implies to us
2 that there's sort of a mistakes being made, that
3 there's a -- or that there's a right and wrong way to
4 do appraisals and so some people are doing them the
5 wrong way and some are doing them the right way. But,
6 in fact, the appraisal really is much more of a
7 professional opinion as to value and professional
8 judgments involved. So I think once someone
9 establishes they're following the Uniform Standards for
10 Appraisals and they're an ASA or other -- meet other
11 qualifications to perform appraisals, it may just be a
12 matter of a difference of opinion of professional
13 judgment as to whether an appraisal would be considered
14 correct or not.

15 You know, for example, if you're -- I guess
16 if you're looking at somebody who is just applying the
17 book value method and no other method of valuing stock
18 in an industry where that's clearly inappropriate that
19 may be an incorrect appraisal. But I think a judgment
20 call on what the multiples are, what the correct EBIDTA
21 multiples are in an industry is much more of a
22 professional judgment that we could disagree over.

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1 So, I guess, that led us to speculate that,
2 you know, perhaps you're seeing unprofessional
3 appraisal reports and I guess we're wondering whether
4 those are being performed by experienced and
5 credentialed appraisers.

6 You know, as I said, in comparing some notes
7 with other people in the Association, I think what
8 we're seeing is that there has been a significant
9 increase in Department of Labor investigations of ESOPs
10 and a lot of looking at ESOP valuations, but I'm not
11 really aware that there have been the investigations
12 like that that have turned into litigation. And, in
13 fact, a lot of those have been closed out where the
14 Department has apparently found the valuation was
15 perfectly fine.

16 So, let me turn to does the -- the question I
17 had was: does the proposal really solve the problems
18 that you've identified? I think that, again, if you --
19 if the problem is that it's an incorrect appraisal,
20 meaning the appraiser doesn't understand valuation
21 theory, if that's what we're getting at, I'm not sure
22 that solves the problem.

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1 One of the, I guess, ugliest things I think
2 I've read in a case in a while was the Gutierrez case
3 in the Ninth Circuit where the District Court really,
4 you know, went on and on about the appraiser who was
5 involved there. I think he either didn't have a high
6 school diploma or didn't have a college degree, was a
7 convicted felon who I think whose felony was
8 related to a financial crime, which is terrible and I
9 don't think any of us want to have those people
10 appraising companies either.

11 But at the same time, I'm not sure making
12 that guy a fiduciary would have changed the outcome
13 there in terms of would that person have performed that
14 appraisal and done it the way he did. I think maybe
15 the problem there was the trustee fell down in its
16 duties of not really carefully selecting the
17 professional to provide that service. And so, I guess
18 my contention would be I'm not sure making that guy a
19 fiduciary would solve the problem.

20 In addition, and just looking at -- there's
21 at least an implication I think in the proposal that
22 over-valuations of stock may be a problem. And in

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1 thinking about that it seems like there's both over-
2 valuations and under-valuations that can be a problem
3 with ESOP's.

4 You've got transactions going on where an
5 ESOP's the buyer and you wouldn't want to have the
6 appraiser over valuing stock in those situations but,
7 at the same time, with ongoing ESOPs that are just
8 getting annual valuations where their benefit
9 distributions are based on those -- the appraisal, if
10 that's being over- valued the participants, of course,
11 are getting more money than they should be getting.
12 So, I think that's -- I'm not sure if we make people
13 fiduciaries here, it perhaps leads to a more
14 conservative approach by appraisers that you're not
15 going to get the outcome you want either because I
16 think then I'm not sure just conservative is the
17 solution to the problem.

18 But, again, you know I think the ESOP
19 Association and other speakers here from the appraisal
20 community would love to have the chance to work with
21 you guys to talk about maybe what -- you know -- what
22 would work.

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1 That clock's moving faster than I thought it
2 would. Okay.

3 So next point I want to make is about -- does
4 the proposal -- what does the proposal do to the
5 appraisal and ESOP community and what are some of the
6 problems that are caused? I guess I'd start by saying,
7 others have said this yesterday, there is an increased
8 cost to ESOP companies from the proposal and I think
9 those costs take the form first in appraisers are going
10 to need to buy fiduciary liability insurance.

11 Right now, I can't tell you how much that
12 costs. Perhaps we can give you some data on that. But
13 what the ESOP trustee community is facing right now is
14 a situation where costs are increasing for their
15 fiduciary liability insurance and, in fact, I think the
16 market is beginning to shrink for that professional
17 service because of the difficulty in finding adequate
18 fiduciary liability insurance.

19 So I'd be concerned that appraisers are going
20 to face the same marketplace when they go out to try to
21 create this new product with their insurers of getting
22 fiduciary liability insurance.

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1 The second concern we have is that we may be
2 driving the good people out of the marketplace and
3 keeping the bad people who maybe are producing
4 appraisals that you're seeing that are a problem.

5 And probably first on that list of concerns
6 is that the folks who are working at multidisciplinary
7 firms where there's investment banking services,
8 there's M&A services, there's capital market services,
9 those people tend to be a small percentage of that
10 firm's gross revenues and we're afraid that what those
11 firms will find is that it's not worth keeping those
12 people around because of the additional fiduciary
13 exposure that's being caused.

14 The third cost is, I think everybody who's at
15 a risk of fiduciary, probably needs their own lawyer.
16 So I think you'll find appraisers are going to have to
17 hire their own law firm to represent them in each of
18 these transactions, which adds another law firm to ESOP
19 deals and increased costs.

20 I also, similarly, I think probably every
21 lawsuit that gets filed against an ERISA -- excuse me,
22 an ESOP fiduciary is going to name the appraiser as a

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1 defendant. And, in fact, I think if the case has
2 pretty much anything to do with the trustee's actions,
3 it's probably going to be malpractice for the
4 plaintiff's firm not to name the appraiser as a
5 defendant in the case.

6 And in thinking about how that might work, I
7 mean, there may be ways to shape the fiduciary limits
8 of the appraiser, but then I look at what courts have
9 done with fiduciary rules and I think I'm not sure even
10 if you try to come up with a rule today, you're going
11 to save these appraisers from years of litigation
12 trying to figure out what the standards are.

13 And, finally, I just think there's going to
14 be some confusion between the role of the trustee and
15 the role of the appraiser in trying to execute
16 transactions where now the appraiser's providing a
17 product, which is a valuation report, and the trustee
18 goes out and makes decisions based on report, if, in
19 fact, they're both fiduciaries it may be that there's
20 not a clear decision-maker there because both parties
21 will feel some fiduciary obligation to make things come
22 out the way they think they should come out.

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1 So, finally, just to mention some thoughts we
2 had about alternatives, you know, first I think we had,
3 as I suggested, I think dialoging with the appraisal
4 community would be -- to talk a little further about
5 the problems are would be a great idea.

6 Can I just take about thirty more seconds?

7 I think in terms of independence, if you look
8 to the adequate consideration regulations, they almost
9 defined independent appraiser for us. And I think if
10 you took the opportunity to go back those, there's
11 probably some relatively straightforward things you
12 could put in there like do you think CPAs auditing the
13 financials should or shouldn't be independent? Do you
14 think somebody who's done estate planning for the
15 shareholder -- other shareholders of the company and
16 have delivered valuations, are they or are they not
17 independent?

18 I mean, I think there are some rules that you
19 could come up with there that would be relatively
20 straightforward. And, similarly, I think in terms of
21 accreditation, without creating a new Department of
22 Labor system that has its own accreditation for

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1 appraisers, which would be way too complicated
2 probably, I don't think you'd want to do it, there's a
3 lot out there in terms of USPAP, the AICPA; there's a
4 lot of standards to look to. I think you could just
5 borrow those and graft them into the adequate
6 consideration regulations to create a standard for
7 accreditation.

8 Okay. I'm going to stop. Thank you very
9 much. I apologize for going over my time.

10 MR. DAVIS: Ms. Carlisle.

11 MS. CARLISLE: Good morning. My name is
12 Linda Carlisle. I'm a partner at White and Case and
13 have served as general counsel of the Employee-Owned S-
14 Corporations of America or ESCA since its creation.

15 ESCA is the national voice for S-corporations
16 owned by ESOPs or Employee Stock Ownership Plans.
17 ESCA's members include privately held ESOP-owned S-
18 corporations and many professional firms that deal with
19 the ESOP community.

20 ESCA, its member companies and their tens of
21 thousands of employee owners appreciate the opportunity
22 to speak with you this morning about these proposed

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1 regulations that would expand the types of advice and
2 recommendations that constitute rendering investment
3 advice for purposes of the definition of a fiduciary
4 under ERISA.

5 In particular, the proposed regulation would
6 make the provision of an appraisal or a fairness
7 opinion to an ESOP concerning the value of securities
8 or other properties investment advice with the result
9 that the duties and liabilities of an ERISA fiduciary
10 would be imposed on such person providing the appraisal
11 or a fairness opinion.

12 As you know, ESOPs are required under 4975 of
13 the Internal Revenue Code, to be designed primarily to
14 invest in employer securities. Section 401(a)(28) of
15 the Internal Revenue Code requires an ESOP to provide -
16 - to obtain a valuation of such employer securities at
17 least annually.

18 In addition, 4975 of the Code and 408(e) of
19 ERISA provide that an ESOP may not purchase employer
20 securities for more than adequate consideration, i.e.,
21 the fair market value of the employee securities as
22 determined in good faith by the ESOP trustee or named

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1 fiduciary.

2 Since S-corporation stock is by definition
3 not publicly traded, the ESOP trustee or the named ESOP
4 fiduciary with respect to the ESOP, cannot rely on
5 market prices or public quotations to determine the
6 fair market value of the stock. Accordingly, such ESOP
7 trustee or ERISA fiduciary generally engages an expert
8 appraiser to give advice regarding the fair market
9 value of the employer securities.

10 ESCA members, therefore, have a keen interest
11 in the effects that the proposed regulation would have
12 on the advisers who provide these annual appraisals to
13 their S-corporation ESOPs.

14 As background, section 3(21)(a)(ii) of ERISA,
15 as you all know, defines a fiduciary with respect to an
16 employee benefit plan to include, "any person that
17 renders investment advice for a fee or other
18 compensation with respect to any monies or properties
19 of such plan or has authority or responsibility to do
20 so."

21 Regulations issued by the Department of Labor
22 in 1975 further defined the circumstances under which a

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1 person is considered to render investment advice to an
2 employee benefit plan within the meaning of ERISA.

3 Under the regulation, a person that does not
4 have discretionary authority or control with respect to
5 the purchase or sale of securities or other property,
6 does not have discretionary control, would not be
7 considered to be rendering investment advice -- or
8 would be considered to be rendering investment advice,
9 rather, only if the five following conditions are met:

10 Such person renders investment advice as to
11 the value of the securities; such advice is rendered on
12 a regular basis; such advice is rendered pursuant to a
13 mutual understanding; such mutual arrangement will
14 serve as the primary basis for acquiring the stock; and
15 such mutual arrangement or understanding will be
16 individualized based upon the particular needs of the
17 plan.

18 Shortly after 1975, the Department of Labor
19 addressed specifically the appraisal duties of a
20 privately-owned S-corporation -- not S-corporation but
21 ESOP company and issued an advisory opinion, which
22 concluded that the valuation of closely held employer

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1 securities to be purchased by an ESOP, did not involve
2 an opinion as to the relative merits of purchasing
3 securities, but that would be relied upon and would not
4 constitute investment advice.

5 That has been the law since 1976. Thus,
6 pursuant to this advisory opinion, the DOL specifically
7 considered whether a person who provides an ESOP with a
8 valuation opinion with respect to closely held employer
9 securities should be considered to be a fiduciary and
10 determined that it should not.

11 The Department of Labor in the proposed
12 regulations has stated in the Preamble why you think it
13 is appropriate now to change the law that has existed
14 for a couple of decades. The Preamble notes that a
15 common ERISA violation is found to be in their -- in
16 your enforcement initiative with respect to ESOPs'
17 incorrect valuations of employer securities. And these
18 cases include instances in which planned fiduciaries
19 have reasonably relied on faulty valuations prepared by
20 professional appraisers.

21 The Preamble states that the Department of
22 Labor believes that broadening the definition of

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1 investment advice to include appraisals and fairness
2 opinions may directly or indirectly address these
3 enforcement issues and align the duties of such
4 appraisals -- such appraisers with those of the plan
5 fiduciaries.

6 The proposed regulations would expand the
7 types of advice and recommendations that result in
8 fiduciary status to include the provision of an
9 appraiser for a fairness opinion.

10 This change would supercede the DOL's 1976
11 advisery opinion, thus fiduciary status would be
12 imposed on all persons who provide an ESOP with an
13 appraisal for the purchase of employer securities or
14 with respect to its required annual valuation.

15 ESCA is concerned about the proposed
16 regulation because it would in -- it results in a major
17 expansion of the legal liability and increased costs of
18 insurance for appraisers.

19 ESCA understands that for many top-tier
20 appraisal firms, ESOP appraisals are not a major
21 portion of the firm's business.

22 ESCA's concerned that such established and

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1 well-respected appraisal firms will choose to
2 discontinue their ESOP appraisal work rather than face
3 the additional legal exposure and insurance costs that
4 come with fiduciary obligations. Removing the most
5 experienced and competent ESOP appraisers for the ESOP
6 appraisal market will force many ESOPs to use smaller
7 and less experienced appraisers who may not be able to
8 provide superior service and necessary ESOP expertise.

9 In addition, increased insurance costs that
10 ESOP appraisers will incur will be passed on to the
11 ESOP.

12 ESCA's concerned that such increased costs
13 will diminish the retirement savings of the S-
14 corporation ESOP participants and may discourage the
15 formation of S-corporation ESOPs.

16 Thus, ESCA's concerned that expanding the
17 definition will not improve the quality of appraisals
18 but rather will have the perverse effect of reducing
19 the number of competent appraisers available to make
20 such valuations and would significantly increase ESOPs'
21 cost of obtaining the necessary advice.

22 Comments with respect to the proposed

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1 regulations have suggested alternative approaches to
2 the problem. ESCA has not endorsed any specific
3 alternative approach but urges the Department of Labor
4 to consider alternative means of ensuring correct
5 valuations. Among the alternatives suggested and other
6 comments it is that regulations provide more specific
7 guidance to ESOP fiduciaries regarding their duties to
8 correctly value employer securities.

9 The DOL proposed regulations issued in 1988
10 that remain in proposed form set forth guidance
11 regarding how ESOP fiduciaries should determine fair
12 market value of closely held employer securities to
13 ensure that such valuations are good faith
14 determinations of fair market value.

15 The Department of Labor, however, has never
16 finalized those regulations and guidance issued by the
17 Department of Labor in final regulations at this time
18 need not be limited to the guidance in the '88 regs and
19 could provide specific guidance regarding the necessary
20 expertise, training or experience providing valuation
21 opinions to an ESOP.

22 My last sentence. It has been 35 years since

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1 the Department of Labor first issued the regulations
2 that govern the types of investment advice
3 relationships that give rise to fiduciary duties. Given
4 the potential problems raised by the proposed
5 regulations with respect to privately owned ESOP
6 companies, ESCA respectfully requests that the
7 Department of Labor not adopt the proposed regulation
8 until it has thoroughly considered other ways to ensure
9 that ESOP-owned S-corporations receive reliable
10 appraisals.

11 Thank you for your time.

12 MR. DAVIS: Thank you, Ms. Carlisle.

13 Mr. Reilly.

14 MR. REILLY: Good morning. Good morning, my
15 name is Robert Reilly. And let me commit that I will
16 not take all ten minutes to read my statement.

17 MS. CARLISLE: I only took thirty seconds
18 more.

19 MR. REILLY: It's like the Academy Awards.

20 When I'm not volunteering for the AICPA, I do
21 work for a valuation firm. In fact, I've worked in the
22 valuation profession since 1976. I performed my first

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1 valuation of an ESOP-sponsored company in 1981, so I've
2 been performing such valuations for 30 years. And over
3 that 30-year period, I've performed hundreds of
4 valuations of employee benefit plan sponsored
5 companies. I'm involved in dozens of such valuations
6 each year and I've testified on numerous occasions in
7 Federal court with regard to the quality of ESOP-
8 related sponsored company valuations.

9 And I was asked to say that by the AICPA just
10 to give my reason for being the member of the committee
11 who was asked to be here today. But today I am here
12 representing the American Institute of Certified Public
13 Accountants or the AICPA, and specifically the Forensic
14 and Valuation Services Executive Committee, the FVSEC.

15 Thank you for the opportunity to present our
16 views on the Department's proposed rule that redefines
17 the circumstances under which a person is considered to
18 be a fiduciary under ERISA by reasons of providing
19 advice to the employee benefit plan or to a plan
20 participant.

21 The proposal specifically includes the
22 preparation of appraisals in connection with plan

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1 transactions related to the value of securities or
2 other property.

3 The AICPA is the national professional
4 membership association of over 360,000 certified public
5 accountants. The AICPA has a forensic and valuation
6 services section for CPAs that perform business
7 valuation services and the AICPA administers the
8 Accredited in Business Valuation or ABV credentialed
9 program.

10 ABV credential holders must hold a valid CPA
11 certificate, pass a rigorous examination, have a
12 significant amount of business valuation experience and
13 maintain continuing professional education
14 requirements.

15 ABV credential holders are committed to
16 continuously improving their valuation skills and
17 expertise resulting in increased professional
18 competency.

19 Many CPAs perform business valuation
20 services. Many of these CPAs regularly value the stock
21 of employer corporations that sponsor an employee stock
22 ownership plan, an ESOP, or other employee benefit

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1 plan. These employer stock evaluations are typically
2 performed for transaction, taxation or plan
3 administration purposes.

4 We commend the Department on its concern and
5 diligence relating to the quality of employee benefit
6 plan sponsor company valuations. The issue of the
7 quality of sponsor company valuations is real and it
8 affects plan participants. Substandard valuations of
9 the sponsor company may cause the associated benefit
10 plan to make an incorrect investment decision if the
11 sponsor company stock was improperly valued at the time
12 that the benefit plan purchases the employer
13 securities.

14 If the employer stock valuation is too high,
15 then the plan participants would earn a decreased rate
16 of return on their investment.

17 We firmly believe, however, that treating the
18 sponsor company valuation analyst as a plan fiduciary
19 is exactly the wrong way to address this issue. In
20 fact, defining the valuation analyst as a fiduciary
21 will be disadvantageous to benefit plan participants
22 for several reasons.

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1 Let me take a few minutes to summarize our
2 concerns as discussed in our comment letter, then I
3 will spend the remainder of my time discussing what we
4 believe is the appropriate and cost-effective solution
5 to the problem of substandard valuations.

6 As stated in our formal comment letter to the
7 Department, we have four significant concerns
8 with the proposed change:

9 One, the proposed change, the definition is
10 incompatible with the Internal Revenue Service
11 regulations for an independent appraisal of employer
12 securities.

13 Two, the proposed change does not address the
14 underlying issue of proper qualifications and
15 professional standards for performing valuation
16 services.

17 Three, the proposed change will increase the
18 cost of valuation services for ESOP and other benefit
19 plans and,

20 Four, the proposed change will restrict the number of
21 valuation specialists willing to perform sponsor
22 company valuations for ESOP and other benefit plans.

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1 First, the conflict with the IRS requirements
2 for independence is a real and significant issue. As a
3 fiduciary, a valuation analyst would have to perform
4 the valuation in a manner that is in the best interest
5 of the plan participants; whereas, the IRS requirements
6 require the valuations be performed such that the value
7 is the most correct value without regard to the impact
8 of that value on the end user.

9 Second, holding valuation preparers to the
10 standard of a fiduciary would open the door to
11 increased litigation, which in turn significantly
12 increases the cost of insurance for valuation analysts
13 if they can get such insurance at all.

14 Third, many of the most reputable and well-
15 established firms would likely stop offering valuation
16 services for employee benefit plans due to the
17 increased risk driving the very professionals who are
18 best suited to prepare such valuations away from this
19 work.

20 And, fourth, for firms that continue to offer
21 these valuation services, the increased cost would be
22 passed on to the plan participants through higher plan

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1 administration costs or decreased earnings of the
2 sponsor company.

3 So what is the solution? The sponsor company
4 appraisals should be performed by a qualified
5 individual in accordance with valuation standards. We
6 believe a qualified appraiser should have proper
7 credentials that demonstrate the individual has the
8 education and experience to perform sponsor company
9 stock valuations.

10 We recommend that the Department require all
11 sponsor company valuations to be performed by
12 professionally credentialed valuation analysts. Those
13 valuation analysts would be required to prepare the
14 valuation in compliance with generally accepted
15 business valuation standards similar to those standards
16 encompassed by Internal Revenue Code section
17 170(f) (11) (e) related to qualified appraisers.

18 Those standards include minimum education,
19 experience, and licensure or certification
20 requirements.

21 We recommend that the Department establish
22 similar minimum qualification requirements for employer

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1 stock valuations. If the Department would require
2 similar requirements for the preparation of valuations
3 for employer benefit plans, then the risk of a plan
4 receiving a low quality appraisal would be
5 substantially mitigated.

6 The AICPA issued Statement on Standards for
7 Valuation Services No. 1 or SSVS-1 in June of 2007.
8 SSVS-1 established standards for AICPA members who are
9 ownership engaged to estimate the value of a business,
10 business interest, security or intangible asset.

11 Since SSVS-1 was issued, all other domestic
12 valuation organizations have changed their valuation
13 standards so they are professionally equivalent. These

14 SSVS-1 standards outline minimum requirements
15 for:

16 One, the development of an opinion of value;
17 and two, the reporting of that opinion.

18 We believe the AICPA professional credentials
19 and professional standards meet the current valuation
20 and analyst requirements of the Internal Revenue Code.
21 In contrast, the definition of the sponsor company
22 valuation analyst as a fiduciary is fundamentally in

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1 conflict with the independence requirements for
2 valuation analysts as presented in the Internal Revenue
3 Code.

4 Again, thank you for your time and interest
5 today. I would be happy to answer any questions.

6 MS. BORZI: Okay. Let me start with this
7 last point that you made because it -- every time I've
8 seen it throughout the comments and I -- I just don't
9 get it, how the Code standard that you have to provide
10 the most -- the independent standard and the most
11 correct standard is fundamentally incompatible with the
12 fiduciary standard.

13 In the fiduciary -- the fact that you perform
14 activities in the best interest of participant and
15 beneficiaries doesn't mean you put your finger on the
16 scale in their favor. Both of these standards ask the
17 person doing the valuation to do -- to provide the most
18 correct, in the words of the Code, valuation.

19 I just -- please help me, because I don't
20 seem to be able to reconcile the fact that you all have
21 -- that you have said here and many of the commenters
22 have said in their comments that these are

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1 irreconcilable standards and I really don't get it. So
2 could you help me out here?

3 MR. REILLY: Sure. Let me answer first and
4 the other panelists may want to answer as well.

5 I would agree if valuation was a science like
6 measuring chemicals in a laboratory or even something
7 as simple as telling time where you could look at a
8 watch and everyone in this room could agree that that
9 number is 29 minutes right now.

10 Then, there should be no difference between
11 being a fiduciary and being independent. I personally
12 believe, and I believe the AICPA would -- I'm saying
13 this for the AICPA as well. The problem is is a lot of
14 judgment in evaluation. There is always a reasonable
15 range within all approaches that we use, within all
16 methods that we use, within all the procedures, within
17 methods, within approaches.

18 If I'm totally independent I want to go right
19 down the middle, and if anything be maybe slightly
20 conservative with regard to the valuation. But really,
21 I want to go right down the middle every time a
22 judgment has to be called in selecting procedures,

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1 methods and approaches or -- and the other way around,
2 approaches first, methods and procedures and in
3 quantifying the valuation variables that go into each
4 of these.

5 If I'm a fiduciary, however, I can't ignore
6 that within my reasonable range; that would be
7 professionally supportable and I'd be willing to
8 testify to, would be absolutely professionally
9 supportable if I know it's in the best interest of my
10 client to have a range -- to have a conclusion that's
11 slightly to the right of center or slightly to the left
12 of center. And I could just as easily justify right as
13 left, frankly, I'm going to select right.

14 MS. BORZI: But that's not -- that -- I guess
15 I still don't understand because, again, the fiduciary
16 standard as interpreted by the Department and by the
17 courts is not that you ignore everything else and
18 single-mindedly put your finger on the scale so you do
19 -- I mean, so that you do the best interest of the
20 participants.

21 If that was -- if that were true, there
22 wouldn't be any instance in which you could actually

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1 fairly balance the interest of the participants and the
2 other people involved and that's not the way the
3 fiduciary rules work.

4 I really, honestly do not see the
5 incompatibility here. Do you have to be careful? Yeah.
6 But, you know, that's what the fiduciary standard
7 demands of everybody that they be careful. So, you
8 know, anyway, I don't see this argument and --

9 MR. REILLY: I see what you're saying, ma'am,
10 but I --

11 MS. BORZI: I mean, I can see why you're
12 afraid but that's what every -- every fiduciary, the
13 point of the fiduciary rules is that you have to be
14 careful.

15 MR. REILLY: I agree. And let me say this. I
16 don't believe -- again, we all have our own personal
17 opinion. I don't believe it's putting your finger on
18 the scale. I believe the scale has --

19 MS. BORZI: I don't either. I think that's
20 what the fiduciary rules say you can't do.

21 MR. REILLY: But I don't think that's what
22 I'm suggesting.

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1 MS. BORZI: Yeah.

2 MR. REILLY: I'm suggesting that the
3 valuation scale says anything between 10 pounds and 11
4 pounds is equally legitimate.

5 MS. BORZI: And I don't think anybody,
6 certainly nobody here at the Department is going to
7 waste resources going after somebody who gives a
8 valuation that's within the reasonable range.

9 But if you look at the reported cases, one of
10 my criticisms of the Department when I was in the
11 private sector is they only took the safe cases. They
12 only took the cases in which no reasonable person in
13 America could think, like the case you cited, that that
14 person gave an evaluation that was consistent with
15 anything, professional standards or not.

16 So I don't think that the record that the
17 Department has shows that it's going to go after people
18 who make valuations when there's a reasonable range.

19 But I want to move on to another question
20 because I don't want to take all the time.

21 The other thing that I noticed about all
22 three of you is that you seem to assume that if the

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1 valuator -- if the person making the valuation comes
2 from a large well-respected entity that somehow the
3 quality of all those valuations is without reproach.

4 And, similarly, you make the point that the
5 most important thing is credentials, you know, how well
6 credentialed people are. Well, again, if you look back
7 at the cases that have been reported and the
8 investigations that the Department has done, what you
9 see is improper valuations are not limited to the small
10 fly-by-night valuation companies. Some of the people
11 that the Department has sued are large well-respected
12 firms. And I don't want to cast dispersion on the firm
13 or firms but I don't -- I don't understand your
14 assumption that because somebody works at a large firm
15 that therefore, they are beyond reproach.

16 MS. CARLISLE: Do you want to do that first
17 or --

18 MS. BORZI: So can you --

19 MS. CARLISLE: I'll be happy to. And, first
20 off, we did -- I did not mean to imply that large firm
21 versus small firm means good versus evil. What I did
22 mean to suggest is that in a large firm that has a big

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1 valuation practice if a small portion of that practice
2 is geared towards ESOP valuations that firm, which by
3 definition has a large client base, has large -- a
4 large number of employees in the profession, will shy
5 away, may shy away, from doing ESOP appraisals in the
6 future. Okay.

7 I am saying that that firm may, as Robert
8 said a few moments ago, have people that are well
9 versed in determining the appropriate range of
10 appraisals just because they do it for a lot of people.
11 Does that mean that a small firm can't do that? Of
12 course, not. Okay. I as well as you know many
13 excellent professionals in small firms and large firms.
14 It wasn't generalization but it was meant to point out
15 that we are afraid that we will lose that pocket of
16 expertise. Not the only pocket but that pocket of
17 expertise that resides in the big firms.

18 Did that help?

19 MS. BORZI: And finally, I have a request for
20 all three of you, because all three of you mentioned in
21 some way that an alternative you would suggest that the
22 Department pursue is to look -- look to revitalize, if

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1 you will, or re-examine the adequate consideration
2 proposed reg.

3 So here's my request. If you could submit
4 for the record some suggestions that you would have of
5 very specific things that given what the proposed
6 regulation was that you think might be helpful if we
7 were to re-examine that to add to that regulation to
8 solve these problems. So that would just be my
9 request.

10 And thank you very much for your testimony.

11 MR. GOLDBERG: You know what, one thing I
12 would add on the big versus little.

13 MS. BORZI: Sure.

14 MR. GOLDBERG: I would agree with the comment
15 that I also did not mean to imply you guys have an easy
16 of just drawing a line --

17 MS. BORZI: And because some of the people we
18 have sued have --

19 MR. GOLDBERG: -- small is bad is good.

20 MS. BORZI: -- a million credentials.

21 MS. CARLISLE: I agree.

22 MS. BORZI: The highest credentials that

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1 would be. And that that -- that isn't sufficient is
2 what I'm suggesting.

3 MR. GOLDBERG: Yeah, one thing that I think
4 the Association wanted to point out is what gets lost,
5 I think, in the community if those firms stop doing
6 ESOPs it's because they are engaged in lots of
7 different kinds of financial advisory services, that I
8 think just add to the knowledge pie of this world of
9 the ESOP community, I think, removing those investment
10 bankers and capital markets people out of the ESOP
11 advisory community is just kind of a loss to the
12 knowledge base.

13 MS. BORZI: I hear you.

14 MS. CARLISLE: Yes.

15 MR. REILLY: And that was the same -- I don't
16 mean to -- but I think this would be of interest to
17 everyone on the panel if I may. I think that's -- the
18 small versus large is not a quality it's how much can
19 you afford? If you work for a small firm and I'd have
20 to say, my firm is a small firm, so I don't want to say
21 that's low quality. We can --

22 MS. BORZI: But I know some expensive small

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1 firms.

2 MR. REILLY: But not only -- well, I think we
3 are an expensive small firm.

4 But the question is: Can a small firm afford
5 the cost of insurance to be a fiduciary? A large firm
6 may be able to, they have hundreds of millions of
7 dollars of revenue a year. A small firm may not simply
8 be able to afford the cost of the insurance.

9 And with regard to credentials versus
10 standards, and this is something -- and I'm saying this
11 as a CPA and I know the AICPA staff members will
12 probably throw tomatoes at me when I say this, but it's
13 not a credentials issue in my opinion. It's not the
14 letters after your name. The only thing you get with
15 the letters after your name is the requirement to
16 comply with standards. Anyone who complies with
17 standards, whether they're AICPA or ASA or IBA or
18 USPAP, if you had a rule that the valuation analyst
19 should comply with one or more of these standards I
20 think that solves the problems. The only thing the
21 initials buy you is if I'm a CPA I have to comply with
22 those standards. I'm also an ASA, I have to comply

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1 with those standards. I'm also a CBA, so I have to
2 comply with the Institute of Business Appraiser
3 standards because I'm required to.

4 Someone who doesn't have those initials but
5 still complies with the standards, you get the same
6 quality.

7 MS. BORZI: I mean, as you know, we do a lot
8 of work with the AICPA and the discussion for another
9 day is of what real teeth -- what real teeth these have
10 -- these standards have, what kind of enforcement.
11 That's not the issue today.

12 So let me just turn it over to Michael.

13 MR. DAVIS: Yeah, and I wanted to ask about
14 this cost issue, the fiduciary insurance issue which
15 you just brought up, Mr. Reilly. And I would ask this
16 of all the panel.

17 You all testified that you're concerned about
18 the availability of fiduciary insurance, the cost of
19 that insurance. Can you be more specific? I think,
20 Mr. Goldberg, you said you don't have that data with
21 you but you could send it forward maybe for the record.

22 But if you guys could give us a better sense

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1 of now, who are the providers? How much does it cost?
2 How is it priced? Is there really an issue with
3 capacity in the marketplace today and are you concerned
4 that if this reg goes forward as proposed, that there
5 wouldn't be adequate capacity to really cover the
6 entirety of the marketplace? Can you be more specific?

7 MR. REILLY: I don't have the numbers, but I
8 could provide them as well.

9 I can say this from my own personal
10 experience. The company I work for is called
11 Willamette Management Associates. It's a funny
12 sounding name, but many years ago, Willamette valuation
13 -- Willamette Management Associates was a registered
14 investment adviser where in addition to performing
15 valuation services, we actually gave investment advice.
16 We couldn't afford to continue doing that. The
17 insurance was just too expensive.

18 As a regional firm, we only have three
19 offices, as a small, small firm, we simply couldn't
20 afford to continue operating, giving investment advice
21 because we needed to have the fiduciary insurance to be
22 a registered investment adviser. We just had to drop

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1 that line of business and focus entirely on business
2 valuation services.

3 Every year, the cost was expensive. And that
4 was the decision we made 20 years ago. Now, I've got
5 to believe the cost of insurance is a lot higher today
6 than it was then.

7 We could all find, I'm sure, current price
8 quotes for you but it was a very expensive proposition
9 for us.

10 MR. GOLDBERG: I would just add, again, I
11 don't have the numbers but I think just to benchmark it
12 a little bit, when I see clients buying fiduciary
13 liability insurance for their company and their
14 transactions, the premiums they're paying on an annual
15 basis probably look like -- they're probably actually
16 somewhat similar to the cost of getting an appraisal
17 done if not a little bit more than larger companies.

18 So if a company is spending \$20,000 to get an
19 appraisal done it wouldn't surprise me to find that the
20 insurance premium that company's paying for fiduciary
21 liability insurance right now is on the order of 20 to
22 \$40,000 as a premium. So it's not a perfect example

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1 but if you graft it on the fiduciary exposure, the
2 insurance company's taking in that policy and saying
3 I'm going to provide this to an appraisal firm, you
4 know, that might be a benchmark to look at.

5 But I do think that, you know, the appraisal
6 community perhaps can come up with better data to give
7 you on it.

8 MR. DAVIS: And is that fiduciary insurance
9 provider marketplace a fairly diffuse set of providers
10 or is it just a few who sort of dominate the market and
11 sort of have a lot of control over --

12 MR. GOLDBERG: Few who dominate the market.

13 MR. DAVIS: Is that right?

14 MR. GOLDBERG: I would -- would you --

15 MR. REILLY: That was exactly our experience.

16 MS. CARLISLE: Yeah.

17 MR. REILLY: We went through an insurance
18 broker and we received a quote from two or three
19 companies every year and we understood that was
20 basically -- those were the players.

21 MS. CARLISLE: But I understand you're asking
22 for more than anecdotal?

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1 MR. DAVIS: Right.

2 MS. CARLISLE: If we can provide it.

3 MR. DAVIS: That would be great.

4 MS. CARLISLE: Yeah, and we -- all I can give
5 you is anecdotal and we'll see what we can do to
6 provide you with.

7 MR. DAVIS: That would be great.

8 And, Mr. Goldberg, I just had a question. I'm
9 just really excited that the Association's testifying.
10 But I did want to understand better the Association
11 itself.

12 It represents both corporations and there's a
13 second there professional membership for service
14 providers?

15 MR. GOLDBERG: Right.

16 MR. DAVIS: Are there circumstances that may
17 land differently for those two classes of groups that -
18 - for which their interest may diverge?

19 MR. GOLDBERG: Between service providers and
20 companies?

21 MR. DAVIS: That's right.

22 MR. GOLDBERG: Sure. Yeah. I think that's

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1 right. I mean, the -- you know, the company members --
2 the organization is really -- I guess I would describe
3 it this way. The organization is really a company-
4 dominated organization. It exists for the benefit of
5 the companies that have ESOPs. And I can tell you as a
6 service provider our expectation is we're supposed to
7 donate lots of free time helping stock companies and
8 volunteer our services.

9 So I think -- but if you -- you know, if you
10 looked at the -- for example, the impact of this, I
11 mean, I think increasing the cost to ESOP companies of
12 having an ESOP might cause ESOP companies to either
13 abandon their ESOP or companies that don't have an ESOP
14 to not have one. That's an impact.

15 But on the service provider side, you know, I
16 think there are some service providers who may look at
17 this and say, you know, the best thing that could
18 happen here is you guys drive out of business three or
19 four of my biggest competitors and I'm a member of the
20 ESOP Association and that's probably not a bad outcome
21 for me from a business standpoint.

22 So, I think there could be some mixed, you

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1 know, interest among the service providers of the ESOP
2 Association. But really in giving our comments, I
3 think what's most constructive for you guys and what
4 we're trying to convey is really what the company
5 members who have employee ownership are looking at.

6 MR. DAVIS: That's great. Thank you so much.

7 MS. CARLISLE: Well, let me -- let me also
8 just mention, because ESCA also has service providers
9 and member companies.

10 ESCA is primarily though a member company
11 organization. So the comments are taking into account
12 the views of our advisers but it is truly focusing on
13 the impact to the S-corporation ESOP --

14 MR. DAVIS: Okay.

15 MS. CARLISLE: -- company.

16 MR. DAVIS: Thank you very much.

17 MS. CARLISLE: Thank you.

18 MR. LEBOWITZ: So it seems to me that we
19 have, I think, a consensus that there's a problem in
20 the -- with valuations in the context of ESOPs. We
21 certainly think there's a problem. And as someone who
22 has some responsibility for an enforcement program, you

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1 know, I kind of see that problem almost everyday.

2 And the frustrating part I think I can
3 represent from our point of view of our investigators
4 and our enforcement people is that what we see is that
5 the individual who who's at the center of the
6 transaction is essentially unreachable under the
7 current rules in any enforcement legal process.

8 And all that means is that everybody else has
9 more responsibility, more liability, but ultimately the
10 loss may fall on the participants themselves because we
11 can't reach the person who was really -- who, as I said
12 and I think you would agree, is at the center of the
13 transaction, the person whose expertise is essential to
14 a determination of how much the plan's going to pay for
15 these assets.

16 And, you know, I think any solution to the
17 problem has to be -- has to take that into account that
18 there's a -- it's a situation that cries out for some
19 kind of resolution. And I'm not sure that, you know,
20 as Phyllis was saying, adding requirements for
21 credentials in the absence of any kind of effective
22 mechanism for enforcing those credentials, we could put

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1 credentials in a regulation, but if there's no sanction
2 for not requiring -- for not meeting those standards,
3 what's the point?

4 We already have a situation in the auditing
5 area where a plan administrator is required to hire an
6 auditor to perform an audit on behalf of participants
7 and beneficiaries. If the auditor performs a sub-
8 standard audit who gets penalized? It's not the
9 auditor under our statute, it's the plan -- it's the
10 plan basically, it's the plan administrator. I don't
11 think we need another one -- another odd provision like
12 that.

13 So, I mean, that's -- those are more
14 observations than questions, I guess. But, let me ask
15 Mr. Reilly, tell me what the role of the plan's auditor
16 is in transaction -- in conducting an audit in the
17 context of an ESOP, and specifically, with regard to
18 the valuation. Does the auditor have any
19 responsibility for determining whether it's a
20 reasonable audit? I mean, what is the -- just what are
21 they supposed to do, because they're ultimately going
22 to issue an opinion?

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1 MR. REILLY: Surely. But, remember, there
2 are two really fundamentally different opinions.
3 There's the audit opinion prepared by the CPA and the
4 valuation opinion.

5 MR. LEBOWITZ: And I'm talking about the
6 auditor's opinion.

7 MR. REILLY: Okay.

8 MR. LEBOWITZ: And I'm talking about the
9 auditor's opinion. The auditor is going to render an
10 opinion for the plan.

11 MR. REILLY: Sure.

12 MR. LEBOWITZ: About the financial statements
13 that the plan has issued.

14 MR. REILLY: Surely. In that case, and
15 again, I'm a valuation guy. It's been over 30 years
16 since I was an audit guy for a few years. But the
17 auditors do have to comply with auditing standards. So
18 they do have to comply with the SAs, the Statements of
19 Auditing Standards in auditing any entity including an
20 employee benefit plan. And if there are valuation
21 aspects to the financial statements as their would be
22 in fair value accounting in certain corporations or in

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1 this case, the value of the employer securities, they
2 do have to comply with the SAS requirements for
3 performing due diligence procedures with regard to the
4 valuation.

5 That doesn't mean they recreate the
6 valuation, they don't --

7 MR. LEBOWITZ: Well, what does it mean?
8 That's my question, what does it mean? What -- just
9 what does the auditor pass -- does the auditor pass
10 judgment? Does the auditor have a responsibility to
11 say this looks -- this doesn't look right, I'm going to
12 issue -- I'm not going to issue an opinion or I'm going
13 to issue an adverse opinion or a qualified opinion?
14 Just -- I've never really understood this in all the
15 years I've been trying to figure out the role of -- you
16 know, just what the significance of an audit opinion
17 is.

18 MR. REILLY: Well, I'm going to have to pass,
19 because I personally have never performed an audit of a
20 pension plan or ESOP.

21 MR. LEBOWITZ: I would --

22 MR. REILLY: I can find out for you and get

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1 you a written answer.

2 MR. LEBOWITZ: Well, I see there are others
3 here from the AICPA, but I would -- I would ask that
4 the AICPA, for the record, give us their understanding
5 of what the auditor's role is in the context of an
6 ESOP, typical ESOP transaction and just -- and
7 specifically, with regard to the valuation that's
8 prepared.

9 MR. REILLY: I can answer though from the
10 other side, again, being participating in really a
11 couple of hundred valuations over the years. We
12 rarely, if ever, communicate with the auditors. We may
13 occasionally seek questions --

14 MR. LEBOWITZ: That doesn't surprise me,
15 frankly.

16 MS. BORZI: Therein lies the problem.

17 MR. LEBOWITZ: I think that's entirely
18 consistent with our sense of things that the auditors
19 really don't spend a lot of time assessing the quality
20 of the valuation. And -- but I -- I don't want to get
21 into an area that you're not in a position to --

22 MR. GOLDBERG: Can I just add a little bit of

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1 color to that. I do have an accounting degree,
2 although I'm not a licensed CPA.

3 So the accounting profession did come out
4 with guidelines that -- a while back that have caused
5 not only plan auditors but maybe more importantly, the
6 auditor of the company's financial statements to be
7 obligated to look at the ESOP valuation and test the
8 reasonableness of the ESOP valuation.

9 And I can tell you from experience, the AICPA
10 could comment better than I can. But our clients who
11 have -- I'm sorry, I'm speaking on behalf of ESOP
12 Association and these are our members. They -- you
13 know, their experience I think now is that they are
14 turning over their valuation reports to their auditors
15 of their companies' financial statements because
16 they're being required by AICPA to test the
17 reasonableness of that. And there have been instances
18 I know of that where there's been heated discussions
19 between the ESOP valuation firm and the companies'
20 auditors to really get to the assumptions being made
21 and the report and, you know.

22 So I would say, since I think this is, you

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1 know, a relatively recent development that is on the
2 company side, there's probably more that will develop
3 from this. But right now I think the start we're off
4 to is that accountants are looking very hard at these
5 ESOP valuations.

6 MR. REILLY: Well, I do know that's true. We
7 do have to submit either through the company or
8 directly to the audit firm, our valuations to the
9 accountants. It may be that we do a decent job because
10 we don't get a lot of questions back. But we do submit
11 our valuations to the accounting firm either directly
12 or through the --

13 MR. LEBOWITZ: Well, again, in the nature of
14 an observation, in each one of our cases in our
15 investigations there's an audit and even in the most
16 egregious situation some auditor has said this is --
17 didn't say anything about the quality of the valuation.

18 There are other problems that exist in our
19 statute in terms of being able to bring any effective
20 sanction against the auditor in that circumstance. But
21 the point I'm making is that there are auditors and we
22 do wonder what their -- what their role is in this. And

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1 they are supposed to be the -- a safeguard here and
2 it's hard to -- it's hard to know exactly how that
3 process is supposed to work.

4 The only other observations -- I'm making a
5 bunch of observations this morning. It did occur to me
6 yesterday actually listening to many of the witnesses
7 and then hearing you this morning, talking about the
8 possibility at least that people will decide if we do
9 what we've proposed to do. Valuation firms may decide
10 to withdraw from the ESOP market.

11 I've been around for a while and it -- I
12 don't know that I could count up -- there's a number
13 high enough of the times that I've heard various --
14 various parts of the employee benefit service provider
15 community say, "If you do this, we're not going to
16 provide services to plans anymore." I'm amazed that
17 there's anybody out there who provides any service to
18 any employee benefit plan, because we've actually done
19 some of those things and, yet, they're still there.
20 But, anyhow.

21 MR. GOLDBERG: I'll give you one example of
22 that, ESOP trustees. I do agree with your comment, but

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1 if you look at the marketplace for ESOP trustees today,
2 it's very different than it was several years ago. And
3 I think that a lot of firms that were in the business
4 got sued. And even when they won lawsuits, what they
5 found was the insurance costs and the costs of just
6 being in the business was just --

7 MR. LEBOWITZ: Well, let me -- I don't want
8 to --

9 MR. GOLDBERG: -- too high to make a profit.

10 MR. LEBOWITZ: -- take too long but let me
11 just -- do you think that might change if the person
12 who's at the center of this transaction, the valuator
13 might have some culpability, might share in the
14 liability for doing it -- for doing an improper
15 valuation?

16 MR. GOLDBERG: In that people won't sue the
17 trustee but they'll sue the fiduciary?

18 MS. CARLISLE: They'll sue everybody.

19 MR. LEBOWITZ: It could be somebody else.

20 MS. CARLISLE: They'll sue everybody. It's
21 joint and several liability.

22 But could I make some observations on your

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1 observations?

2 MR. LEBOWITZ: It's to share it a little more
3 equitably, don't you think?

4 MS. CARLISLE: One observation that you made
5 is that we all -- there is a consensus that there are
6 problems with ESOP valuations. I mean, I'm not sure
7 that that consensus is shared by the private sector.
8 Okay. To the extent we understand that there are
9 problems with the ESOP valuations, we will do
10 everything we can to address those, but I'm just noting
11 that I'm not sure that there is a private sector as
12 well as public sector consensus there.

13 When you say the center of it all is the
14 appraisal, the trustee or the ESOP fiduciary is the
15 person who has to accept the appraiser. Okay? Has to
16 get the appraisal. To me, they are at the center of
17 the transaction and they are definitely fiduciaries.

18 So those are just my -- oh, and with respect
19 to services, the other, I agree with you. The sky is
20 always falling and people are always leaving. But I am
21 -- but it is true that costs will go up and they will
22 impact the benefits to ESOP participants and that's

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1 what we are concerned about.

2 MR. HAUSER: Mr. Goldberg, based on your
3 experience in the industry, do you think that plan
4 fiduciaries generally when they seek an appraisal, are
5 looking for the most correct opinion as to value or do
6 you think they're slanted, they're looking for a
7 slanted opinion?

8 MR. GOLDBERG: Well, I'd say my short answer
9 is I think they're looking for the most correct --

10 MR. HAUSER: And do you think they breach
11 their fiduciary obligations by asking for the most
12 correct opinion?

13 MR. GOLDBERG: No. No, I don't.

14 MR. HAUSER: So do you think then that the
15 fiduciary duty of loyalty in the case of these
16 fiduciaries requires them to do anything other than get
17 the most accurate information about what the valuation
18 is so they can act in an informed manner?

19 MR. GOLDBERG: Yeah. Actually -- well, it
20 would, because I think once they've contracted to get
21 this valuation and they've seen the price or more often
22 a range of prices, I think the duty of loyalty really

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1 kicks in in terms of executing their fiduciary
2 responsibilities as a trustee to decide what do I do
3 with this work product? Am I doing benefit
4 distributions and taking into account a lot of factors
5 about the ongoing company and I'm looking at it through
6 that lens or a transaction.

7 So I guess I would say the loyalty -- I would
8 say is exercised by the trustee.

9 MR. HAUSER: I agree completely with that.
10 So, Mr. Reilly, when you're doing -- you've heard Mr.
11 Goldberg testify. I mean, don't you think that you're
12 not doing any favors to the fiduciaries if you slant
13 the opinion in any way? I mean, isn't the best thing
14 you can do for the plan and the fiduciary is just to
15 give an honest rendering of what you think the best
16 value is, including the best range of values and then
17 let them go execute on it?

18 MR. REILLY: Under the current definition of
19 a fiduciary where the valuation analyst is not the
20 fiduciary, I would agree with that entirely.

21 MR. HAUSER: No, but the guy asking you the
22 question and looking for the valuation, he is a

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1 fiduciary and I don't think he has any duty to look for
2 a slanted appraisal. So why would you have a duty to
3 slant the appraisal if you became the fiduciary?

4 MR. REILLY: Well, while he doesn't have a
5 duty to ask for a slanted appraisal and I'm not
6 suggesting that personally I want to give a slanted
7 appraisal --

8 MR. HAUSER: I don't think so.

9 MR. REILLY: -- he does have a duty to try to
10 get the lowest price if the ESOP is buying the stock
11 and to get the highest price if the ESOP is selling the
12 stock.

13 MR. HAUSER: Right. But that's his job in
14 executing the -- you know, doing the negotiations,
15 doing the transactional work on behalf of the ESOP. And
16 in actually executing his fiduciary responsibilities
17 isn't it best that he just know what your best estimate
18 of what the real value is so he can make sensible
19 decisions about what the right point to sell at and
20 what the right point to buy is?

21 MR. REILLY: Again, if he is a fiduciary and
22 I am not, I would agree. If we are both fiduciaries or

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1 I'm a fiduciary, now it's my obligation to help the
2 ESOP buy at the lowest price and sell at the highest
3 price.

4 So if I can otherwise present a range of
5 values but it's now time for the ESOP to sell out to a
6 corporate acquirer, let's say, I don't have to present
7 the entire range. I can present the top half of that
8 range. Now, that's still within my range but I am --
9 and I'm not saying that's again my finger is on the
10 scale, because I feel very comfortable with that range
11 but I'm trying to then as a fiduciary help my client,
12 the ESOP, sell its -- the employer's stock for the
13 highest price it can get when it wants to sell.

14 MR. HAUSER: Will that anxiety go away if we
15 make it clear in our regulation or in the Preamble that
16 that's just not your duty with respect to the plan even
17 if you're a fiduciary?

18 MR. REILLY: That would go a long way, yes,
19 sir.

20 MR. HAUSER: Okay. And I guess going to this
21 range point, most -- I've done a fair amount of ESOP
22 work and most of the valuations I've seen -- and

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1 valuation work. Most of the valuations I've seen
2 present a range. I mean, so it is -- when you're
3 talking about, you know, kind of where within the range
4 your price should be, are you suggesting that you would
5 actually give a different range depending on whose side
6 of the transaction you were or just at kind of the
7 strike point or what have you for the fiduciary, you
8 know, might be in a different point within that range?
9 Or what are you saying?

10 MR. REILLY: Well, again, if I was a trustee,
11 I'm not suggesting I would give a different range. The
12 range wouldn't go from \$8 a share -- let's say \$20 a
13 share to \$24 a share. I wouldn't move it then to \$26
14 to 30. If the range is 20 to 24, I may present 22 to
15 24. That's still within my reasonable range of values.
16 I'm not going outside the range, I'm not moving the
17 range over. I may be presenting the range that would
18 help my client buy at the low price and sell at the
19 high price as long as I'm still professionally
20 comfortable that I'm within my range.

21 MR. HAUSER: As you understand it, and really
22 for anyone on the panel, is there currently a set of

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1 non-ERISA state law or other obligations that, you
2 know, require that the valuation firm render its
3 opinion in accordance with professional standards that
4 they rendered impartially and that would give injured
5 parties a means of obtaining a remedy in the event that
6 you didn't meet those standards?

7 MR. REILLY: Well, I won't -- let me just
8 give my answer and then you'll get the legal answer
9 from the lawyers.

10 But I did mention that I have testified a
11 number of times in what I call and this isn't the
12 correct title, the "failed ESOP cases." And in those
13 cases, either what's happened is the ESOP participants
14 believed that they paid too much years down the road
15 and the plan itself sues a number parties, including
16 the valuation analyst. Or, in other cases, the selling
17 stockholders think that they received too little for
18 the sale of their stock and they sue the valuation
19 analyst and the charge there's not -- so I don't know
20 if you all could bring this suit, because it's not an
21 ERISA violation, it's a gross negligence violation.

22 You were simply negligent or grossly

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1 negligent. You recommended 20 to \$24. It really
2 should have been \$10 or it should have been \$30, but
3 I've testified either in defense of the valuation
4 analyst or as an expert witness against the valuation
5 analyst in probably a good handful of cases -- two
6 handfuls of cases related to these types of plan
7 participants as the plaintiff or selling shareholders
8 as the plaintiff where numerous parties could be the
9 defendant, the lawyers, the fiduciary, but the
10 valuation analyst is always named as a defendant in
11 those cases.

12 MR. HAUSER: But to what extent do your
13 clients think you're standing behind these valuations
14 and accountable for them? How clear are you about the
15 limit being gross negligence or negligence, or what
16 exactly is your sense of what your clients understand
17 your accountability to be for the valuations you render
18 under current law?

19 MR. REILLY: Well, I personally -- again,
20 this is not a legal opinion, so only as the valuation
21 analyst to the fiduciary, our client, or in some cases,
22 our client is a selling stockholder, you know, working

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1 that side of the transaction.

2 I believe our clients think we are
3 responsible for the valuation and we should be held
4 accountable for the valuation and if there's reasons to
5 think after the fact that they bought the stock for \$20
6 based on our valuation when the real value was \$30,
7 well, if they -- that would be the seller being --
8 complaining about that. But if they bought the stock
9 for \$20 when the real value was \$10, I would think that
10 we would be named.

11 In fact, there was a case when we were named.
12 We were a defendant in a case, it was dismissed but we
13 were named as a defendant in a case where an ESOP said
14 we paid too much because we relied on a Willamette
15 valuation and after a lot of discovery it was
16 dismissed. But we were named and we incurred a lot of
17 legal fees for a company our size, you know, a lot of
18 legal fees defending ourselves.

19 MR. HAUSER: Did you have an insurance
20 carrier for that?

21 MR. REILLY: We had an insurance carrier who
22 picked up a portion of the expense but we still had our

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1 own deductibles and other expenses I think didn't cover
2 it.

3 And we had to hire other valuation analysts
4 to come in and support our work and attorneys and go
5 through depositions and all of that.

6 MR. GOLDBERG: You know, if I can just add
7 one other thought to that, because I think maybe the
8 Association might disagree with one comment Robert
9 made.

10 In terms of --

11 MR. DAVIS: Could you speak into the mike?

12 MR. GOLDBERG: Yeah.

13 In terms of trying to define the scope of the
14 fiduciary, I think, you know, sitting here today, I
15 think a group of ERISA lawyers could try to draft a
16 definition very tightly of what this valuation
17 fiduciary is that attempts to address some of these
18 concerns.

19 But I think that what seems open-ended to me
20 at least, is that when you then toss that out to the
21 plaintiff's bar to litigate and figure, number one,
22 they're going to name appraisers as defendants in every

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1 lawsuit that gets filed. And, number two, that will
2 give the courts the chance to sort of shape what these
3 narrowly defined terms are.

4 I'm just afraid what will happen is I'm a
5 fiduciary, I've produced this report, people have gone
6 off and used it to do things and yet I have no ERISA
7 fiduciary responsibility apart from defending the
8 correctness of the report. I just think the
9 opportunity is there for courts to really put a lot
10 more at my doorstep as an ERISA fiduciary for things
11 the trustee has done with my report and the analysis
12 it's gotten.

13 You know, and fiduciary litigation can, you
14 know, go out of control as we've all seen.

15 MR. PIACENTINI: Good morning.

16 MS. BORZI: Good morning.

17 MR. PIACENTINI: So I think I heard, at least
18 from Mr. Reilly and maybe from others that there can be
19 a difference in different valuations in terms of where
20 you come out in the range. Pardon me. Where you bound
21 the range, because there is some judgment inherent in
22 any valuation and sort of depending on whose behalf

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1 you're working and so forth.

2 So, and we talked a little bit about -- you
3 know, had some debate, I guess, about how that might or
4 might not work if you're a fiduciary.

5 How does it work now? Where does the
6 valuation, you know, sort of move and because of, you
7 know, what -- because of on whose behalf you're
8 preparing it?

9 MR. REILLY: Well, let me answer it first as
10 the valuation guy. I would say right now without --
11 because we, or our fiduciaries, we can put the
12 valuation right down the middle of the road, put the
13 range right down the middle of the road whether I'm
14 working for the selling stockholder or whether I'm
15 working for the plan participants, whether it's a buy
16 side transaction or sell side transaction or just an
17 annual administrative allocation, I can put the range
18 right down the road and not have to worry about who I'm
19 working for because I don't have the obligation to help
20 my client get the best deal that they can get.

21 MR. PIACENTINI: And the client is the
22 trustee?

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1 MR. REILLY: If we're working for the -- ESOP
2 would be the trustee, yes, sir.

3 MR. PIACENTINI: And the trustee is sometimes
4 often or not the plan sponsor?

5 MR. REILLY: No. Well, it could be the --

6 MS. CARLISLE: It could be.

7 MR. REILLY: It could be an independent
8 trustee or it could be an employee directed -- it could
9 be an employee trustee.

10 MR. PIACENTINI: Are any of these answers
11 different in the case of a leveraged ESOP, sort of at
12 the beginning where there's this big transaction taking
13 place versus down the road in annual valuations?

14 MR. REILLY: From a valuation perspective, I
15 would say no.

16 MR. PIACENTINI: Okay.

17 MS. CARLISLE: Now, can I -- can I just --
18 I'm not an appraiser but I -- you know, I am a lawyer
19 that deals a lot with appraisals and my view has always
20 been valuation is an art, not a science as we've talked
21 about. There is always a range of appropriate answers
22 and fair market value will be within that range,

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1 between a willing buyer and a willing seller regardless
2 of what point in time the transaction is appraised or
3 values are determined.

4 MR. GOLDBERG: Yeah, I would just add quickly
5 if your question at the end there was the difference
6 between a transaction versus ongoing ESOP, I think one
7 difference would be when presented with a range of
8 values a trustee who's negotiating a new leverage
9 transaction would be able to use that range to try to
10 negotiate a deal of let's say the low end of the range,
11 but understand what room the trustee has in the
12 negotiations to try to get to a deal with a third party
13 who may be wanting to get the highest price they can
14 get for their shares. Whereas, in an ongoing ESOP
15 valuation, the consideration's still there, I think, in
16 terms of range, the appraiser still may report a range,
17 but now you get a trustee who's making decisions not
18 about acquiring shares or selling them as much as kind
19 of running the benefit distribution system of the plan
20 and the annual administration in where the trustee
21 feels the value should fall within that range for
22 administration.

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1 So I think those considerations are probably
2 different ones, more external dealing with a third
3 party transaction whereas the others are more internal.

4 MS. CARLISLE: Yeah, it's still -- you're
5 always concerned about in the annual appraisals what
6 are you allocating to your participants this year that
7 will impact the allocations to participants in
8 subsequent years, so you have to be extraordinarily
9 careful in all appraisal situations.

10 But this -- this whole concept of what is an
11 appraisal -- is the range going to change and the like?
12 Remember, an ESOP trustee is required to not pay more
13 than fair market value. I can certainly pay less,
14 okay? So that range does not preclude me from
15 negotiating a deal less than the range.

16 MR. PIACENTINI: Okay. Let me ask just one
17 other question. So in this general topic of ranges and
18 whether they vary or not, depending on who the client
19 is and so forth and how wide ranges might be sometimes,
20 there is some academic research in this area that's
21 come to my attention.

22 Let me cite just one example. I just want to

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1 see whether some of you have looked at some of this or
2 other research and whether you have a reaction.

3 So this is a 2002 Harvard study by Moore, et
4 al. And one of the findings of the study and one
5 experiment they carried out with 112 auditors, auditors
6 for buyers valued a deal at 12.3 million while auditors
7 for sellers valued it at 21.4 million. So that strikes
8 me as sort of a wider range than we've mostly talked
9 about except where we were talking about abuses.

10 So I wonder if there's any reaction to that.

11 MR. GOLDBERG: Well, I'm not familiar with
12 that study.

13 MS. CARLISLE: I'm not.

14 MR. GOLDBERG: But I think off the top of my
15 head, my reaction to that would be this is just buyers
16 and sellers out in the marketplace who have so many
17 different things --

18 MS. CARLISLE: It is.

19 MR. GOLDBERG: -- going on in terms of
20 strategic players in their industry versus not.

21 You know, what an ESOP appraiser's supposed
22 to do is figure out willing buyer, willing seller, the

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1 Revenue Rule 59-60 standard, which does narrow the road
2 a little bit.

3 You know, I think you'd find the range of
4 values when someone is -- when an appraiser is told
5 give me a valuation under 59-60 versus I've got a
6 friend here who wants to sell their company, let's talk
7 about a range of reasonable values out in the
8 marketplace.

9 MR. PIACENTINI: But in terms of the
10 credentials and the standards that you all said
11 applied, within the profession they'd be the same in
12 both circumstances or not?

13 MS. CARLISLE: Yes.

14 MR. GOLDBERG: The credentials?

15 MR. PIACENTINI: The credentials and --

16 MR. GOLDBERG: Yes.

17 MR. PIACENTINI: -- standards that apply
18 within the profession?

19 MR. GOLDBERG: Yeah, I think that would be
20 the same.

21 MR. PIACENTINI: Thank you.

22 MR. DAVIS: Thanks, Panel 8.

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1 Thank you very much.

2 MS. CARLISLE: Thank you.

3 MR. REILLY: Thank you, sir.

4 MR. DAVIS: Panel 9. We'll make an orderly
5 transition.

6 Panel 9 is Donna Walker with the American
7 Society of Appraisers, Larry R. Cook representing Larry
8 R. Cook Associates and Jeffrey Tarbell, representing
9 firms that provide valuations and fairness opinions.

10 You guys all set?

11 MS. WALKER: I think so.

12 MR. DAVIS: Okay. We'll start with Donna
13 Walker representing the American Society of Appraisers.

14 MS. WALKER: Good morning. Thank you.

15 The American Society of Appraisers
16 appreciates the opportunity to testify today at on
17 EBSA's proposed fiduciary rule, which would broaden
18 ERISA's definition of the term "fiduciary" to include
19 individuals who provide ESOP related appraisal
20 services.

21 My name is Donna Walker. And I'm testifying
22 on behalf of the ASA. By way of personal background,

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1 I'm an accredited senior appraiser credentialed by ASA
2 in business valuation and have been providing ESOP
3 related services since 1984. I'm a developer and
4 teacher of the ASA course on ESOP, valuing ESOP shares
5 and I'm all the past president of the ASA and a current
6 member of the Business Valuation Discipline Committee
7 of ASA.

8 The American Society of Appraisers submitted
9 some extensive written comments expressing our strong
10 opposition to the proposed rule. ASA is sincerely
11 interested in working with the Department to address
12 demonstrated patterns of weakness in the reliability
13 and independence of ESOP valuations and to explore the
14 most cost-effective way to strengthen the ESOP
15 valuation function.

16 We believe the current proposal is both
17 inappropriate and a counter-productive response to

18 EBSA's concerns. In our view, the proposed
19 appraiser as a fiduciary approach is inappropriate for
20 several reasons:

21 First, because it is totally unproven as a
22 method that is likely to enhance the quality of

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1 appraiser services.

2 Second, it is inconsistent with the appraiser
3 reform programs adopted through the rest of the
4 government by every federal agency with the
5 responsibility for administrating or regulating
6 valuation services, including the Internal Revenue
7 Service.

8 And, third, because it would force thousands
9 of professionally credentialed appraisers who provide
10 ESOP services, including those who adhere to the
11 Uniformed Standards of Professional Appraisal Practice
12 or as it's commonly referred to as USPAP, to violate
13 their ethical obligation to be independent of all
14 parties and interest involved in a transaction
15 including an ESOP appraisal.

16 It is also ASA's view that the proposed rule
17 is actually counter-productive not only to the general
18 public policy purposes of ESOPs, but also to the
19 specific interest of the very people the proposal is
20 supposed to protect, the employee/owners of ESOP plans
21 and the protection of those plan's assets.

22 The Rule as proposed, would impose

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1 significant financial burdens on the ESOP appraisers by
2 requiring them to purchase, in addition to standard E&O
3 insurance, special high cost E&O policies, which would
4 cover the enhanced liability for the liability risk of
5 the fiduciary status.

6 Moreover, the increased exposure to personal
7 liability that the proposed Rule creates will drive
8 many highly experienced ESOP appraisers out of this
9 practice area, thereby sharply reducing the pool of
10 qualified individuals available to value employee
11 plans.

12 In our opinion, the bottom line is that the
13 proposed Rule will increase the cost of ESOP valuations
14 and these costs will ultimately be borne by the
15 sponsors and employee beneficiary of those ESOP plans.

16 If imposing fiduciary status on appraisers
17 were the -- was the only way or even the best way to
18 improve both the independence and reliability of ESOP
19 appraisals, then the negative and disruptive results
20 discussed would perhaps be unavoidable. But the
21 appraiser as fiduciary approach is neither only the
22 best way to address the Department's concern -- it's

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1 neither the only best way to address your concerns but
2 indeed in our opinion, it will create many more
3 problems than it solves.

4 While the ASA does not doubt that faulty or
5 even abusive ESOP related appraisals occur on occasion,
6 the collective judgment of our most experienced members
7 in this area of appraisal practice is that problematic
8 appraisals are rare and that a pattern of such abuses
9 just does not exist.

10 But even if it did, there is a way to
11 strengthen ESOP valuations that is not only proven but
12 avoids the proposed Rule's two most negative effects,
13 which undermine -- is the undermining of the
14 independence of ESOP appraisers and the substantial
15 increase in cost in performing ESOP valuations.

16 We respectfully urge EBSA to adopt the
17 appraisal reform model being utilized successfully by
18 all other Federal agencies with important valuation
19 responsibilities. Specifically, reliance on
20 professionally credentialed appraisers who have
21 demonstrated valuation competency and who are legally
22 prohibited from self-dealing and who are fully

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1 accountable for the integrity of their work, either to
2 a state appraiser licensing board, in the case of real
3 estate appraisals or to a recognized professional
4 appraiser credentialing organization in the case of
5 business valuation appraisals.

6 An appraiser's failure to be independent to
7 adhere to generally accepted appraisal standards when
8 performing an appraisal can, and does, result in
9 imposition of sanctions, including in the most serious
10 cases, a loss of a license or a credential.

11 Importantly, Congress thought highly enough
12 of this type of appraisal reform model that we are
13 urging adoption of, that it was made part of the
14 Dodd/Frank Financial Reform and Consumer Protection Law
15 for the purposes of insuring the integrity of
16 appraisals in connection with mortgage loans and other
17 collateralized extensions of credit.

18 Also important, is that this same basic
19 appraisal reform model is in effect at the Internal
20 Revenue Service in connection with ensuring the
21 independence from a liability of valuations for a
22 variety of tax related purposes, including the billions

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1 of dollars annually in non-cash charitable
2 contributions.

3 We highlight this fact that the IRS utilizes
4 this model because of the mutual responsibility and
5 interest that EBSA and IRS share in assuring the ESOP
6 plans comply with Federal laws and properly safeguard
7 the assets of plan beneficiaries. This strong
8 mutuality of interest and responsibility extends to
9 ensuring the integrity and reliability of ESOP
10 valuations.

11 Indeed, in Chapter 12 of EBSA's enforcement
12 manual it discusses and describes the agreement between
13 the DOL and the IRS for the coordination of
14 investigations of employee benefit plans. Additionally,
15 one of the required elements of qualified

16 -- of qualified pension, profit sharing and
17 stock bonus plans under the Internal Revenue Code
18 involves the use of independent appraisers to value
19 plans and their assets. This relevant provision states
20 and I quote:

21 "A plan meets the requirements of this
22 subparagraph if all valuations of employer securities

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1 which are not readily traded on an established
2 securities market with respect to activities carried
3 out by the plan are by an independent appraiser.

4 For purposes of the preceding sentence, the
5 term 'independent appraiser' means any appraiser
6 meeting the requirements similar to the requirements of
7 the regulations prescribed under section 17(A)(1)."

8 IRS regulations and guidance pursuant to Code
9 section 170, established the particulars of who is a
10 qualified appraiser and what constitutes a qualified
11 appraisal in connection with the deductibility of non-
12 cash charitable contributions and for other certain
13 tax-related valuation purposes. Our February comment
14 letter discussed this in detail on Pages 3 and 4.

15 ASA's comment letter to DOL on the rulemaking
16 proposal noted, approvingly so, that DOL has proposed
17 but not yet adopted, regulations relating to prohibited
18 transaction exemptions whose valuation components move
19 in the direction of the IRS valuation requirements.

20 Given the closely aligned responsibility and
21 interest of both the DOL and the IRS, with respect to
22 ESOPs and ESOP enforcement actions, and given the

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1 migration of the proposed EBSA valuation requirements
2 for prohibited transaction exemptions in the direction
3 of those required by the IRS for many tax purposes, and
4 given the overall success of Federal agencies reliance
5 in professionally credentialed appraisers to value
6 tangible and intangible property in many of the most
7 important federally related transactions, we strongly
8 believe that the adoption of valuations requirements
9 similar to those adopted by the IRS for all ESOP
10 valuations is both logical and very desirable.

11 This concludes my testimony. I thank you for
12 your -- the time and I'll be ready to answer any
13 questions you might have.

14 MR. DAVIS: Thank you.

15 Mr. Cook.

16 MR. COOK: Yes. Thank you very much.

17 My name is Larry Cook. I am the owner of
18 Larry Cook and Associates, P.C. in Houston, Texas.
19 Thank you for allowing me to provide testimony today at
20 the Department of Labor Fiduciary Definition Hearing.

21 I can only hope that my testimony along with
22 many others opposing the proposed definition expansion

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1 of fiduciary to include appraisers will provide the
2 catalyst for reassessment and overcome this rule
3 change.

4 It is with strong conviction that I come to
5 Washington today compelled to respectfully oppose the
6 manner, the fiduciary definition rule seeks to
7 strengthen the reliability of ESOP valuations. In my
8 opinion, if this definition of fiduciary prevails, it
9 will spell the demise of small company ESOPs. It will
10 force a substantial number of qualified appraisers to
11 end their services to ESOPs.

12 I think it important that my testimony come
13 from my direct personal knowledge and experiences from
14 several career perspectives of which I've served for
15 the past 38 years.

16 I was out of college two years and an officer
17 of a small private construction company when ERISA
18 became law in 1974. As part of the cessation plans of
19 those -- of a sole shareholder of this company, I
20 researched, recommended and assisted in implementing a
21 new retirement plan called an ESOP.

22 At age 27, I became a beneficial stockholder

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1 of the company that I worked for through this employee
2 stock ownership plan. I served as a plan administrator
3 for the ESOP and a longstanding profit sharing plan.
4 When I left the company after about 11 years of
5 service, I was fully vested in both plans.

6 As a result of my activities with the ESOP, I
7 chose a career path as a business appraiser. Over the
8 next decades, I have worked with business owners and
9 management of private businesses in a variety of
10 successful engagements that include the implementation
11 of employee equity, incentives and ownership through
12 ESOPs.

13 For the past 28 years, I've provided business
14 appraisals for ESOPs. I have served several appraisal
15 organizations at the national, state and local level.
16 I've published a book, Financial Valuation of Employee
17 Stock Ownership Plan Shares. I've co-authored a
18 technical book of valuation -- Financial Valuations,
19 Applications and Model with James R. Hitchner and
20 others.

21 I believe in the detail and the ideals of
22 capitalism and that all employees can share in the

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1 opportunity to be enriched through a beneficial
2 ownership of equity in the very company in which they
3 work; in a system where a shareholder of a private
4 company has a mechanism of passing their equity shares
5 to employees for their retirement.

6 On numerous occasions, I've experienced the
7 incentivized power of a well-implemented and managed
8 ESOP. I've witnessed the overwhelming strength the
9 participant of an owner of the company has from a
10 janitor to an engineer. I have lived the American
11 Dream of company ownership and spent a career promoting
12 its benefits to others.

13 This is why I've traveled to D.C. today to
14 represent not only myself but the collective views of
15 the valuation members of the Financial Consulting
16 Group, the Loren D. Stark Company and a voice for many
17 companies' shareholders and employee participants in
18 hopes of providing a perspective that will assist in
19 the continuation of that aspiration of widespread
20 employee equity ownership.

21 In an attempt to minimize repetition and in
22 the interest of time, I hope to convey three

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1 straightforward points that this change and definition
2 brings from a plan, a participant, a sponsor, a
3 fiduciary and an appraiser's perspective.

4 Number one, risk. In the proposed rule
5 change context, the appraiser would be held personally
6 responsible for any damages incurred by a plan
7 participant as a result of a breach of duty.

8 As it stands today, without the proposed rule
9 change, I wonder what my responsibilities will actually
10 be. Will this duty extend to acts of management of the
11 company? Will corporate and participant transactions
12 entail a duty? What and how is control over the plan
13 assets extended to the appraiser? Will the appraiser
14 be held liable for actions of co-fiduciaries? Who
15 would bring an action against the appraiser in this
16 context? What actually is the statute of limitations
17 responsibility of the appraiser?

18 Looking back 30 years, I can't help but ask
19 myself if informed with a certainty of my person, and
20 profession being exposed to this level of risk and
21 liability as currently proposed in this definition
22 change, I would undoubtedly have chosen a different

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1 career path.

2 Number two, conflict of interest. The
3 appraiser in the context of the proposed rule change
4 will act solely on the behalf of participants and their
5 beneficiaries with undivided loyalty. In reflecting on
6 the proposal, I have asked myself these among others:

7 Will the duty of the appraiser be likened to
8 a power of attorney where decisions are to be made
9 solely on a principal's behalf? How will the appraiser
10 exercise discretion or control over the plan and the
11 administration of benefits to participants? How will
12 the appraisal satisfy the professional ethics and
13 standards of the appraisal societies with which they
14 are members, where this proposed definition change runs
15 in direct contradiction to those core standards?

16 How many -- how very different this is than
17 where appraisers practice today. And how the conflicts
18 of interest landscape will change should this proposed
19 definition rule be confirmed and allowed to stand.

20 I come back the same conclusion, this
21 proposal is incompatible with the results -- with the
22 realities of professional standards and the practice of

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1 financial valuations. Impartiality, objectivity and
2 independence collectively spell professional neutrality
3 and speak to those foundational standards that anchor
4 the appraisal profession for all of us.

5 The proposed rule will pose an uncompromising
6 risk and conflict of interest to appraisers and the
7 users of their services. Appraisers will no longer be
8 independent or impartial of all parties in interest
9 involving the transactions or annual valuations of
10 participant accounts; a sobering reality for us all to
11 be aware of.

12 Number three, cost. Why is it that
13 professional liability insurance is so specific to
14 exclude coverage of fiduciary responsibility and more
15 specifically, those related to ERISA? We know that the
16 cost of insurance will increase the cost of ESOP
17 valuation services. And any increase in cost to the
18 plan or the sponsor of the plan will negatively impact
19 the plan participants. In this proposed rule context,
20 appraisers will assess the potential cost of exposure
21 to expanded litigation environment.

22 Additionally, regardless of the appraiser's

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1 insurance coverage, or the merits of litigation filing,
2 the added risk factors will necessitate the appraiser's
3 consideration of exposure to deductibles, the energy
4 for furnishing documents and the disruption of services
5 to other engagements.

6 With widespread reasonably priced
7 professional liability coverage that extends to cover
8 the appraiser as a fiduciary, few professional
9 appraisers will assume the personal liability.
10 Additionally, and assuming an adequate liability
11 coverage is afforded, there remains the haunting cloud
12 of expanded litigation, defense of the appraiser's work
13 product, not to mention the proposal runs foul of all
14 independent standards.

15 The proposed rule will impose costly
16 unnecessary and unrealistic burdens to the appraiser
17 and the plans they serve.

18 As my friend in Houston with over 50 years
19 experience with thousands of ERISA plans, Don Stark of
20 the Loren D. Stark Company said, and I quote: "The
21 single largest expense to a small ESOP is the cost of
22 the appraisal. Should the Department of Labor

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1 fiduciary proposal prevail it would undeniably increase
2 the cost of an appraisal and that alone will signal the
3 end of the small ESOP."

4 Finally, painting a picture of the existing
5 climate of private business trends transitioning from
6 one generation to another, we are in the midst of a
7 baby boomers that closely held companies transacting
8 their equity ownership. The next eight years or so
9 will mark the most significant transitioning by
10 selling, gifting, contributing or liquidating non-
11 public company ownership perhaps in our country's
12 history. It is the time where the option of
13 transitioning private company equity to the next
14 generation can be made in whole or in part using an
15 ESOP as the transition of choice for those companies
16 that have a workforce and management to possess that
17 think like owners culture to do so.

18 Because of the level of personal liability
19 that will be imposed on appraisers, the significant
20 cost increase to the appraiser and further to the ESOP
21 and the conflict of interest posed under this proposed
22 rule I respectfully and vehemently disagree with the

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1 potential rule.

2 With my years of professional experience
3 involved in ESOPs and their valuation, it is my
4 professional and personal belief that this proposed
5 rule will nail -- will be a nail in the coffin for
6 small ESOPs.

7 I plead with the Department of Labor to
8 reconsider this proposal and against the best interest
9 of ESOPs and their participants.

10 That concludes my testimony. And, again, I
11 thank you for allowing me to be here today.

12 MR. DAVIS: Thank you so much.

13 Mr. Tarbell.

14 MR. TARBELL: Thank you.

15 Good morning. My name is Jeff Tarbell and
16 I'm a director with Houlihan Lokey and I have more than
17 20 years of experience rendering valuations and
18 fairness opinions related to employee stock ownership
19 plans or ESOPs.

20 I'm testifying on behalf of seven firms that
21 provide ESOP valuations and fairness opinions and these
22 firms are believed to be -- to have some of the largest

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1 and most active ESOP valuation practices in the
2 industry. In fact, the professionals in these
3 organizations are arguably the most experienced and
4 qualified professionals currently providing such
5 services.

6 As set forth in our comment letter, we have
7 serious concerns about the impact of the proposed
8 regulation on our professional responsibilities and on
9 the more than 10 million active and retired employees
10 who rely upon their company's ESOP for their retirement
11 security.

12 We strongly believe that ESOP valuation and
13 fairness opinion providers should continue to be
14 excluded from the definition of investment advice for
15 the following reasons:

16 First, we believe the longstanding rationale
17 for excluding ESOP valuation and fairness opinions
18 remains valid today. As the DOL noted in its 1976
19 advisery opinion, an ESOP valuation or fairness opinion
20 does not make a recommendation as to a particular
21 investment decision. It does not address the relative
22 merits of purchasing employer securities and it -- nor

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1 does the ESOP valuation or fairness opinion provider
2 have any decision-making authority over a trustee's
3 decision whether to purchase or sell the employer's
4 securities.

5 In other words, ESOP -- an ESOP valuation or
6 fairness opinion does not constitute investment advice.
7 And I would respectfully, strongly disagree with the
8 assertion made previously that the valuation provider
9 is the center of an ESOP transaction. That is the
10 trustee's job.

11 Consequently, we do not understand why
12 providers are singled out for fiduciary treatment when
13 control over the terms and conditions of an ESOP
14 transaction actually lie with other parties to the
15 transaction.

16 Second, we are not aware of evidence that can
17 -- conflicts of interest or incorrect or biased
18 valuations are a common problem in ESOP valuations and
19 fairness opinions. In fact, at the conclusion of my
20 remarks, we would appreciate if the panel would respond
21 to the question of whether such evidence exists and if
22 it does exist, we would ask the DOL to make the

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1 evidence publicly available in order to allow an
2 opportunity for public comment.

3 With respect to conflicts of interest, it's
4 my understanding that none of the seven firms for which
5 I speak perform ESOP valuations or fairness opinions
6 for contingent compensation and each firm's fee
7 arrangements are fully disclosed in their engagement
8 letters.

9 Third, we submit that the proposed regulation
10 is at odds with the impartiality and independent
11 requirements under professional standards of valuation
12 practice as well as the Internal Revenue Code.

13 Professional valuation associations such as
14 the ASA and the AICPA require their members to approach
15 and perform valuations with independence and
16 impartiality. Making a provider of ESOP valuations or
17 fairness opinions a fiduciary, does effectively make
18 them an advocate and partial to plan participants, and
19 it therefore, violates the ethical guidelines of these
20 associations as well as the fundamental principles of
21 independent appraisal.

22 In addition, as Ms. Walker explained more

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1 fully, under the Internal Revenue Code, valuation
2 providers are required to provide an independent
3 opinion of value. The IRS looks to generally accepted
4 appraisal standards to determine if a valuation has
5 been conducted impartially and independently including
6 the principles embodied in the Uniform Standards of
7 Professional Appraisal Practice. It is clear under
8 both the Internal Revenue Code and well-established
9 professional standards, that the role of the valuation
10 professional is not to advocate for a value or an
11 investment on behalf of anyone, instead to provide an
12 impartial and independent opinion of value.

13 And, again, I would strongly disagree with
14 the assertion made previously that the range of value
15 is dependent upon the client who hires you. Our task
16 is exactly contrary to that. Our task as an
17 independent valuation firm is to provide a range of
18 value independent of who hires us.

19 Fourth, we believe the proposed regulation
20 would have serious unintended adverse effects by
21 decreasing the service value to ESOP companies and plan
22 participants. If the proposed regulation is finalized

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1 in its current form, ESOP valuation opinion -- ESOP
2 valuation and fairness opinion providers will need to
3 purchase fiduciary insurance, incur ongoing legal fees
4 and expand their scope of non-valuation and fairness
5 opinion work. This will dramatically increase the cost
6 of providing such services. And I'll be happy to
7 discuss cost if you have those questions, as I believe
8 you probably will.

9 Those costs will be passed on to ESOP
10 companies and ultimately affect the balance of plan
11 participant accounts. The overall quality of ESOP
12 valuation and fairness opinions may drop because many
13 firms, including the firms in our group, will have a
14 significant disincentive to continue providing ESOP
15 valuations and fairness opinions in light of increased
16 risks and oversight.

17 In fact, we believe that it is unfortunately
18 the larger firms with the most qualified and
19 experienced professionals perhaps who generally have
20 other sources of business that are the most likely to
21 leave the ESOP market. Consequently, we believe more
22 valuations will be performed by low cost providers who

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1 sometimes compensate for a lack of experience and
2 training by offering their services at low prices.

3 Fifth, we believe that the relationship
4 between an ESOP trustee and an ESOP valuation and/or
5 fairness opinion provider will be undermined by making
6 the provider a co-fiduciary. In a proposed
7 transaction, the parties have a very clear
8 understanding of their roles.

9 The ESOP trustee's role is to conduct a
10 prudent investigation as to the merits of a particular
11 investment decision. And as part of that process, the
12 ESOP trustee normally retains ERISA counsel and an
13 independent valuation provider to assist them in
14 evaluating the financial terms of the proposed
15 transaction including obtaining an opinion as to the
16 value of the employer's securities proposed to be
17 purchased or sold, which opinion the independent
18 trustee reviews and analyzes. That valuation opinion
19 is only one of many factors that is considered by the
20 trustee when they make their investment decision.

21 For example, the advice provided by legal
22 counsel as to the terms of a particular transaction,

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1 which is certainly material to the overall economic
2 value of the proposed deal -- excuse me, and yet, the
3 attorney would not be deemed a fiduciary under the
4 proposed reg.

5 Were both the trustee and the valuation
6 provider co-fiduciaries, these well-established
7 relationships are disrupted. For example, the ESOP
8 trustee may -- simply may cede financial issues to the
9 provider thereby eliminating the benefit of a rigorous
10 review of the valuation or the ESOP valuation provider
11 may not be able to cede final decision-making authority
12 to the trustee on areas of disagreement creating
13 confusion, expense and inefficiency.

14 For example, if the valuation provider
15 provides a range of value and the trustee decides to
16 purchase shares for a price other than the mid point of
17 that range, as the co-fiduciary under the proposed
18 regulations, what would you propose the valuation
19 provider do?

20 The question comes down to who's in charge
21 and who holds ultimate responsibility for the
22 investment decision, which is clear under the current

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1 reg but just the opposite under the proposed
2 regulation. As a result, an ESOP company may decide
3 that retaining two co-fiduciaries is expensive,
4 unnecessary, and problematic and therefore, the ESOP
5 company may eliminate the independent trustee in favor
6 of an internal trustee or committee, or eliminate the
7 trustee role entirely which would eliminate a critical
8 part of the prudent investigation process.

9 For these reasons, we urge the Agency to
10 modify the rule in the following respects:

11 First, the DOL should create a safe harbor
12 for valuation and fairness providers, allowing them to
13 perform traditional ESOP related services as a non-
14 ERISA fiduciary. As long as the valuation or fairness
15 opinions provider does not exercise decision-making
16 authority over the investment decision, does not render
17 advice concerning the relative merits of a proposed
18 transaction or any available alternative transaction,
19 and does not provide individualized investment advice
20 to the ESOP or the participants on investment policies
21 or strategies or folio composition or diversification
22 of plan investments.

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1 Rather, the provider's only role is to
2 provide an independent and impartial opinion of value.
3 The fact that the provider does not have decision-
4 making control in a particular transaction is
5 consistent with the treatment of fairness opinion
6 providers outside of the ESOP context where the
7 company's board, not the provider of the opinion, bears
8 the decision-making authority and responsibility on
9 behalf of the company shareholders.

10 Second, if the DOL's aim is to provide
11 guidance on critical ESOP valuation issues, the DOL can
12 do that directly. Many providers of the ESOP
13 valuations and fairness opinions are members of
14 professional valuation organizations that continually
15 examine complex valuation issues including those
16 related to ESOPs. We're confident that such
17 organizations would welcome DOL's participation in such
18 discussions.

19 In closing, I would like to emphasize that we
20 approach valuations of privately held ESOP stock
21 seriously and rigorously. We well understand that
22 these valuations affect the retirement assets of ESOP

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1 plan participants. We disagree with the Department's
2 assumption, however, that making us fiduciaries will
3 somehow change or improve how we conduct our financial
4 analysis.

5 If there is a problem with substandard
6 quality of work in preparing ESOP valuations and
7 fairness opinions, it likely derives from inexperienced
8 and unqualified providers. And making those parties
9 fiduciaries is not going to transform them into
10 experienced and skilled professionals. It will,
11 however, put us in direct conflict with the independent
12 requirements of our profession, create legal
13 uncertainty and impose responsibility on us without any
14 actual decision-making power or authority.

15 Thank you for the opportunity to testify and
16 I welcome your questions.

17 MR. DAVIS: Thank you.

18 MS. BORZI: I want to thank all of you for
19 your testimony. Just a couple of questions.

20 You have -- I didn't -- I can't -- I didn't
21 count the numbers of experience, but you clearly have
22 many years of experience in the valuation context, so

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1 can you give me a sense of how often in your experience
2 does the ESOP trustee rely on the valuation that
3 they've been given by the valuation expert?

4 MR. TARBELL: Are you asking me?

5 MS. BORZI: I'm asking any or all of you.

6 MR. TARBELL: In my experience, their task is
7 to rely on it in part, but it is ultimately the
8 trustee's responsibility to determine valuation.

9 MS. BORZI: Have you -- so they generally do
10 rely on it. Are there experiences that any of you had
11 where the valuation that the ESOP trustee is given, the
12 ESOP trustee has said I want a second opinion or -- is
13 that a common industry practice?

14 MR. COOK: I can give you a -- I hope this
15 works. I can give you a specific situation and it goes
16 to answer one of your questions from the previous one.

17 MS. BORZI: Sure.

18 MR. COOK: This is a real live one where they
19 were terminating an ESOP; they were terminating a plan.
20 The company did not own the -- the ESOP did not own it
21 100 percent. I can't recall exactly the percent. It's
22 been years ago. But the trustee went out and didn't

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1 get one but two valuations independent of one another.
2 There was an 18 percent disparity between the values on
3 terminating the plan.

4 I was asked to come up and take a look at
5 that plan and see which of the two were the most
6 reasonable to assist that trustee in making that
7 determination.

8 MS. BORZI: Sure.

9 MR. COOK: If I were to follow the proposed
10 definition of fiduciary, my duties would be for the
11 sole benefit of those employee participants. I am now
12 in a pretty big quandary. Is it the 18 percent higher
13 one or the lower? Because it was clear -- it would be
14 clear that that one that was 18 percent higher would be
15 in the benefit of those employee participants. Unlike
16 the reality was, the lower value was the one I
17 considered to be closer to that of reality.

18 I now am placed in a position of making the
19 decision as the trustee should have, of which that
20 trustee would rely on. That makes it the case for
21 exactly what we've been talking about here. We have to
22 be independent, we have to be objective and impartial

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1 in doing the work that we do.

2 I can tell you categorically that the
3 trustees in these small plans rely on what I give them.

4 MS. BORZI: Yeah, I'm going to get to the
5 impartiality question in just a minute. What I'm
6 really trying to see is from the point of view from
7 your experience and from your point of view when you
8 give an opinion there is certainly an expectation that
9 the trustee will rely on it, not exclusively
10 necessarily as you point out, but obviously when you
11 give that opinion you're using your best judgment and
12 you're assuming that the trustee's going to rely on it?

13 MR. COOK: Yes.

14 MS. BORZI: Am I incorrect in making that
15 assumption?

16 MR. COOK: In my circumstances that would be
17 the case.

18 MS. BORZI: Okay. So the notion that
19 obviously you took some offense that that the
20 valuation, the person doing the valuation is at the
21 center of the transaction is -- is not as off-the-mark
22 as you seem to suggest. Would a trustee go forward

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1 without a valuation opinion?

2 MR. TARBELL: Well, I think that -- I'll
3 respectfully -- we'll agree to disagree on the point,
4 but the trustee needs to make the decision on whether
5 to go forward or not.

6 Just like when I buy stock that's publicly
7 traded, I need to know the price before I make the
8 decision.

9 MS. BORZI: Right.

10 MR. TARBELL: But the price alone doesn't
11 tell you whether to buy or sell it. There's
12 fantastically more --

13 MS. BORZI: But the price is an essential
14 part of the decision-making tools that you use.

15 MR. TARBELL: It's essential, but in a
16 private company -- and, you know, if you're dealing
17 with a public stock, it is a dominant decision factor.
18 If you're dealing with a private company, there are,
19 you know, there are dramatic other things, a dramatic
20 number of other factors that the trustee should
21 consider.

22 MS. BORZI: Like?

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1 MR. TARBELL: The quality of the management.
2 Their opinion of the -- is this a -- you know, is this
3 is a declining industry or an upward industry. The
4 structure of the transaction do I believe this is too
5 much debt on this leverage, the ESOP deal or not.

6 I mean, we provide a -- you know, I don't
7 mean to dismiss it or minimize its importance but we
8 provide a mathematical number. And, again, it's one of
9 many factors. But once we provide that piece of
10 information to the trustee, they seek, you know, a
11 tremendous amount of legal advice and have a
12 responsibility to then decide without our input whether
13 or not to enter into the transaction. So there's a big
14 difference between providing a piece of information.
15 That's important, and deciding whether or not to pull
16 the trigger and do the deal or not.

17 MS. BORZI: Okay. One other short question
18 and then I'm going to get to the impartiality
19 discussion. And that is, Mr. Tarbell, you suggested
20 that in a big company context where big companies have
21 as part of their services that they offer ESOP
22 valuation, that were the Department to move forward in

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1 some form of this proposal which would make the person
2 providing the valuation opinion a fiduciary for
3 purposes of that opinion, and that's actually something
4 that I was concerned about and the way you described
5 this, Mr. Cook.

6 Fiduciary duty attaches only to the duties
7 that you actually perform. It doesn't make you broadly
8 liable for any other thing that could possibly take
9 place. So to the extent that you would render a
10 fiduciary would be -- if a person were a fiduciary and
11 the -- the fiduciary activity that they would be
12 engaging in, is rendering an opinion, all those
13 peripheral things that the ESOP trustee would be
14 responsible for, a co-fiduciary would not be
15 responsible for. You're only responsible for the
16 things that -- the duties that you perform.

17 So back to my question, I got sidetracked
18 here. So are you basically saying that Houlihan Lokey
19 would withdraw from this business?

20 MR. TARBELL: Well, we'll make the decision
21 if the rule passes. But I would say that there's a
22 strong opinion in my firm as to -- by those who make

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1 those decisions that that's -- this is an unacceptable
2 amount of risk relative to the revenues that we
3 generate from this business.

4 MS. BORZI: Okay. What percentage of your
5 revenues is generated from this business? Do you have
6 an idea?

7 MR. TARBELL: Less than 1 percent.

8 MS. BORZI: Okay. Now I want to get to the -
9 - the question -- I don't know whether you were in the
10 audience when we were -- I was talking with the other
11 panel about this, but I -- I see no conflicts between
12 the duty that you have under the Internal Revenue Code
13 to render the most correct opinion and the duty you
14 would have under fiduciary rules, because the fiduciary
15 rules do not -- do not require you to be an advocate
16 for the participant.

17 What you would be required to do is basically
18 do the same thing that you're supposed to be doing
19 under the Internal Revenue Code which is to render the
20 best opinion you can with the same kind of impartiality
21 and independence. The fact that it's -- that the duty
22 flows to the participants and beneficiaries, the

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1 participants and beneficiaries do not expect, nor would
2 they be entitled to expect that you put your finger on
3 the scale in their favor. They have the same
4 objectives of an opinion that is in the best -- the
5 most correct that you could possibly render that's
6 impartial in an independence -- independent form.

7 And I just -- I'm wondering -- and if you
8 look at the ERISA case law you'll see that that's what
9 the courts have said. So I'm wondering why it is that
10 you think that these are -- I know you strongly believe
11 it, I'm not -- I'm not disputing that you strongly
12 believe -- feel strongly about this and I respect that.
13 But I'm wondering what evidence you have that that
14 would be the result?

15 MR. COOK: With the difference between what
16 IRS does?

17 MS. BORZI: Right.

18 MR. COOK: Well, that wasn't part of my
19 testimony, but I'll be more than happy to address --

20 MS. BORZI: Well, I think it's more of a sub-
21 rosa, a part of what you were concerned about because
22 you said this would require you to -- I forgot the

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1 third word, I didn't write fast enough to get the third
2 word you used.

3 MR. COOK: Sorry.

4 MS. BORZI: But you said that if this
5 proposal were adopted you could no longer render an
6 impartial or independent opinion or whatever that third
7 word was.

8 MR. COOK: Anything that will create any
9 independence question or impartiality question, and a
10 fiduciary does that in my opinion, changes the balance
11 and the landscape of what we work through as one of our
12 bedrocks to doing valuation work. A fiduciary
13 responsibility in my mind puts me in a different place
14 than I am now. It's obvious in a different place or
15 you wouldn't be bringing this up.

16 MS. BORZI: Yeah. So if we said in the
17 regulation --

18 MS. WALKER: May I make a comment on your
19 question?

20 MS. BORZI: Certainly.

21 MS. WALKER: I guess, accepting what you just
22 said that our role would be exactly the same, then I

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1 guess my question to you then why impose a fiduciary
2 status on us, because it has negative consequences and
3 I don't think it gets to what I perceive to be your
4 ultimate concern which is about the quality of
5 appraisals and appraisers.

6 And I think by -- I don't think fiduciary
7 status is -- equates to competency.

8 MS. BORZI: Well, the question really is: In
9 terms of -- in terms of qualifications, impartiality
10 and independence is part and parcel of the duty that
11 you have. And if what -- let me just turn the question
12 on its ear here.

13 If what you're telling me is that everyone
14 who renders a valuation opinion does so with the utmost
15 conformance to the independence impartiality standard,
16 part of competence is -- are these features. So,
17 therefore, what -- the only difference I see is that
18 under a regulation, which holds you to those standards,
19 we would have a method of enforcing it if those
20 standards warrant that. And -- which is where I was
21 going a minute ago.

22 And so, to the extent in a regulation, in the

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1 same regulation that imposed these kinds of duties, we
2 made it clear that the nature of the duty with respect
3 to impartiality and independence is exactly the same
4 duty that you would have now under the Internal Revenue
5 Code.

6 Would that make you feel a little more
7 confident that -- that we would not be asking you to do
8 something like putting your finger on the scale for the
9 participants?

10 MS. WALKER: Let me respond to that. Again,
11 I go back to that I am going to do that anyway. I do
12 that anyway. I have to because I'm an ASA. I have to
13 follow USPAP and I'm --

14 MS. BORZI: And what are the enforcement
15 mechanisms?

16 MS. WALKER: I'll tell you.

17 MS. BORZI: Okay.

18 MS. WALKER: And I follow USPAP, and I work -
19 - I do work for -- before the IRS and so I know I must
20 follow their rules and regulations, and their rules and
21 regulations as they apply to ERISA.

22 So I still say I do that, but I do not want

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1 to have the fiduciary status, because it gives me other
2 issues of costs and risks that I don't think are --

3 MS. BORZI: Yeah, I get that, but I'm --

4 MS. WALKER: -- appropriate.

5 MS. BORZI: -- just trying to address this
6 one issue here.

7 MS. WALKER: Well, I think -- I guess I have
8 -- I think I have addressed it. I'm saying, we -- we
9 will -- qualified appraisers will follow independents
10 and lack of bias and they don't need a fiduciary duty
11 to do that.

12 MS. BORZI: And what happens if they don't?

13 MS. WALKER: Okay. Well, I think under -- if
14 they follow USPAP or they're a credentialed appraiser,
15 they can be brought up for violations of their
16 professional practices under ASA or USPAP and they can
17 be brought for violations. We have an ethics procedure
18 where people -- anyone --

19 MS. BORZI: Are they then debarred? What
20 happens?

21 MS. WALKER: They may be. There are several
22 -- the process is that you have to have a written

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1 complaint. There's some process, there's an ethics
2 committee that looks at these and there are -- there
3 are a number of possible outcomes. There are called
4 suggestions where you do something that is considered
5 to be unethical or against professional practices and
6 you are suggested a way to correct it. You're supposed
7 to take a course or something.

8 MS. BORZI: Uh-huh. And is there -- so you
9 take a course?

10 MS. WALKER: Okay. Well, that's the --
11 that's the minimal. You could be censured. You can be
12 suspended and you can be expelled.

13 MS. BORZI: Okay. And if -- and what happens
14 if after those --

15 MS. WALKER: So then you can no longer hold
16 yourself out as an ASA. If you do some -- the IRS has
17 --

18 MS. BORZI: Do people render these opinions
19 if they're not an ASA, if they don't have those letters
20 after their name?

21 MS. WALKER: They may, but I think we're
22 advocating that by looking at credentialed appraisers,

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1 you will have people who've got the experience, the
2 education to give competent appraisals.

3 And the IRS has -- has sanctions against
4 appraisers. You may not be allowed to practice before
5 the IRS and that's --

6 MS. BORZI: And do you have a sense of how
7 often they're applied?

8 MS. WALKER: They have an Office of
9 Professional Practice that is looking into that.

10 MS. BORZI: Well, we'll certainly reach out
11 and explore those things.

12 MS. WALKER: And so -- and they are doing
13 that. So I think appraisers who work before the IRS
14 certainly take those as serious consequences and have
15 looked at the IRS's new requirements of what is a
16 qualified appraiser and a qualified appraisal. And I
17 think those are credentials that, as we said in our
18 testimony, the IRS has accepted and other agencies have
19 accepted and they are proving to be workable models.

20 MS. BORZI: Okay. I don't want to take
21 anymore time, but thank you for your suggestions and
22 your testimony.

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1 MR. TARBELL: May I just make one comment?

2 MS. BORZI: Sure.

3 MR. TARBELL: The ultimate enforcement in our
4 industry is that you don't get hired again. And to the
5 extent that someone is, as you said, as Donna said,
6 expelled from the ASA or to the extent that they do
7 biased or non-independent or just schlocky work, and
8 they are still getting hired by a plan trustee who is
9 accepting their valuations, then I think -- I think
10 what we have here is a trustee problem, not an
11 appraiser problem.

12 MS. BORZI: How -- how do trustees know that
13 -- is this made public? Is there a press release if
14 you're expelled from the ASA? How do --

15 MS. WALKER: It's published. I mean, it's
16 not in the New York Times but it is published.

17 MS. BORZI: But where is it published? Or --

18 MS. WALKER: I mean, you should be able -- if
19 someone holds themselves out to be an ASA --

20 MS. BORZI: No, I'm saying they're not. So
21 you --

22 MS. WALKER: Yeah, you should be able to --

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1 MS. BORZI: So you expel them. They take
2 those three letters off their resume, but they still
3 hold themselves out.

4 MS. WALKER: But they would have to -- you
5 would have to look into the person's background. I
6 mean, they're not going to tell you in its -- if you
7 call the ASA they would probably give you that
8 information.

9 But, again, I guess I agree with Jeff's point
10 about that is that I think there is some responsibility
11 on the trustee to interview and understand --

12 MS. BORZI: Unquestionably.

13 MS. WALKER: -- appraising --

14 MS. BORZI: Unquestionably. I'm with you.

15 MS. WALKER: They should be able to -- they
16 should be able to find that out and if they look to see
17 if they have credentialed appraisers who have
18 experience, then they should know that those people are
19 interested enough in credible appraisals to, you know,
20 to be -- to have gone to a -- belong to an organization
21 that teaches and tests and requires peer-review of
22 reports and requires continuing education.

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1 So that should tell you as a trustee then
2 that this is a serious professional appraiser.

3 MS. BORZI: Okay. I'm going to just stop
4 there, cause I've dominated the time, and I don't want
5 to.

6 MR. DAVIS: Just quickly, I'll ask you --
7 this panel the same question I asked Panel No. 8. And,
8 I think, Ms. Walker, in your comment letter you talked
9 about the E&O insurance costs going up dramatically if
10 this reg was passed as proposed or finalized as
11 proposed.

12 Do you have more specifics? And I guess I
13 would ask this of the entire panel, specifics as to,
14 you know, how much would the fiduciary rider cost as a
15 separate policy? Who are the providers? Just be more
16 specific in terms --

17 MS. WALKER: I don't have any more specifics.
18 I personally for my firm have looked and asked for a
19 quote on those kinds of policies. They don't exist
20 right now, because appraisers have not been fiduciaries
21 before.

22 Now, I have every confidence that the

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1 insurance market will produce a product. How much it
2 will cost I don't know. But E&O insurance is very, I
3 think, quite expensive for the coverage you get. I
4 expect this will be more expensive. So I can't give
5 you a dollar amount but certainly -- and that is just
6 one component of the expense.

7 I think appraisal firms will have to look at
8 that insurance, they'll have to look at the overall
9 risk, which will mean that they'll have to have more
10 legal counsel. And if -- as a fiduciary, you would
11 have to have legal counsel in every transaction that
12 you were involved in.

13 So, no, I can't give you a dollar amount. I
14 guess my point is that there is some amount and it will
15 be borne in large part by benefit plans because
16 appraisal firms will try to pass those expenses on to
17 the extent they can to -- to the plan.

18 MR. DAVIS: But in your comment letter, you
19 stated that the cost, it would be extremely costly is
20 what I think your quote was.

21 MS. WALKER: Yes, I think it will be.

22 MR. DAVIS: So what was the basis of saying

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1 that it was extremely costly if you don't have more
2 specifics?

3 MS. WALKER: Well, because I understand the
4 cost of errors and omissions insurance and I talked
5 just generally about other fiduciary types of insurance
6 is expensive. You know, I can't go out there and price
7 a policy now for -- for an appraisal firm to be a
8 fiduciary. It doesn't exist.

9 MR. DAVIS: Anybody else? Thank you.

10 MR. TARBELL: Well, the insurance isn't the
11 only cost either.

12 MR. DAVIS: Yeah, I understand that, but I
13 just want to stay with the insurance topic now. I
14 understand the litigation costs. But just with respect
15 to insurance.

16 MR. TARBELL: But there's a component of
17 insurance, which is the retention or the deductible.

18 MR. DAVIS: Okay.

19 MR. TARBELL: And my understanding from ESOP
20 fiduciaries is that's about \$500,000 normally. I'll go
21 out on a limb but I think, you know, I've done this 20
22 years, I have a pretty good idea that for a lot of

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1 small ESOP providers that's a year's worth of profits.

2 So, and in other words, and again, we're not
3 concerned -- I don't think we're all concerned about
4 suits from the DOL, what we're concerned about is suits
5 from the plaintiffs part. And, you know, you may
6 interpret the reg one way but there's -- you know,
7 other people have sat at these chairs the last couple
8 days that may interpret them extremely differently.

9 And to the extent that we have to fight one
10 lawsuit, win or lose, just to get your name off the
11 cover, you know, you may not get to that -- you may not
12 even get into your insurance but you may end up paying
13 the \$500,000 and that's enough to put some of these
14 providers out of business.

15 MR. DAVIS: Mr. Cook, did you have a thought?

16 MR. COOK: Let me just answer this. The cost
17 of insurance is one piece of this. Okay. This is
18 something I didn't bring in testimony. I will now.

19 I'm also a registered investment adviser and
20 I hold a securities license. I'm done if this is
21 passed. I'm done, because I handle an outside business
22 activity for the -- as defined by Security Exchange

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1 Commission, no insurance will cover. I will remove
2 myself from this and I've done this 38 years now.
3 Either that or I will have to jettison part of -- two
4 parts of my business, the ESOP side of it and the
5 securities side.

6 There's a cost that goes larger than that of
7 just the premiums; that of defending ourselves to a
8 plaintiff's attorney that is always going to include
9 us, always on anything that goes down inside of an ESOP
10 or any other ERISA plan. Those are the costs that are
11 going to impact us.

12 We can take conflict of interest as being a
13 great argument. Risk is where we are not going to be
14 able to provide the same thing we provide now. It
15 makes it extremely complicated.

16 MR. DAVIS: Thank you.

17 MR. LEBOWITZ: To my mind, this -- you know,
18 this issue is really about accountability. And I think
19 that's really what we've been talking about mostly this
20 morning.

21 Ms. Walker, when you -- you took -- let's
22 talk a little bit more about the IRS requirements. Now,

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1 if the -- if the appraiser fails the IRS requirements,
2 what happens under the tax law, what's the consequence?

3 MS. WALKER: Well, under the regulations now
4 for tax purposes, you have to be a qualified appraiser
5 or appraiser.

6 MR. LEBOWITZ: Qualified as they define it?

7 MS. WALKER: Yes.

8 MR. LEBOWITZ: And if you're not? If you --

9 MS. WALKER: Well, they say then it's not
10 acceptable --

11 MR. LEBOWITZ: Meaning a deduction is --

12 MS. WALKER: Yeah, that the --

13 MR. LEBOWITZ: -- there's a tax consequence?

14 MS. WALKER: Right. That they would not --

15 MR. LEBOWITZ: It's a -- so somebody's
16 accountable in a very tangible way? There's a penalty
17 and the penalty is that a deduction is disallowed,
18 correct?

19 MS. WALKER: Yes, the IRS will say they don't
20 accept that --

21 MR. LEBOWITZ: So there's nothing comparable
22 on our side. I mean, you suggested we adopt those

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1 kinds of standards but -- and, again, to my mind, this
2 is all about accountability about holding people
3 responsible for what they've -- for the actions they've
4 taken.

5 Under the Code there's a -- there's a clear
6 and tangible penalty for violation of those standards
7 and that is that a tax penalty is applied.

8 What -- there's nothing comparable on our
9 side --

10 MR. TARBELL: There's more than that.

11 MR. LEBOWITZ: There is no deduction.

12 MS. WALKER: Well, no and the deduction is to
13 the taxpayer not to the appraiser, but there are --
14 there are --

15 MR. LEBOWITZ: But there is a penalty?

16 MS. WALKER: There is a penalty of monetary -
17 -

18 MR. LEBOWITZ: That applies to somebody. It
19 applies to the client of the appraiser.

20 MS. WALKER: There is a monetary penalty that
21 can be levied against the appraiser.

22 MR. LEBOWITZ: Okay.

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1 MS. WALKER: And the appraiser can be barred
2 from performing tax-related appraisals.

3 MR. LEBOWITZ: And under ERISA, we --

4 MS. WALKER: Which is the real hammer.

5 MR. LEBOWITZ: -- have -- we can do neither
6 of those things. There is no monetary penalty, there's
7 no civil penalty for --

8 MS. WALKER: Well, certainly --

9 MR. LEBOWITZ: -- performing substandard
10 appraisals and there's no -- we have no ability to bar
11 an appraiser from providing services to clients.

12 MS. WALKER: Well, I think you could probably
13 get that authority and --

14 MR. LEBOWITZ: Would you support legislation
15 to do that?

16 MS. WALKER: Yeah, I think -- again, I --

17 MR. LEBOWITZ: You would. Would you, Mr.
18 Cook?

19 MS. WALKER: I think that's a way to look --

20 MR. LEBOWITZ: Can I get an answer from Mr.
21 Cook?

22 MS. WALKER: Well, wait. Let me -- you

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1 haven't let me answer your question.

2 I think accountability is the issue. And I
3 think under the IRS Code, which also has some authority
4 over ERISA, that perhaps that Code could be enforced.

5 I do think you should be able to bar people
6 if -- from practicing under ERISA; that's what IRS has
7 done and that has been, I think, something that
8 appraisers who practice in that arena, you get their
9 attention.

10 Of course, the issue is then we will want to
11 work with you to be sure that those rules and
12 regulations we think are appropriate and we have an
13 appropriate access to be sure that we get due process
14 in that.

15 But, again, I think our whole idea about
16 looking at credentialed appraisers are the base -- by
17 looking at someone who has a credential, they are
18 accountable.

19 MR. LEBOWITZ: And I agree with that, but
20 again, for someone who's involved in the enforcement
21 operation here, if it's not enforceable, it's a
22 voluntary standard that essentially is the same thing

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1 as having a speed limit that would just -- whatever you
2 feel like driving. We suggest it's 65, but you want to
3 go 90, that's okay too.

4 Anyhow, Mr. Cook and, Mr. Tarbell, would you
5 comment on this? Do you think that this -- that
6 approach that Ms. Walker was just talking about is on -
7 - that would make some sense --

8 MR. COOK: Let me --

9 MR. LEBOWITZ: -- to create a statutory
10 standard and one that would be enforceable on a
11 tangible way?

12 MR. COOK: We work under that environment
13 currently with the Internal Revenue Service.

14 MR. LEBOWITZ: Not under this you don't.

15 MR. COOK: I understand. But, somehow, I'm
16 getting the sense, and I understand it has got to be
17 frustrating from an enforcement perspective. I hear
18 what you're saying. But at the other side of this is
19 it would have seemed from listening to the comments
20 here that it makes -- builds the case at least that's
21 what I'm hearing, that as appraisers in an ESOP
22 environment, we're immune from anyone.

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1 Would not the trustee have a cause of action
2 against us for any errors or acts or omissions or
3 anything that we do? Would they not have a cause of
4 action if you were to pursue or Department of Labor,
5 not you, were to pursue that trustee for a faulty
6 valuation for whatever reason, would not that trustee
7 have a subrogation ability to come back against us?
8 Would not that be their duty to do so? Is it not why
9 we have a trustee with a fiduciary responsibility and
10 it provides us the opportunity to make recommendations
11 and suggests and, yes, opine on exactly what that
12 trustee might be willing to transact those shares with
13 the participants to be?

14 I think we're in a very compliant position as
15 being an appraiser as we sit here today without the
16 fiduciary requirement.

17 MR. LEBOWITZ: And what we're talking about
18 could well be an alternative to that. In other words,
19 a statutory -- something that's in the statute that
20 prescribed professional standards and also imposed a
21 penalty for failure to meet them.

22 MR. COOK: I would --

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1 MR. LEBOWITZ: But not fiduciary standard,
2 not with all of the problems that you've -- that you've
3 identified.

4 MR. COOK: I believe there is much wisdom in
5 the 1988 proposed adequate consideration. There was a
6 lot of wisdom. If anybody ever read my book, which a
7 few have, you will see that I think that is a bedrock.
8 I don't agree with 100 percent, but if you get 100
9 percent agreement with everybody, somebody's not
10 thinking somewhere.

11 But there are so many positive things that
12 are written so specifically in that 1988 ruling that
13 impose things for us as appraisers for what a trustee
14 could lean on as being a -- and to assist them if they
15 do their job right in assessing not only what appraisal
16 firm to hire, but also the valuation itself.

17 MR. LEBOWITZ: I guess that was an answer.

18 MR. COOK: It was an answer.

19 MR. LEBOWITZ: Thank you.

20 Mr. Tarbell?

21 MR. TARBELL: Well, I would disagree with the
22 premise that there is a consensus that there is a

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1 problem. But to the extent that something had to
2 change, we would far rather see the IRS model of
3 testing value as to what defines incorrect, monetary
4 penalties on the appraiser and potential disbarment,
5 then we would see the proposed reg pass as it is
6 written.

7 MR. LEBOWITZ: Thank you.

8 MR. HAUSER: Let me -- maybe following up on
9 Alan's comments earlier this morning, let me just, you
10 know, start with something that's more an observation
11 than a question.

12 And the observation is that from our
13 standpoint, and we could have a discussion about why
14 the legal framework plays out this way, but from our
15 standpoint, the appraiser, if a fiduciary, would not
16 have a duty to bias their work in favor of the plan.
17 And, in fact, we don't think you're doing a favor to
18 the plan if you give advice essentially that amounts to
19 telling it what it would like to hear as to the price.
20 We think you're doing a disservice in that
21 circumstance, just as we don't think right now that
22 fiduciaries of ESOPs or any other kind of plan should

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1 be asking their advisers when they're asking for an
2 opinion to slant the advice or they should be looking
3 for advisers who would slant the advice.

4 Everybody's job when it comes to getting
5 advice as to what the price should be is just getting
6 it right. Then it's the job of the other fiduciaries
7 to execute on that, to make sensible decisions based on
8 an informed position on what the true range of values
9 is.

10 And, you know, if you give wrong advice, if
11 you inflate it because they're a seller, you deflate it
12 because you're a buyer, you're doing -- they're a
13 buyer, you're doing a disservice. They need to know
14 what the number really is so they can decide which
15 deals to sensibly forego or not.

16 So I think that's a complete red herring, I
17 think it's false, but what we can do for sure is make
18 that clear. We can make it clear that your duty does
19 not require in any way slanting an opinion. It doesn't
20 require in any way compromising your impartiality when
21 you render an opinion as to advice and it doesn't
22 require you to exceed the normal scope of your

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1 engagement in the sense of getting involved in the
2 mechanics of actually, you know, negotiating on what
3 the transaction price should be. It requires none of
4 that.

5 So to the extent that there's any anxiety
6 right now that's based on those concerns, that we can
7 and would rectify whatever we do with this regulation.
8 So I don't think that's a problem.

9 So that, I guess, leads me to the -- a couple
10 questions, and one is I agree, the trustee's job is to
11 -- ultimately, the responsibility rests with the
12 trustee to decide whether or not to move forward with
13 the transaction. And it's a very weighty
14 responsibility. They have to read the report, they
15 have to understand it, they have to identify what the
16 assumptions are underlying it. They have to think
17 about whether any kind of sensitivity analysis was
18 done. They have to ask themselves if the mathematical
19 portion and the appendix actually matches the narrative
20 in the document. There are a million things involved
21 in it. It's very hard.

22 But the fact is, as Mr. Goldberg from the

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1 ESOP Association testified earlier, we're often talking
2 about, you know, small businesses and small owners that
3 they're mainly -- what they know is how to do their
4 operating business. They know how to produce whatever
5 it is they produce. They're not valuation experts and
6 they look to you for that advice.

7 And what I'm not understanding, and what I'd
8 like you to respond to now after this long lead up, is
9 -- is assuming that the obligation is simply to render
10 a professional, competent, impartial decision that's
11 within the range of professional judgment, recognizing
12 that it is a range, that this is somewhat subjective
13 and it requires judgment, I get the sense from all
14 three of you that you think there's something
15 fundamentally unfair about -- about you being called to
16 account and when the result of your advice is somebody
17 relies on it and the plan is injured by it in the sense
18 of being on the hook for those losses.

19 And I guess I'm wondering what -- you know,
20 putting aside the issues of costs and benefits, that's
21 a separate discussion, I get the sense that you think
22 there's something fundamentally unfair about you being

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1 on the hook if you cause those losses. And I'd just
2 like to understand why that is, because, again,
3 speaking as an enforcement person, it has been truly
4 frustrating to us in some of these cases where it's
5 really seemed to us like the engine that made the deal
6 go was the appraiser, and the price was really, really
7 wrong and it really didn't reflect competent judgment,
8 but that person we can't go after.

9 We can go after the guy who's running an
10 operating company was also the trustee and relied on
11 you. To me, if anything, that seems more unfair in the
12 current regime, and I'd just like to understand why you
13 disagree because I think you all three plainly do?

14 MR. COOK: As one observation to another one
15 here.

16 MR. HAUSER: Please, only fair.

17 MR. COOK: Again, I can't speak for anybody
18 but me. I've been around ESOPs a long time. At the
19 end of the day, I sense from your observation, that
20 there is no pressure that can be applied to me as an
21 appraiser if I really, really, miss it. That's just
22 not true. That trustee has a cause of action against

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1 me and my liability policy, assuming I have one, and
2 they -- nothing precludes them from saying if you said
3 it's messed up and you prove that to the trustee for
4 them not to subrogate there, is there? Am I missing
5 something?

6 MR. HAUSER: Well, I think you are in a sense
7 and maybe you can respond to this too. But the problem
8 for -- I mean, again, remember, the whole framework.
9 And I think all three of you echoed this was that,
10 well, the trustee's really the person on the hook.

11 So now ask yourself, if I'm a trustee and I
12 think that the valuation went bad, at least -- unless
13 and until some participant or the Department of Labor
14 happens upon it and sues me, don't I have a powerful
15 disincentive not to bring the lawsuit against the
16 appraiser because that's almost putting a target on my
17 back?

18 If I'm saying I -- I shouldn't have relied on
19 this appraisal because it was incompetently rendered,
20 I'm also saying from a conventional fiduciary
21 standpoint, I breached my duties as a fiduciary in
22 relying on it. That's a powerful disincentive for

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1 ever bringing that lawsuit.

2 And then, the other issue is in a number of
3 these cases what we've seen is that the transactions
4 are, you know, sometimes the abuse is just somebody's
5 gotten the price wrong. They've rendered an
6 incompetent job, it really was kind of imprudent.

7 Other times it's a company that's being
8 drained in substantial part of its assets for the
9 benefit of a corporate insider. And the fact is the
10 corporate insider is the guy driving the transaction.
11 He's not going to sue you because he's in on the deal.

12 MR. TARBELL: Well, you identify a
13 hypothetical there of a trustee who's -- who's
14 reluctant to sue their valuation firm because they've
15 improperly relied on the appraisal. The core of that
16 problem is that the trustee improperly relied on the
17 appraisal. That -- the fact that they've gotten
18 themselves into that mess is not -- is not our mistake.

19 MR. HAUSER: You don't -- is that what you
20 tell your customers? I mean, they hire you because
21 they think they should be able to rely on you, don't
22 they?

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1 I mean, I'm not saying what's core and what's
2 not core. I'm saying you're both there. And it seems
3 on this -- maybe I'm being superficial but it seems --
4 on the surface, it seems unfair to have kind of your
5 customer in the dock, but you're not there with them
6 when they relied on your advice.

7 MR. TARBELL: Well, we are there with them.

8 MS. WALKER: Yes.

9 MR. TARBELL: We are exposed to their -- to
10 their judgment and liability and ability to sue us.

11 I don't think it's unfair and I do think
12 you're simplifying it with all due respect. The fact
13 is that, yes, they hire us because we think -- they
14 think we will give them a reasonable opinion of value.
15 But that doesn't relieve them of their duty to
16 investigate.

17 Just like -- I mean, ignore ESOPs. Think
18 Delaware law -- right, corporate law. Right? A board
19 of directors akin to a trustee is not relieved of its
20 duty to investigate the advice it receives.

21 MR. HAUSER: I appreciate that. And so that
22 -- let me just say a completely different question and

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1 maybe I'll just direct this to you, Ms. Walker.

2 But I -- I -- I understand the point about
3 credentials and state regulation and licensing and all
4 the rest when it comes to real estate appraisers. But
5 can you identify -- are there any states, and I don't
6 know the answer, I mean, are there any states right now
7 that impose licensing, testing, sorts of requirements
8 on people who appraise stock or who are in that
9 business or limit their ability to practice based on
10 any -- any conduct or qualification standards?

11 MS. WALKER: Well, for business valuations
12 there is no state licensing. And we certainly don't
13 advocate that. But, again, we think if you look to
14 credentialed appraisers you will look at people who are
15 both, you know, independent, competent, and
16 accountable, which I think is what we're trying to get
17 at.

18 MR. HAUSER: And are there any state laws
19 that specifically, you know, purport to even provide
20 remedies specifically for appraisers apart from, you
21 know, for claims against appraisers, apart from kind of
22 general negligence standards and the like that you can

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1 think of?

2 MS. WALKER: I don't --

3 MR. COOK: Again, I don't know --

4 MS. WALKER: I don't know.

5 MR. HAUSER: Okay.

6 MR. COOK: I'm also a CPA and have
7 credentials, okay? My license with the state is that I
8 must do -- do professional care and I cannot undertake
9 any project or any engagement that I am not competent
10 to do so. If I do and it is brought up, my license
11 will be suspended or I will go to disciplinary action
12 depending upon the severity of how I messed up.

13 MR. HAUSER: So, and that's a good point.
14 Thank you. But if your license were taken away as a
15 CPA and in the state you practice in, would you still
16 be able to market yourself as an appraiser for stock?

17 Would any -- are you aware of any state law
18 that would --

19 MR. COOK: I'm not aware --

20 MR. HAUSER: -- prevent you from doing that?

21 MR. COOK: I'm not aware of any. I'm not.

22 MR. HAUSER: Okay. Thank you.

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1 MR. TARBELL: Larry and I are both registered
2 representatives under FINRA and while that is not
3 directly a business valuation issue, you know, that
4 organization as well as the Charter Financial Analyst
5 Program, which I and Ms. Walker are a member of, and
6 many ESOP appraisers are, and the ASA, have -- have --
7 you know, they're not toothless in enforcement.

8 There are -- and, in fact, most serious at
9 FINRA, there are very serious regulations about
10 customer complaints, about complaints to the
11 organization regarding ethics and those are taken
12 seriously and, you know, that's an important question
13 the trustee should ask their appraiser. And I think
14 they are eventually if finally, you know, adjudicated,
15 they are a matter of public record.

16 MR. HAUSER: Thank you very much.

17 MS. BORZI: Can I just ask one quick
18 question?

19 Are you then required under those rules to --
20 when you sign your engagement letter to tell your
21 customers they have the right to complain to FINRA?

22 MR. TARBELL: We don't perform ESOP

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1 valuations as a broker/dealer. I don't know the answer
2 to that. I mean, the answer must be no, because we
3 don't and we don't do them as a broker/dealer. But
4 even if we did, I don't -- I couldn't tell you the
5 answer.

6 MR. PIACENTINI: I guess I want to follow up
7 just a little bit more on the question of sanctions
8 within the profession and credentialing because it's
9 not yet completely clear to me how public these
10 sanctions are.

11 Ms. Walker, you said that a trustee could
12 call up and find out whether somebody was still
13 accredited. So I guess that goes to whether they've
14 been expelled. But it sounds like that's not somehow
15 posted publicly, they actually have to call up.

16 And are the lesser sanctions public
17 information or not?

18 MS. WALKER: The lesser sanctions I don't
19 believe are. But, again, I think -- I think it would -
20 - I would hope a trustee would know. I guess if I was
21 a trustee and I was hiring an appraiser I'd ask. I
22 have been asked, you know, do you have any sanctions

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1 against you? Have you ever been -- you know, had any
2 action against you by your professional organization?

3 So, you know, there is that kind of due
4 diligence on the part of the trustee that I think can
5 get to some of these sanctions and whether there's been
6 any ethical violations on behalf of an appraiser.

7 MR. PIACENTINI: That might be the trustee
8 discharging their duty. But it's less clear whether
9 they would always be told, I guess.

10 Are there examples of these kinds of
11 sanctions that have occurred in ESOP cases, ESOP
12 abuses? Do you know or --

13 MS. WALKER: I don't know.

14 MR. PIACENTINI: Okay. Then I have a
15 question for Mr. Cook. In questions for Ms. Borzi, you
16 talked about an example where there were two valuations
17 18 percent apart. And you were asked to opine on which
18 one was better. So -- and that was a termination.

19 MR. COOK: That's correct.

20 MR. PIACENTINI: So just so I'm clear so then
21 what's going on in that transaction is the company's
22 buying back the stock or...

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1 MR. COOK: Yes.

2 MR. PIACENTINI: Okay. And then I guess my
3 last question for anybody on the panel, for the first
4 panel, I gave an example of some academic research that
5 had found that appraisers who are, you know, told sort
6 of in an experimental setting that they're conducting a
7 valuation on behalf of a buyer come to a value at least
8 in this particular study, came to a value that was only
9 a little more than half of the value that people who
10 were told they were performing this valuation for a
11 seller.

12 Have you seen research in this area as this -
13 - is there a view you have on what we should think
14 about, about that sort of thing?

15 MR. TARBELL: I'm not familiar with the study
16 and I haven't seen research in the -- on the topic so I
17 can't address the study. But -- but there was a
18 fundamental premise and I think, you know, I know some
19 of the previous participants on the previous panel for
20 about 20 years. I was -- I will posit that they share
21 this view even if they didn't comment on your comment
22 earlier, which is that value depends upon your client

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1 and who hired you.

2 Not in our world as ASAs, not when we are
3 asked to determine fair market value. That is -- you
4 know, I couldn't disagree with anything stronger. It
5 doesn't -- it is -- and that -- you know, that's a
6 fundamental problem here where some of the disagreement
7 is is that we're -- our task, as we've been trained to
8 do, is to determine value from an independent, unbiased
9 perspective without identification of -- or assumption
10 of the identity of a willing buyer -- of the buyer or
11 seller, right there, hypothetical parties, yet, there's
12 this statement that a fiduciary acts in the best
13 interest of a plan participant. And it's very hard to
14 reconcile those two statements.

15 MR. PIACENTINI: May I make a request of you
16 all and that's that obviously who knows what's going to
17 be in the final regulation, but it seems to me if we
18 were to include appraisers, you're going to want us to
19 say something on this point about independence and
20 partiality, scope of the engagement and the like. And
21 it would be very helpful if you could give us a comment
22 on what you'd like that language to look like if it

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1 came to that.

2 MR. TARBELL: And, you know, I don't know
3 that there's any effect of me saying this, but I think
4 to the extent that you're considering putting in
5 provisions like that, it would also be very helpful for
6 us to see those regs and have a chance to comment on
7 them before they're issued final.

8 Thanks.

9 MR. PIACENTINI: I have nothing else.

10 MR. DAVIS: Thanks, Panel 9.

11 We went a little longer than scheduled, but
12 we wanted to make sure we got all the questions out. It
13 was a spirited dialogue and we appreciate it.

14 Thank you very much.

15 We'll move right into Panel 10. And after
16 lunch, we'll try to get back on schedule. But if Panel
17 10 can come up.

18 Panel 10 we have Mr. Hardock with Davis and
19 Harman, Mr. Kaswell, with the Managed Funds Association
20 and Mr. Anderson with the Retirement Industry Trust
21 Association.

22 We'll start with Mr. Hardock.

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1 MR. HARDOCK: Thanks. I'm Randy Hardock. I'm
2 a partner at Davis and Harman. Our firm represents
3 numerous large financial institutions including
4 insurance companies, mutual fund companies, brokerage
5 firms and banks.

6 I appreciate the opportunity so speak with
7 you today.

8 For the almost 50 million U.S. households
9 with an IRA it's imperative that the Department's
10 proposed changes to the investment fiduciary definition
11 be successfully coordinated with the SEC review of the
12 appropriate standard of care or standard of conduct
13 applicable to broker/dealers providing investment
14 advice to retail customers and including especially
15 IRAs.

16 I'm not going to focus on substance, on what
17 the DOL and SEC should be doing, but rather on the
18 process for jointly getting to the correct answer, the
19 best answer for participants.

20 The bad news I think is that on the 10th
21 Panel of the second day, I, and probably you, feel that
22 everything has been -- that can be said already has

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1 been said, just not by me. The good news for me is
2 that every question that you probably have has already
3 been asked and answered, just not by me. So I'll recap
4 a little bit of what I heard yesterday and I hope you
5 heard also and briefly give you our perspective.

6 First a few of the points that were raised,
7 really by multiple witnesses yesterday and in multiple
8 comment letters.

9 I start with IRAs are different. They are
10 not ERISA plans. They are regulated in large measure
11 by the Internal Revenue Code, with the Internal Revenue
12 Code Prohibited Transaction Rules and Internal Revenue
13 Code penalties, ultimately enforced by the Internal
14 Revenue Service. You have great responsibility there,
15 but the IRS also is involved.

16 IRAs also exist in a very different
17 environment from employment-based retirement plans, but
18 generally a retail environment without the involvement
19 of an employer.

20 We also learned yesterday and you already
21 know this, that there is very little analysis that has
22 been done on the costs of the DOL's proposed changes in

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1 the IRA world, costs that could ultimately, almost
2 certainly will ultimately, be passed through to
3 consumers.

4 Witnesses also noted that an integral part of
5 the ongoing congressionally mandated SEC review of the
6 standard of care that should be applied to brokers and
7 dealers, including specifically whether brokers and
8 dealers should be treated as fiduciaries includes the
9 IRA world and IRAs specifically.

10 We heard that the SEC and the DOL projects
11 were interrelated, that they overlapped at least at
12 some level. And we heard that the DOL and the SEC
13 projects had the potential to conflict in substantial
14 ways and thereby potentially impede the provision of
15 investment assistance to individuals and cause
16 widespread disruption of IRA providers and the way they
17 provide services, particularly in the commission-based
18 environment.

19 There was considerable discussion of how
20 exactly the department and the SEC should interact. I
21 think somewhat tongue-in-cheek, Phyllis, you said
22 should the DOL just roll over and follow the SEC lead?

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1 Obviously, not.

2 But the two government agencies do need to
3 work together and the words are "coordinate" or
4 "consult" or "harmonize." I don't really know the
5 difference between those words. I think certainly
6 there is a consensus that the agencies need to work
7 together and that they would work together. So we
8 agree with that approach.

9 But I'm also, you know, living in the real
10 world and I know that everyone over there who has ever
11 worked on a cross-agency project knows just how painful
12 that can be. The other agencies don't always agree
13 with you and that's a difficult process.

14 All too often when agencies say they're
15 coordinating, they basically go in, having made up
16 their minds on what they think the right answer is and
17 then -- and then argue about it and try and beat the
18 other agency into submission.

19 So we urge you in this context not to go in
20 and to actually work with the SEC. This is really an
21 opportunity to do that and to get to a better answer
22 for everybody in the case of IRAs, because any other

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1 approach in this world -- in the IRA world could be
2 very dangerous.

3 SEC and DOL should not craft their own rules
4 in advance, get their feet set in stone and then get
5 together at the end of the process and look for direct
6 conflicts. That is not going to be the best approach
7 for consumers. As one of the witnesses said yesterday,
8 I'll paraphrase him, what ends up happening in that
9 world is you may get dual standards and the good guys
10 incur the costs, the good guys follow the rules and the
11 bad guys don't in the IRA world.

12 Rather we urge you to follow the principles
13 laid out in the President's recent Executive Order
14 which requires active coordination, not simply
15 notifying other agencies of pending projects. The
16 Executive Order is very critical of regulatory
17 requirements that are inconsistent or overlapping and
18 requires agencies to attempt to promote coordination,
19 simplification and harmonization.

20 Consistent with that direction from the
21 President, the Department and the SEC should start
22 working together now towards a clear single standard

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1 fairness opinions conduct for broker/dealers providing
2 investment assistance to consumers.

3 This does not mean the Department rolls over
4 and does what the SEC says or vice-versa. Rather, the
5 agencies should work together from the outset in a
6 mutual effort to create a single consistent and clear
7 set of rules applicable to brokers and dealers
8 assisting customers with their IRAs.

9 Yes, the fiduciary and transaction rules
10 applicable to IRAs and the securities laws are
11 different. They have different objectives and both the
12 SEC and the Department have their own responsibilities
13 with respect to those statutes. But the benefits of a
14 consistent rule from our perspective -- given the
15 consumer are significant and that needs to be the goal.

16 In concluding that the same standard of care
17 should apply uniformly to both broker/dealers and
18 investment advisers, the SEC staff study concluded that
19 different standards of care served to confuse retail
20 customers and the consistent standards would increase
21 consumer protection. That's what's needed in the IRA
22 space, a single consistent standard.

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1 The Department has the authority to achieve
2 that objective through the fiduciary definition or
3 through prohibited transaction class exemptions.

4 Tim, you asked yesterday whether all of the
5 problems or many of the problems that were raised could
6 be dealt with by changing or tweaking the existing
7 prohibited transaction exemptions or providing new
8 ones. I think the answer may well be yes, but you
9 haven't done so. And that is obviously a great concern
10 when you're dealing with potentially massive
11 disruptions in the way business has always been done.
12 Disruptions that you may well not intend.

13 So those PT exemptions are critical and must
14 be adopted and considered concurrently with any changes
15 in the investment fiduciary definitions in order to
16 avoid that unnecessary disruption, particularly in the
17 IRA space. You've done that in the past with PT
18 exemptions associated with regulations and it is
19 completely appropriate in the case of major changes
20 like those you're dealing with right now.

21 And just as changes with the DOL's investment
22 fiduciary definition should be coordinated and

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1 harmonized with the SEC standards, appropriate PT
2 exemptions should to the extent possible be harmonized.

3 Once again, we appreciate that it's difficult
4 to reach that consensus opinion and that it could take
5 time. It also may lead you to conclude that it may
6 make sense to break out these non-ERISA plans from
7 other issues addressed in the proposed investment
8 fiduciary regulations, as you did for welfare benefit
9 plans under 408(b)(2), and now that project is ongoing
10 in that context.

11 But it doesn't, once again, mean that the
12 Department should step aside and just wait to see what
13 the SEC does. It doesn't have to mean that. Actually,
14 a dialogue starting right now between the DOL and the
15 SEC and I caution to say this, I dare to say this to
16 all of you, but the Treasury and the IRS folks who are
17 going to be responsible for enforcing this regime in
18 the IRA PT rules, those agencies should, consistent
19 with the President's Executive Order, agree at the
20 outset that the goal should be to work to arrive at a
21 single standard for broker/dealer's interacting with
22 retail customers in the IRA space.

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1 As I said, that single standard if properly
2 implemented and enforced consistently by the SEC and
3 the IRS, would be in the best interest of IRA
4 participants.

5 MR. DAVIS: Thank you.

6 Mr. Kaswell.

7 MR. KASWELL: Thank you. My name is Stuart
8 Kaswell and I am general counsel for the Managed Funds
9 Association.

10 MFA is pleased to provide the statement in
11 connection with the Department of Labor's hearing on
12 the proposed definition of the term fiduciary under the
13 Employee Retirement Income Security Act.

14 MFA represents professionals who manage and
15 advise hedge funds, funds of funds, and manage future's
16 funds as well as industry service providers.

17 MFA's members manage a substantial portion of
18 the approximately \$1.9 trillion invested in absolute
19 return strategies around the world.

20 MFA strongly supports the Department's goal
21 of protecting benefit plans and their participants and
22 we recognize that imposing fiduciary status in certain

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1 circumstances is important to achieve that goal. We
2 also support the Department's efforts to examine its
3 existing rules to see if they have become outdated.

4 Our concern, however, that the Department's
5 proposed definition of fiduciary may be broader than
6 intended. And it inadvertently could capture many
7 market participants that Congress and the Department
8 previously have explicitly determined should not be
9 fiduciaries under ERISA.

10 Each of the issues discussed in my testimony
11 today are also addressed in MFA's February 3rd comment
12 letter.

13 Before discussing the specifics of the
14 Department's proposed rules, it is important to note
15 that hedge funds and other alternative investment
16 vehicles are a valuable component of the investment
17 portfolio for sophisticated investors including pension
18 plans. The properly managed addition of hedge funds to
19 a portfolio -- sorry -- provides diversification, risk
20 management and returns that are not correlated to
21 traditional equity and fixed income markets. These are
22 critical benefits that help plans generate sufficient

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1 returns to meet their obligations.

2 The value that hedge funds add to plan
3 portfolios is demonstrated through the significant
4 investments made by plans and endowments in hedge
5 funds. Plans and endowments in every state invest in
6 hedge funds because of the benefits to their investment
7 portfolios.

8 The proposed rule may make a broad range of
9 entities fiduciaries for purposes of ERISA, including
10 the general partner and adviser to a fund that does not
11 hold plan assets under ERISA and persons providing
12 valuation services to such non-plan asset funds.

13 While it is clear whether -- while it is
14 unclear whether the Department intended to include such
15 parties within the scope of the proposed rule, we
16 respectfully submit that such an interpretation would
17 be inconsistent with a clear Congressional mandate that
18 such entities should not be fiduciaries under ERISA.

19 Congress most recently spoke to this issue
20 when it enacted the Pension Protection Act of 2006,
21 which added section 342 of ERISA. Section 3(42) states,
22 as you know, the assets of any entity shall not be

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1 treated as plan assets if immediately after the most
2 recent acquisition of any equity interest in the
3 entity, less than 25 percent of the total value of each
4 class of equity interest in the entity is held by
5 benefit plan investors.

6 The statutory language and the Department's
7 rules clearly demonstrate that advisers and service
8 providers to non-plan asset funds are not fiduciaries
9 under ERISA.

10 Because the language in the proposed rule is
11 drafted so broadly, we are concerned that it could be
12 interpreted in a way that is inconsistent with the
13 plain language of ERISA as well as with the
14 Department's own rules and guidance with respect to
15 non-plan asset funds.

16 Accordingly, we urge the Department to make
17 clear in any final rule that nothing in the rule will
18 cause a general partner, adviser or service provider to
19 a non-plan asset fund to become a fiduciary because of
20 any statement, report or recommendation regarding the
21 value of the non-plan asset fund or any of its assets.

22 We also are concerned that the proposed rule

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1 could make the general partner or adviser to a plan
2 asset fund a fiduciary to plan investors simply because
3 the plan asset fund sends periodic reports to fund
4 investors. Such an interpretation would create
5 uncertainty as to whether the fees charged by an
6 adviser could violate the prohibited transaction
7 provisions of ERISA. As a result, managers may not
8 provide comprehensive information to plan investors.

9 Each of the service providers or counter-
10 parties that provide information regarding the value of
11 an asset also could be a fiduciary under the proposed
12 rule, which could invalidate their asset-based fee
13 compensation. Faced with potentially prohibitive costs
14 or the inability to find suitable service providers,
15 funds may be reluctant to take investments from ERISA
16 plans which would greatly limit plans' alternative
17 investment options.

18 We urge the Department to consider a more
19 narrowly tailored approach with respect to determining
20 which persons involved with the valuation of assets of
21 a plan fund, asset fund should be considered
22 fiduciaries.

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1 Turning to other topics, we are concerned
2 that the selling exception may not adequately cover the
3 marketing activities of pooled investment funds. We
4 recommend that the Department revise the exception to
5 cover the selling of services and investment products
6 by a fund or its adviser to a new and existing
7 investor. A fund's marketing activity should not by
8 itself create a fiduciary relationship.

9 Further, the proposed rule requires that the
10 seller warn the plan that its interests are adverse. We
11 urge the Department to delete the term "adverse." In
12 our view, it should be sufficient if a seller makes
13 clear that it is providing marketing services and not
14 impartial investment advice. We would have no
15 objection requiring marketers to state when they have a
16 financial interest in the outcome.

17 The selling exception also should make clear
18 that it covers counter-parties and swaps and other
19 lending credit arrangements. Finally, it should cover
20 contractual rights and the exercise of those rights.
21 Without appropriate exceptions fund counter-parties may
22 refuse to deal with any fund -- any plan asset fund

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1 because the risk that the counter-party could be deemed
2 a fiduciary.

3 The proposed rule also changes three well-
4 understood tests for determining fiduciary status which
5 remove uncertainty and clarity from the definition.

6 First is mutual understanding. We believe
7 the rule should be based on both parties' understanding
8 when a person becomes a fiduciary, as under current
9 law. Eliminating the term "mutual" creates uncertainty
10 whether a plan could elect on its own to make another
11 person a fiduciary.

12 We respectfully urge the Department to
13 reinstate the term "mutual."

14 Second, may be considered. Another change is
15 that advice does not need to be a primary basis for a
16 plan's decisions. A person may become a fiduciary if
17 the advice may be considered in the plan's investment
18 decision.

19 We respectfully submit that this formulation
20 is overly broad and could apply to all information
21 conveyed to the plan. The proposed rule would create
22 significant uncertainty and potentially broad liability

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1 for market participants.

2 The Preamble to the proposed rule states that
3 the rule is intended to capture persons who
4 significantly influence the decision of plan
5 fiduciaries and have a considerable impact on plan
6 investment. We urge the Department to use that
7 standard, "significantly influence" rather than may be
8 considered in the test for when advice should be deemed
9 fiduciary advice.

10 Third, tailored advice. Under the proposal,
11 public recommendations such as information provided at
12 conferences and publicly available research materials
13 may be deemed fiduciary advice regardless of the forum
14 and even if the recommendations are not tailored to a
15 particular plan. While the Department may have not
16 intended this far-reaching result, the proposal creates
17 uncertainty as to the scope of recommendations that
18 will be deemed fiduciary advice.

19 Accordingly, we urge the Department to amend
20 this part of the proposed rule.

21 We also are concerned that the definition of
22 fees in the proposed rule could be interpreted to

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1 require aggregating many unrelated transactions
2 resulting in fiduciary status for unwitting service
3 providers. It is critical for market participants to
4 fully understand the scope of this new definition.

5 Accordingly, we encourage the Department to
6 provide guidance on the intended scope of the
7 definition and to allow a further period for public
8 comment.

9 MFA appreciates the opportunity to testify
10 before the Department. We hope to play a constructive
11 role in shaping any changes to the scope of the
12 fiduciary status rules.

13 I'd be pleased to try to answer any
14 questions.

15 MR. DAVIS: Thank you, Mr. Kaswell.

16 Mr. Anderson.

17 MR. ANDERSON: Good morning. My name is Tom
18 Anderson. I'm the vice chairman and founder of the
19 Pensco Trust Company and president of the Retirement
20 Industry Trust Association who I reference as RITA.

21 The good news is that we're near the end of
22 this hearing for you. The bad news is I'm going to be

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1 adding to the litany of concerns, however, the good
2 news there is I have fewer concerns than some of the
3 others because of the nature of our business.

4 I do appreciate the opportunity to testify on
5 behalf of our organization. We are a nonprofit
6 national trade group consisting of federally and state
7 registered banks and trust departments or trust
8 companies and we administer approximately 400,000
9 retirement accounts with approximately \$55 billion in
10 retirement assets.

11 RITA members generally act as directed
12 custodians or non-discretionary trustees of self-
13 directed IRAs and individual pension plans like 401(k)s
14 for sole providers.

15 These plans generally hold alternative assets
16 including real estate, private equity, private debt,
17 real estate being foreign, domestic, and many other
18 alternative assets that are permitted under the
19 Internal Revenue Code. We also include traditional
20 assets such as stocks and mutual funds.

21 Unlike the majority of the nation's IRA
22 administrators and custodians, we don't channel or

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1 limit the choices of the clients' investments. The
2 client can be the fiduciary and usually is, along with
3 another selected fiduciary like an adviser, directs us
4 to acquire whatever assets that are permitted under the
5 law.

6 In that sense and by virtue of the facts that
7 we provide no investment advice and we sell no
8 investment products, but for some of the provisions
9 under the proposed regulations, we are about as far
10 from being fiduciaries as most of the people who
11 testified here in the last two days.

12 However, because of certain elements within
13 the Department's proposal, we will indicate our
14 objections, which we believe could potentially be
15 harmful to not only us but the Americans that we serve.

16 In short, there are three problematic
17 elements in the Department's proposal that resulted in
18 our wanting to be here to testify.

19 First, we do not believe self-directed
20 custodians and trustees should be deemed fiduciaries
21 merely for reporting assets and their values determined
22 by other third parties as implied in the current

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1 proposal.

2 We do believe that we should be able to
3 provide helpful information to participants and IRA
4 owners on the rules, tax consequences and mechanics of
5 both discretionary and mandatory distributions. We
6 think, in fact, that's our duty as -- under our service
7 agreements.

8 And, lastly, we believe that IRA custodians
9 should be granted the same exemption from being
10 considered investment advice, that is the provision of
11 educational material and a platform for the
12 distribution of mutual funds and other securities as
13 granted defined contribution plan administrators.

14 To support our position, RITA members have
15 never been deemed fiduciaries heretofore. RITA is not
16 hiding behind our disclosures but being judged by our
17 contractual obligations and our actions. RITA members
18 do not give investment advice. Consequently, we do not
19 contract nor charge for something that we don't
20 provide. We also do not sell investment products nor
21 do we have any business relationships with ASA sponsors
22 or advisers. We do not determine the value of assets

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1 we hold as self-directed custodians. It is the
2 fiduciary's responsibility to obtain the value and to -
3 - and we report on that after we receive it from them.

4 Custodians are, however, subject to certain
5 reporting obligations under the Internal Revenue Code.
6 Most notably custodians of IRAs must provide annual
7 evaluations in order to comply with reporting
8 requirements of the Code. In doing so, self-directed
9 custodians report values that are provided by third
10 parties such as investment providers and investment
11 managers who in turn may rely on professional valuation
12 or appraisal firms.

13 Furthermore, self-directed custodians do not
14 have the legal authority to demand from investment
15 sponsors the information that would be required to
16 independently perform valuations on alternative assets.
17 I think it is both infeasible and unrealistic to assign
18 responsibility when the authority to execute it is
19 neither existent or granted in conjunction with that
20 responsibility.

21 As stated by several parties yesterday, the
22 mere act of passing through the value of an asset

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1 determined by someone else should not be considered a
2 fiduciary act even in conjunction with a distribution
3 event. In addition, we feel it is axiomatic that a
4 person without discretionary authority is not acting as
5 fiduciary. In fact, the very notion of extending
6 fiduciary status to self-directed custodians is at odds
7 with ERISA's functional definition of a fiduciary.

8 A person is a fiduciary only to the extent
9 that that person is performing a fiduciary function and
10 the mere transmittal of valuation information is not a
11 fiduciary function.

12 Similarly, one can fairly characterize the
13 role custodians serve satisfying the reporting
14 obligations of the Code as a mere ministerial role,
15 which again is a type of a role that ERISA clearly
16 views as non-fiduciary.

17 I would also like to at this point agree with
18 my colleague over here that we're talking IRAs here for
19 the most part or non-ERISA pension plans. So there's
20 even more of a reason to divide the issue.

21 As clarification on this point to eliminate
22 fiduciary status for mere reporters of asset values is

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1 critical to ensuring the ongoing viability of self-
2 directed IRAs and retirement plans. I think all of us
3 in the industry appreciate the Department's efforts and
4 that of other regulators to raise the bar, if you will,
5 to avoid the next Bernie Madoff. But let's all be
6 clear here Bernie was a fiduciary and the imposition of
7 new regulations wouldn't have helped. And, basically,
8 the enforcement of the existing regulations were -- was
9 needed. It would have helped immensely.

10 The moral here is the imposition of new
11 regulations has to be carefully thought through so the
12 intended consequences achieved in a manner that is
13 cost-effective overall for the intended beneficiary,
14 the consumer. Put another way, if we end up through
15 additional regulation to pass on more net expense to
16 the retirement system and savers that we serve, we have
17 missed the mark.

18 To demonstrate how easy that is, and in all
19 deference to Ms. Borzi, I have to be honest and admit
20 that I did unintentionally consume a small amount of
21 foie gras last evening when I -- when I intentionally
22 ordered the chestnut soup at Marcel's without having

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1 read the small print.

2 So I think while the five points that are --
3 exist in the 1975 Code for exceptions, are maybe
4 subject to some consideration for change, I think the
5 one thing that's good about those five points is
6 they're understandable and digestible and you can, much
7 like IRC 4975, you can maintain compliance with them.

8 But seriously, I'd like to say that we concur
9 with many of the previous speakers as follows:

10 The proposal appears well intentioned but has
11 the potential to have negative consequences that could
12 far outweigh the intended benefits.

13 Expanded rules and regulations could result
14 in inefficiencies, unnecessary litigation, loss of
15 services and higher costs.

16 The proposal, if not harmonized with that of
17 the other regulators, could result in the development
18 of overlapping and conflicting regulation between
19 regulators which is likely to do nothing more than add
20 more legal expense and litigation.

21 We agree with the Department, we agree with
22 the Department that entities should not hide behind

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1 their disclosures. I for one believe that actions, not
2 words of disclosures, speak louder than such words and
3 I believe case law substantiates that the courts do as
4 well. In other words, if it walks and quacks like a
5 duck, it is a duck despite what it quacks to the
6 contrary.

7 As stated yesterday, fiduciary status should
8 be based on the actual nature of the advice provided
9 and not what is said about the advice in terms of what
10 -- what it might be -- might be when it is provided.

11 To conclude for us, imposing a fiduciary
12 status on custodians would also not serve the policy
13 concern that is motivating the Department. Directed
14 custodians do not operate under any conflict of
15 interest nor are they in a position to exert any
16 influence over plan decisions. When they furnish plan
17 reports to satisfy tax law requirements the custodian
18 is merely complying with the -- sorry, supplying the
19 information provided by third parties.

20 Unfortunately, the potential imposition of
21 fiduciary status could have enormous consequences. IRAs
22 hold more than 4 trillion in retirement assets which

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1 represents more than one-quarter of all U.S.

2 retirement wealth. It is critically

3 important that directed custodians continue to offer

4 cost-effective administrative services to millions of

5 Americans diligently saving for retirement.

6 Custodians do not currently carry fiduciary

7 insurance and more than likely would be unable to

8 obtain it even at a high cost. Some custodians could

9 exit the industry leaving fewer providers to administer

10 retirement plans and at higher cost to consumers. This

11 in turn could result in fewer investment choices for

12 retirement savers, less investment diversification and

13 therefore, higher investment risk for American savers.

14 In conclusion, for the reasons discussed

15 above, we urge the Department to modify the final

16 regulation to explicitly provide that the custodians

17 who furnish valuations or do value assets prepared by

18 third parties on plan reports are not investment

19 fiduciaries. The absence of such a clarification would

20 have enormous implications for our industry, the

21 clients we serve and the retirement system.

22 Thank you for consideration and we're open to

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1 any questions.

2 MR. DAVIS: Thank you.

3 MS. BORZI: Well, notwithstanding the fact
4 that your Panel 10, I think you -- I want to thank you
5 for your valuable contribution to these hearings. And
6 everyone will be relieved to know that I have a -- just
7 a few things that I want to say and then I'm going to
8 disappear.

9 And for those of you who are of the panels
10 this afternoon, you will probably be even more relieved
11 to discover that I'm not going to be here this
12 afternoon because I'll be with the Secretary at the
13 PBGC Board Meeting.

14 So really, there are just -- there's just
15 really one thing that I want to say and I want to
16 reiterate it for the people who weren't here yesterday.
17 Randy, we're not going to take your advice to begin to
18 coordinate now, because actually we've been trying to
19 work with the other agencies and have been working with
20 the other agencies for quite a while because we think
21 it -- we thought that this was very important. We
22 worked with the SEC, with the CFTC, from prior to the

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1 enactment of Dodd/Frank and, of course, we have a
2 longstanding relationship with the IRS.

3 I am completely mindful because both of us
4 had prior lives, about the difficulty of working
5 together. And that's why yesterday I made it quite
6 clear that what we're trying to do is harmonize these
7 rules, and that's our goal and objective. Not just --
8 and the reason I engaged in that dialogue with Steve
9 Saxon yesterday was because on one of the earlier
10 panels we were admonished that coordination wasn't good
11 enough. That if coordination meant just talking to
12 each other and telling each other what we're doing that
13 that wasn't good enough. And there isn't anything that
14 I agree with more than that.

15 So let me also repeat something that I said
16 yesterday and I feel very strongly about, we have no
17 intention and there's no mileage for us, to increase
18 the cost to the regulated community by having you have
19 to comply with multiple and conflicting standards.
20 Having been in this business for too many years than I
21 care to count, certainly since the passage of ERISA,
22 I've seen both in the public sector and the private but

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1 in the government and the private sector, I've seen the
2 destructive and counter-productive impact of
3 conflicting rules and regulations. And if there's one
4 thing that I'm determined to avoid it's that.

5 So you should -- nobody should have any doubt
6 of our desire to avoid all the concerns that you and
7 the prior panelists have exhibited. Is it going to be
8 easy t try to reconcile these things? Probably not.
9 But are we committed to doing it, the answer is
10 absolutely, yes.

11 But I can't resist pointing out one thing and
12 you were in the audience yesterday I think when I --
13 when I responded to this as well. There is not -- we
14 cannot guarantee, given the fact that we have multiple
15 legal regimes here, that broker/dealers will have a
16 single standard. And that was the nature of my
17 question yesterday, because I was a bit confused about
18 some of the testimony.

19 Yesterday, a lot of people talked about it
20 and you referred to it as well, the SEC study of broker
21 -- that was required in Dodd/Frank. And people tend to
22 talk about how there needs to be a uniform federal

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1 standard as if that had a much broader direction from
2 Congress for application. You correctly stated that
3 this uniform Federal standard that Congress directed
4 the SEC to study was under the securities laws and it
5 had to do with whether the standards that currently
6 apply to investment advisers should advise -- should
7 expand -- be expanded to broker/dealers.

8 But certainly there's no implication and one
9 should take none from Congress' direction to the SEC to
10 look at that, that that in any way means that our ERISA
11 standard which is a higher fiduciary standard than that
12 in the securities law needs to be subrogated to that,
13 if you will.

14 So as -- building on what Alan observed
15 before, in my mind, the project that we're engaged in,
16 the mutual dialogue that we're engaged in and the --
17 it's all about three things. It's about
18 accountability, it's about transparency, and it's about
19 conflicts of interest.

20 And my hope, my goal, is not just that we
21 will try to harmonize the potential conflict in these
22 other statutes but that we will continue to work with

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1 all of you in the regulated community. I heard some
2 very important things over these past two days and
3 surely agree with at least some fairness opinions them.

4 And to the extent that we can address them
5 and work cooperatively we're going to. That will be
6 our goal. So with that, I'll stop and have my
7 colleague here ask his questions.

8 MR. DAVIS: I have no questions. I can't top
9 that. I'll pass it on to Alan.

10 MR. LEBOWITZ: None from me. Thanks for your
11 thoughtful comments.

12 MR. PIACENTINI: I guess I have just one
13 question for Mr. Hardock. In terms of IRAs being
14 different, I will note that there are some IRAs that
15 are also ERISA plans and for that purpose, do they go
16 in the bucket with the plans or in the bucket with IRAs
17 or in a third bucket or why?

18 MR. HARDOCK: I think as a -- I think I
19 started saying I was going to talk about process and
20 not substance. I think they are in a third bucket. You
21 clearly have different factors there and you would need
22 to have that be part of the process.

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1 And as Phyllis indicated, you have
2 responsibilities not only there but in interpretative -
3 - or in the allocated responsibility in the IRA space.
4 So, but I do think there are different factors that
5 would have to be taken into account there.

6 MR. PIACENTINI: Thanks.

7 MR. WONG: I just have one question. This is
8 for Mr. Kaswell. In talking about plan asset vehicles,
9 he seemed to express concern that with respect to a
10 plan asset vehicle, when the general partner sends out
11 a statement to its investors reflecting the value that
12 that would be considered fiduciary in nature under the
13 proposal.

14 So my question is: Under current law would
15 you view that fiduciary -- that valuation of the plan
16 asset vehicles assets as being fiduciary in nature in
17 and of itself just because it's a plan asset vehicle?

18 MR. KASWELL: Well, I think with respect --
19 certainly with respect to the investment adviser's act
20 that the advisers to the fund is a fiduciary and to the
21 securities law. Now, I understand I'm sitting in the
22 Department of Labor not at the SEC and I get it. But

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1 the responsibilities of the -- of the adviser in that
2 setting are formidable.

3 There are very strong incentives to get it
4 right and we know that if we don't get it right, bad
5 things can happen. That if you set it too low because
6 fees for investment managers are linked to the -- how
7 well the fund does you've hurt yourself. If you set it
8 too high and somebody's redeeming, you're going to bail
9 out somebody, you're going to pay out somebody at a
10 higher rate and penalize the rest of the -- the rest of
11 the advisers -- the rest of the investors, excuse me.

12 So we think that there are strong incentives
13 for an adviser to get that right and to make sure that
14 the -- the assessment -- the analysis on the evaluation
15 is as correct as they can make it and also want to be
16 able to go to outside parties if we're not sure we have
17 the expertise internally, the manager, that is, so that
18 it can say well, we think for most of these assets we
19 can do it but we want to get some outside advice to
20 validate our own analysis. We want to make sure that
21 all of those things remain open.

22 MR. WONG: And just -- so I'm making sure I

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1 fully understand your response. We are talking about a
2 plan asset vehicle that has greater than 25 percent
3 benefit for an investor and doesn't meet one of the
4 exceptions in the current plan asset regulation?

5 MR. KASWELL: Right.

6 MR. WONG: Is that correct?

7 MR. KASWELL: Yeah. I must admit that since
8 I am not an ERISA lawyer, I can get lost in this. And
9 so if we need to clarify for the record I'm happy to do
10 that.

11 MR. WONG: Okay. We'll clarify that. Just
12 please feel free to do so.

13 MR. KASWELL: Sure.

14 MR. DAVIS: Thanks, Panel 10. Thanks for
15 your time. Very helpful comments. We're going to
16 adjourn lunch and reconvene on time at 1:15. So we'll
17 see you in just about an hour.

18 A F T E R N O O N S E S S I O N

19 MR. DAVIS: If the members of Panel 11 could
20 approach the stage, take your seats. We have Mark
21 Smith with the Financial Services Institute:
22 John Watts and Peter Schneider; Primerica and Brian

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1 Tate with the Financial Services Roundtable.

2 Okay, Panel 11, we'll start with Mark Smith.

3 MR. SMITH: Good second afternoon of the
4 hearing. I am Mark Smith from the Sutherland Law Firm.
5 And I'm testifying today on behalf of the Financial
6 Services Institute or FSI. My testimony focuses on the
7 impact of the proposed definition of fiduciary on plan
8 participants and IRA owners who obtain investment
9 services through independent broker/dealers.

10 FSI is a policy and advocacy organization for
11 independent broker/dealers and independent registered
12 representatives. In the U.S., approximately 201,000
13 registered representatives operate as self-employed
14 independent contractors of independent broker/dealers
15 rather than employees of an affiliated broker/dealer
16 firm.

17 Independent broker/dealers primarily engage
18 in the sale of packaged products, such as mutual funds
19 and variable insurance products to invest individual
20 investors in retirement plans and have been an
21 important part of the retirement savings community for
22 more than 30 years.

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1 Independent broker/dealers and their
2 representatives are especially well suited to provide
3 middle-class Americans with the investment products and
4 services necessary to achieve their retirement security
5 and other financial objectives and goals.

6 The proposed redefinition of fiduciary is
7 without question among the most consequential ERISA
8 rulemakings the Department could undertake. The
9 existing regulatory definition of investment advised
10 fiduciary promulgated in 1975, just after the enactment
11 of ERISA has informed 35 years of practice for employee
12 benefit plans and providers of investment services to
13 those plans.

14 While FSI addressed a number of issues in our
15 comment letter, our principal point today is that the
16 financial services industry in the main is not and
17 cannot be organized as ERISA fiduciaries. I should
18 emphasize that this is not because FSI's members see
19 their interest as adverse to those of plan participants
20 or other investors. The objective and aspiration of
21 independent broker/dealers is to serve the best
22 interest of their customers and FSI supports, for

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1 example, a harmonized securities law standard for
2 broker/dealers and investment advisers that promotes
3 investor interest and choice, transparency, low cost
4 investment products and services and the avoidance of
5 conflicts.

6 And having noted that, I do feel obliged to
7 note that FSI's written comment letter did not exhort
8 the Department to harmonize with other agencies given
9 our absolute confidence that the responsible agencies
10 already were actively and constructively engaged in
11 that process in a manner that will be a credit to all
12 at the end of the day.

13 MR. DAVIS: Thanks, Mark.

14 MR. SMITH: You're most welcome.

15 Instead, our concern reflects the reality
16 that financial services companies sell investment
17 products and services. Specifically, independent
18 broker/dealers and their registered representatives
19 provide highly regulated professional investment
20 services to investors in accordance with standards of
21 conduct specified by the SEC, FINRA, State Insurance
22 Commissioners and other regulators in addition to the

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1 Department. Most often, they are lawfully compensated
2 on a commission basis, a form of compensation allowed
3 service providers under ERISA but not investment advice
4 fiduciaries as the Department interprets the statute.

5 Over the last 35 years, the Department has
6 devoted significant resources to building a regulatory
7 structure that makes it possible for broker/dealers to
8 continue their important services for plans and their
9 participants and necessarily so.

10 The investment services provided by
11 broker/dealers are both exclusively available for them
12 in many cases as a matter of federal and state law and
13 integral to the purposes of ERISA plans.

14 The requirements of this regulatory structure
15 turn in many instances on whether the broker/dealer is
16 or is not acting as an investment advice fiduciary for
17 the plan. Since independent broker/dealer firms are
18 most fundamentally selling firms, doing business in the
19 ordinary course on a commission basis inconsistent with
20 the requirements for ERISA fiduciaries, a distinction
21 between non-fiduciary and fiduciary activity is
22 sensible both in the marketplace at law. And whatever

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1 its perceived faults, the current five part regulatory
2 test for investment advice fiduciary status provides a
3 reasonably reliable way for independent broker/dealers
4 to structure their relationship with the plan on either
5 a fiduciary or non-fiduciary basis as appropriate to
6 the circumstances.

7 FSI's concerned that the Department's
8 proposed redefinition of fiduciary status upsets this
9 carefully crafted and balanced regulatory structure.
10 The proposed replacement of the five-part test with the
11 new multi-factor test would substantially prevent a
12 broker/dealer in a plan from purposefully and reliably
13 arranging their relationship on a non-fiduciary basis.

14 It may even be that ordinary broker/dealer
15 sales activity incidental to securities transactions
16 would be treated as investment advice under the
17 proposed multi-factor test.

18 Moreover, the new excerpts in the proposed
19 in the proposed regulation as drafted, neither provide
20 a reliable means for a plan and a broker/dealer to
21 avoid fiduciary status when that status is both
22 unintended and unwarranted, nor reflect a distinction

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1 under ERISA between marketing and fiduciary activity
2 recognized by the courts.

3 In short, the -- in our judgment, the
4 proposal threatens to undo 35 years of work by the
5 Department to assure that the necessary investment
6 services provided by securities firms remain available
7 on viable terms to ERISA plans.

8 Also, there are entirely legitimate business
9 reasons for financial services firms to limit their
10 activities to plans to non-fiduciary services. The
11 incremental risks and costs of acting as an ERISA
12 fiduciary is, for many firms, beyond the prudent reach
13 of their resources. If the final regulation does not
14 provide a clear path to avoid fiduciary status where
15 appropriate, these firms will be driven out of the
16 retirement market by regulatory uncertainty rather than
17 for any reason on the merits which is not to the
18 benefit of plans, their participants or our capital
19 markets.

20 Given the detriment to plans and their
21 participants of leaving these issues unaddressed, we
22 respectfully submit that any final regulation must

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1 unambiguously provide a means for broker/dealers to
2 continue in the ordinary course to provide their
3 necessary services to plans other than as ERISA
4 fiduciaries.

5 This might be accomplished in a variety of
6 ways, which are outlined in FSI's comment letter to the
7 Department. They might include providing a specific
8 exemption crafted for broker/dealers or reframing the
9 selling exception to cover investment intermediaries
10 who state in writing that they are not undertaking to
11 act as fiduciaries in the manner required by ERISA.

12 I should also comment on the potentially
13 profound impact of the proposed redefinition on IRA
14 owners who work with independent broker/dealers. We
15 share the view you have heard from many others that the
16 proposal would have the unintended consequence of
17 constraining both the choices of IRA owners and the
18 availability of commission-based products and services
19 in a manner that may increase costs and reduce
20 retirement savings.

21 Accordingly, we concur that in light of the
22 fundamental structural differences between ERISA plans

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1 and IRAs, the Department should consider whether the
2 appropriate scope of fiduciary status should be
3 different for IRAs and Title I plans.

4 Finally, I should also note that while we did
5 not cover this point in FSI's written comments, we have
6 come to the conclusion that it would not be possible to
7 meet the 100-day -- 180 days after publication
8 effective date in the proposal. If the final
9 regulation necessitates either any meaningful analysis
10 of or any adjustments to the millions of relationships
11 independent broker/dealers have with ERISA plans and
12 IRAs, no less than 12 months would be required.

13 We didn't want you all to think just cause we
14 hadn't commented on it we didn't care.

15 This concludes FSI's testimony. We
16 appreciate the opportunity to testify today and welcome
17 the opportunity to answer your questions and work with
18 the Department on this important regulation.

19 MR. DAVIS: Thanks so much, Mr. Smith.

20 Now, Mr. Watts and Mr. Schneider.

21 MR. SCHNEIDER: Yes. Peter Schneider. I'm
22 the general counsel, executive vice president of

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1 Primerica.

2 On my right is John Watts who's the chief
3 counsel of our broker/dealer.

4 We very much appreciate the opportunity to
5 discuss the proposed rule with you and we very much
6 want to work with the Department to try and craft the
7 rule if there's going to be a change in a way that
8 allows companies like ours to function.

9 And what I thought I'd do is tell you a
10 little bit about Primerica, because Primerica's very a
11 interesting company but I think more importantly, we
12 operate in a marketplace, in an IRA marketplace that
13 I'm not sure you've heard a lot about. So I'd like to
14 start there.

15 So, Primerica is -- we have an insurance
16 company, we have a broker/dealer, which is what's
17 relevant here, and we will also do a loan for a client.

18 The households that we go into are distinctly
19 middle market households. So our clientele is going to
20 earn between \$30,000 a year and \$100,000 a year. They
21 way I like to characterize our client is if you go into
22 a Wal-Mart you're going to see our client. If you go

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1 into a Target you're going to see our client. They're
2 probably not going to be in Neiman Marcus and they're
3 probably not going to be in Family Dollar. So that's
4 where our clientele is going to be.

5 And we have tremendous diversity among our
6 client base and they have extraordinary needs that
7 frankly, are not met at all by the traditional
8 broker/dealers, because the small account, the small
9 investor, the investor that does not have a huge nest
10 egg of money to invest, has not been where the
11 traditional industry is focused for the simple reason
12 that the transition sizes tend to be very small.

13 So what a Primerica rep does, and we have a
14 lot of them, so, we have about 20,000 Primerica
15 representatives, I think it might make us the largest
16 broker/dealer in the country by number of reps, we will
17 knock on doors that no one's knocking on.

18 And let me tell you what we do. First of
19 all, we knock on the door. So we're going to go into a
20 household that has probably never met with someone in
21 the financial services industry and we're going to sit
22 down at their kitchen table, we're going to help them

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1 understand their needs. We're going to talk to them
2 about death protection and that's our insurance
3 product.

4 We're going to talk to them about how to
5 manage debt. What we would say in our market, the
6 saying we have, is they have "too much month at the end
7 of the money." So they always have debt. And they are
8 very unlikely to have any savings.

9 So, anecdotally, we looked at what we find
10 when we come into a household with respect to an IRA.
11 And out of 25 homes that we go into and sit across from
12 those families, about 5 are going to have any IRA at
13 all and they're very likely to be unfunded.

14 And so what's our goal? Our goal is to take
15 that family and first of all, give them a financial
16 education. So I did bring some materials, which I can
17 pass out. I don't know if we're supposed to be
18 distributing things our not, but we have something
19 called How Money Works, which takes them through --
20 it's a very good document. It takes them through
21 financial education. We have little brochures about
22 IRAs 'cause our clients probably don't know a lot about

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1 IRAs.

2 And what we want them to do -- if we do our
3 job, we go into this household and we do our job,
4 they're going to have debt protection, they're going to
5 have a better understanding of their debt. We can't
6 always help them with that, especially with the current
7 lending environment, although we only did fixed rate
8 loans, never variable mortgages. And we only do, by
9 the way, term insurance. We don't believe in whole
10 life insurance for our market. We will pay this year
11 about a billion dollars in death claims to middle
12 market personnel.

13 But focusing on, I think, what you care about
14 is the IRA. So about almost 60 percent of all the
15 accounts we open are IRAs. Around 56, 57 percent are
16 IRAs.

17

18 And what we want that family to do is to put
19 money aside for retirement. We'll also, by the way, we
20 also carry 529 college savings plans. So we're looking
21 at save for college, save for retirement. But the main
22 thing is save. Because in this market with our

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1 clients, the biggest competition we have is not
2 broker/dealers, not ERISA plans -- a lot of the folks
3 in our market don't have employers who are going to
4 provide them with 401(k)s.

5 The biggest competition we have and I'm not
6 being facetious is American Idol, because if we were
7 not in that home helping that family, they're going to
8 get distracted by all the things we all get distracted
9 with in life and they're not going to put money aside.

10 So our goal is to start them savings. And so
11 we'll take what we do what's called "pre-authorized
12 checking" so we'll set up a monthly debit to a checking
13 account that will then go into an IRA. And we'll do
14 \$50, we'll do \$100. You know, these are not huge
15 accounts but you have to start somewhere. And over
16 time, these accounts accumulate a fair amount of money,
17 although, they're still very modest when you compare
18 them to other broker/dealers.

19 We also have though, just like everyone else,
20 we have a fixed cost infrastructure. So we have to
21 have websites, we have to have a platform, we have to
22 send out account statements, we have to pay a

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1 representative to go into that home. We have to have
2 compliance and we have to have legal; all of that
3 exists.

4 And, by the way, you have to do that for a
5 small account and you have to do that for a big
6 account. The difference is the big account can easily
7 afford those costs; the smaller account it's much more
8 challenging.

9 And the fear that we really have with the
10 Department of Labor's proposal is this: We
11 can't figure out how that can work economically in a
12 marketplace like ours. What we do know is how the
13 current market works. The broker/dealer model that we
14 deal with day in and day out works. It's able to
15 provide enough revenue, a commission to a
16 representative for opening an account. It's able to
17 help us defray our infrastructure. It helps us service
18 a client.

19 But if the prohibited transaction rule, if
20 this applies to us, if we become a fiduciary for what
21 we do and the prohibited transaction rule applies to
22 us, then you've got to look at a model change. And if

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1 we go to an advisory model where there's going to be a
2 fixed fee based on assets, it doesn't work. And the
3 reason it doesn't work is number one, the asset sizes
4 aren't enough if you're going to charge a small fee.

5 So if someone's putting \$1,000 into an
6 account in a year, that's \$11.50 that's for fixed costs
7 and paying the rep. In today's gas prices they
8 probably can't drive across town to do that servicing.
9 So you have that concern.

10 But the alternative to that is well, why
11 don't you just make the advisory fee enough to cover
12 all of your costs. Well, now you're at an advisory fee
13 that is so exorbitant that it doesn't make sense for
14 that account to open an IRA. So naturally what they
15 would do is they'd look for other products. But we're
16 believers in IRA, we think it's good for our clients.
17 We think it's important to save money for retirement.

18 And, finally, you got to have a
19 representative. The folks in our market, as well
20 meaning as they are, they're not going to be solicited
21 by other broker/dealers and they're very unlikely to
22 walk into a bank and just open an IRA on their own.

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1 That representative plays a crucial role. So in an
2 advisory model there's all sorts of licensing
3 requirements that they would have to go through to get
4 themselves licensed as an investment adviser and other
5 duties what would be continuing.

6 That's the struggle we have and that's the
7 concern we have with the rule. What is very important
8 to us is that the Department really understand how this
9 rule affects the small investor, the starter IRAs,
10 because the danger is if that's not understood, and
11 it's just a bludgeon approach, that will substantially
12 impact the ability of companies like ours and then a
13 lot of companies like ours to service that initial
14 small investor. And that's what we'd ask of the
15 Department.

16 MR. DAVIS: Okay. Thank you.

17 Mr. Tate.

18 MR. TATE: Hello. Good afternoon. And thank
19 you for the opportunity to testify today. I'm Brian
20 Tate with the Financial Services Roundtable.

21 The Roundtable supports strong consumer
22 Protections for retain investors. We have long been

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1 supportive of the harmonization of the regulations for
2 broker/dealers and investment advisers when providing
3 personalized investment advice about securities to
4 retail customers.

5 Consistent with Congress' interest in
6 developing a uniform standard of care, we believe that
7 these worthy goals can be achieved without subjecting
8 broker/dealers and investment advisers to duplicative
9 and overlapping regulatory regimes that create
10 confusing -- confusion among investors and may not
11 recognize and allow for differences in the business
12 models, services and products provided by a range of
13 financial services professionals.

14 Last year, Congress pursuant to Dodd/Frank,
15 charged the SEC with studying the obligations of
16 broker/dealers and investment advisers. The SEC was
17 mandated to report on the effectiveness on existing
18 federal, state, legal, or regulatory standards in the
19 protection of retail customers relating to the
20 standards of -- standards of care for broker/dealers,
21 investment advisers and their respective associated
22 persons when providing personalized investment advice

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1 and recommendations about securities to retail
2 customers.

3 In their report, the SEC staff recommended
4 that the SEC promulgate rules to implement a uniform
5 fiduciary standard of conduct for broker/dealers and
6 investment advisers when providing personalized
7 investment advice about securities and to retail
8 customers and such other customers as the SEC
9 determines.

10 The staff recommended that the SEC define the
11 standard of care as a duty to act in the best interest
12 of the customer without regard to the financial or
13 other interest of the broker/dealer or investment
14 adviser providing the advice.

15 As part of the rulemaking, the staff
16 recommends that the SEC address not only the clones on
17 the universe -- uniform fiduciary standard, but that it
18 also provide guidance on specific scenarios to assist
19 broker/dealers in transitioning to the new standard.

20 Many of the issues that we would expect that
21 -- the SEC address are included in the DOL's proposed
22 definition of fiduciary. Accordingly, it is critical

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1 that DOL and the SEC work together to develop a
2 practical approach that addresses investor protection
3 needs but preserves investor choice and accommodates a
4 range of business models.

5 The DOL's proposal would substantially
6 increase the categories of service providers who are
7 deemed fiduciaries for purposes of ERISA. The
8 Roundtable believes that the wide reach of proposed
9 language would have unintended consequences that could
10 create uncertainty among service providers and
11 potentially reduce the level and types of services
12 available to benefit plan -- to plan beneficiaries and
13 individual retirement accounts.

14 One fundamental issue that we need -- that
15 will need to be resolved is the Department's
16 prohibitions -- I mean, prohibits persons or entities
17 that are deemed fiduciaries from engaging in certain
18 activities. But the SEC generally allows entities
19 deemed to be fiduciaries such as broker/dealers that
20 are duly registered as investment advisers or
21 affiliated broker/dealers and advisers to manage
22 conflicts of interest by disclosing them to clients.

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1 Under the proposed rule, an oral or written
2 representation or acknowledgement by a person that is
3 acting as a fiduciary or making recommendations would
4 result in imposition of fiduciary status.

5 We agree that if a person providing advice
6 represents or acknowledges that they are acting as a
7 fiduciary, such a person should be deemed a fiduciary.
8 The Roundtable is concerned, however, that if oral
9 representations are sufficient to confer fiduciary
10 status, faulty recollections by persons interacting
11 with financial institutions could result in after-the-
12 fact fiduciary status. Thus, we strongly urge the
13 Department to provide that a person can only be deemed
14 a fiduciary by formal writing.

15 As proposed, there would be no longer -- as
16 proposed there would no longer be a requirement that a
17 plan fiduciary provide advice on a regular basis or
18 mutual understanding. As a result, a person could be
19 deemed a fiduciary as a result of one off conversation,
20 an informal discussion with human resource
21 professionals or other inadvertent triggers.

22 If a plan manager happens to have informal

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1 one off discussions at a conference with a variety of
2 contacts, which the plan executes transaction and
3 receives brokerage commissions, it is unclear whether
4 each of these context in the context employers would
5 then become fiduciaries. The risk of inadvertent
6 fiduciary status will reduce the flow of information in
7 the marketplace as broker/dealers and other financial
8 institutions will sharply curtail the ability of
9 personnel to have even informal communications with
10 clients and potential clients.

11 Furthermore, without a mutual agreement
12 requirement, misunderstandings between parties may
13 arise. We believe that the current mutual agreement
14 requirements provide certainty to both parties of a
15 fiduciary relationship and creates an environment that
16 encourages an exchange of information including any
17 issues related to a conflict of interest.

18 Roundtable members are concerned -- next, the
19 Roundtable members are concerned about the seller's
20 exemption, specifically that regarding securities
21 brokers, insurance agent or real estate brokers makes a
22 recommendation to a plan regarding the purchase of a

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1 security or property and ends up not acting for the
2 other side of the transaction. They will not be able
3 to rely on this -- on this exception.

4 In addition, if this exception is adopted as
5 proposed, we respectfully ask that the Department
6 clarify the meaning of "adverse interest." Also, we
7 respectfully assert that a requirement to inform a
8 party that otherwise has a customer relationship that
9 is -- that a broker/dealer is adverse, could
10 potentially result in investor confusion and
11 effectively limit investor choice in selecting brokers.

12 Additionally, since the proposed regulation
13 may expand the definition of investment advice to also
14 include referrals to or recommendations of investment
15 advisers the Roundtable believes that the seller's
16 exception should be expanded to include recommendations
17 regarding the purchase of services and not limit it to
18 recommendations of purchases of -- or sales of
19 property.

20 The Roundtable supports the Department's
21 recognition that many service providers offer up
22 platforms of investments that do not involve rendering

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1 investment advice but instead provide a menu of
2 investments from which plan fiduciaries can select a
3 more limited menu that will be made available to plan
4 participants.

5 In the context of IRAs and 401(k) plans,
6 however, we believe that it would be helpful for the
7 DOL to provide additional guidance regarding what
8 constitutes individualized needs. And we particularly
9 ask that the SEC clarify the application of the
10 investment platform exceptions to IRAs.

11 Roundtable members are keenly concerned that
12 the elimination of mutual written agreement
13 requirements and practical elimination of the seller's
14 exception would greatly diminish, if not eliminate, the
15 range of -- a range of account services including
16 information tailored to a particular investor's needs
17 provided to retail investors by broker/dealers. This
18 would result in two classes of investors.

19 The first would be investors who can afford
20 to pay higher fees based off the size of their accounts
21 or assets under management. Those investors would
22 receive investment advice.

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1 The second class of investors would be those
2 who have brokerage accounts and generally only pay fees
3 when the, affected transactions receive investment
4 advice that is incidental to their trades -- to those
5 trades.

6 The Roundtable believes that if the regular
7 basis and mutual understanding requirements are
8 eliminated this second class of investors is likely to
9 no longer receive investment advice unless the investor
10 is willing to establish an advisory -- advisory account
11 which likely will result in higher fees for the
12 investor.

13 Next, further guidance is needed as to when
14 the line between investment advice and investor
15 education is drawn. We are concerned that the
16 availability of information to non-advisory clients
17 likely would also diminish because of concerns that
18 educational information or opportunities to participate
19 in occasional web casts or conference calls might be
20 deemed investment advice and result in inadvertent
21 fiduciary relationships.

22 Regarding appraisals, Roundtable members are

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1 particularly concerned that the exception in the
2 proposed regulation has the potential of making every
3 report provided by a trustee or custodian, a plan of
4 fiduciary or fiduciary service.

5 We respectfully recommend that the Department
6 revise the proposed text of the regulation by omitting
7 the requirement that the report be provided for
8 purposes of compliance with the reporting and
9 disclosure requirements by the Act.

10 We are also concerned about the impact the
11 inclusion of appraisals of securities and property
12 could have on ESOPs as well as hard to evaluate assets
13 such as swaps and derivatives.

14 We do not believe that the preparers of the
15 appraisals, valuation or fairness opinions should
16 themselves be deemed fiduciaries for purposes of the
17 Act. Rather, we believe that the fiduciary
18 responsibility should rest with the provider of
19 investment advice to use appropriate diligence in
20 selecting the preparer of the opinion or report.

21 We think it would be more appropriate to
22 require this category of market participant to meet

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1 certain minimum qualification standards.

2 We also note that providers of fairness
3 opinions are generally already subject to comprehensive
4 regulation by the SEC as broker/dealers in the case of
5 municipal securities and municipal advisers.

6 With respect to management of securities or
7 other property the proposal applies to advice or
8 recommendations as to the management of securities or
9 other property; however, no guidance is provided as to
10 the meaning of management of securities or other
11 properties. For example, it is unclear whether this
12 would include record keeping and other administrative
13 services or even a recommendation as to a property
14 management company to use for a rental property.

15 The Roundtable respectfully requests that DOL
16 clarify that the phrase "management of securities or
17 other property" does not include recommendations of
18 administrative services, property management, or other
19 non-investment management related services.

20 In regards to compensation, we believe that
21 the proposed definition of compensation is too
22 expansive and would include brokerage commissions,

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1 mutual fund sales and insurance sales commissions as
2 well as fees and commissions based on multiple
3 transactions involving different parties.

4 The proposal's inclusion of brokers'
5 commissions including those with respect to mutual fund
6 shares in the insurance products paid in the course of
7 providing investment advice, steps ahead what Congress
8 had directed to the SEC to consider whether to
9 eliminate the broker exception from the definition of
10 investment adviser under the Investment Adviser's Act.

11 The current statutory provision allows
12 broker/dealers to provide investment advice in
13 connection with the execution of securities
14 transactions for customers as long as brokers --

15 (Bell rings signifying time is up.)

16 MR. TATE: Can I get an additional minute?

17 MR. DAVIS: Sure. Go ahead.

18 MR. TATE: Thank you.

19 The current statutory provisions allow
20 broker/dealers to provide investment advice as long --
21 in connection with the execution of securities
22 transactions for customers as long as the broker

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1 receives only brokers' commissions for effecting a
2 transaction and does not receive a separate fee for
3 providing the advice.

4 The Department's proposal, however, would
5 essentially make the ability of broker/dealers to avail
6 themselves of this exception. Given that Congress
7 specifically charged the SEC in the Dodd/Frank Act to
8 study the regulation of broker/dealers and investment
9 advisers to engage in rulemaking necessary to address
10 any gaps in the regulation, we believe that the SEC and
11 not the Department, should be charged with promulgating
12 any regulation that potentially fundamentally changes
13 the manner in which broker/dealers are compensated.

14 Finally, the Roundtable is particularly
15 concerned that the application to affiliates is overly
16 broad and far-reaching without identifying the actual
17 potential harm to investors. It would be logistically
18 difficult to track compliance for complex multi-
19 national financial institutions that engage in a
20 variety of investment advice, transactional insurance,
21 real estate and other potentially covered activities in
22 numerous entities.

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1 We respectfully ask that Department narrow
2 its application to affiliates.

3 Thank you for your time and I'm happy to
4 answer any questions you have.

5 MR. DAVIS: Thanks so much, Mr. Tate.

6 We'll turn to the government panel now.
7 Before we do, I just wanted to let people know we did
8 have some substitutions over lunch.

9 Jeffrey Monhart is a senior member of our
10 Office of Enforcement to my left.

11 To my immediate right is Ivan Strasfeld who
12 is the head of our Office of Exemption Determinations.

13 Leslie Perlman with the Solicitor's Office.

14 Joe Piacentini and Fred Wong remain from this
15 morning.

16 So with that, I'll turn to Jeff.

17 MR. MONHART: Thanks, Michael.

18 I have a question for the witness from the

19 Financial Services Institute. In your
20 comment letter you make mention of the existing
21 regulatory principles for brokers' suitability and best
22 execution, but, of course, ERISA imposes different

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1 standards: prohibition against self-dealing and the
2 duty of loyalty.

3 So in the space that you described, brokers
4 dealing with small plans and participants, isn't it
5 hard to ignore the potential for conflict when the
6 broker is compensated solely by commissions?

7 MR. SMITH: The -- there really is a -- kind
8 of fundamental tension here between regulatory
9 constructs that are at work in this area. The
10 securities law constructs, the insurance regulatory
11 constructs, do not exclude the possibility that a
12 representative can both look after the best interest of
13 the client and be paid on a commission basis.

14 The ERISA regulatory construct has worked in
15 a different way on that. The way you all have
16 accommodated that, of course, is, you know, in the
17 course of preparing this letter it was an occasion to
18 kind of reflect back on all the work you all have done
19 over the years to fit broker/dealers into ERISA's
20 regulatory structure, you know, starting from five
21 minutes after ERISA was enacted up through individual
22 PTEs that you were granting last year.

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1 The amount of time and effort you all have
2 put into fitting broker/dealers into ERISA regulations
3 is staggering it seems to me. I mean, there's been a
4 significant part of the way you all expended your
5 resources. And as best as we can figure out, it's
6 worked. As best as we can figure out, the
7 broker/dealers have continued to be able to provide by
8 and large the services that the plans need on a viable
9 basis for both and primarily acting in a non-fiduciary
10 capacity. And we're not aware that there's been any,
11 you know, systemic abuse that would suggest that the
12 existing structure isn't working that you guys -- you
13 all didn't succeed in what you set out to do, and that
14 the existing structure is not effectively working for
15 plans and their participants.

16 MR. MONHART: One more.

17 MR. DAVIS: Go ahead.

18 MR. MONHART: And a question for the witness
19 from the Roundtable, please. You coin an interesting
20 phrase in your comment letter, "the inadvertent
21 fiduciary status." And you mention that "the
22 inadvertent fiduciary status might have a chilling

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1 effect on informal communications."

2 I'd just like for you to elaborate on that.

3 It sounds like the inadvertent fiduciary status is sort
4 of like kryptonite, it would have a chilling effect.

5 But I'm not really following why that would be. In
6 order for a plaintiff to make that a case you have to
7 have a fiduciary, a breach and a breach that causes a
8 loss.

9 So how would informal communications be
10 chilled by this so-called inadvertent fiduciary status?

11 MR. TATE: I would say that the overall goal
12 for all of, I guess, the regulations from whatever
13 department makes them, should be to encourage and
14 facilitate conversations between all parties. And that
15 -- that the appropriate disclosures are made, that the
16 consumer or the investor gets all the information that
17 they need to make good decisions. And I think that
18 anything that we can do to help facilitate that process
19 would be extremely helpful.

20 I think if there is a -- if there is still a
21 gray area of who is and who is not a fiduciary and if I
22 make a certain statement whether or not I am now a

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1 fiduciary when I'm only having a conversation or that
2 we are just meeting for the first time or -- there is a
3 number of scenarios that one could think of where one
4 could say, as we addressed in our testimony, that are
5 just conversations and aren't giving, I guess, regular
6 advice on -- and it's not the primary basis for making
7 a decision, and if those -- if those standards go away,
8 then you're having a conversation and there is -- and
9 coupled with the fact that there may or may not be any
10 kind of written disclosure or written agreement that we
11 are -- I am representing you at some point, I think it
12 causes confusion.

13 And I think if you don't have those standards
14 in place then, again, as we pointed out, after-the-fact
15 that we've had a conversation, well, one person may be
16 thinking that we're having a conversation for another
17 reason and the other party thinks we're having a
18 different kind of conversation I think there could be
19 some confusion there at the end of the day. Once we
20 step away from that conversation, a couple of days,
21 weeks, months later and come back and say, hey, he was
22 a fiduciary and the other party goes I don't believe we

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1 had that conversation. I thought we were talking about
2 something else.

3 And so going back to our testimony, I think
4 having a written mutual understanding, a written
5 agreement that I am representing you in this X
6 capacity, I think would be extremely helpful going back
7 and saying overall for everyone's time, going -- you
8 know, this is the conversation that took place and
9 here's why and this is what we talked about.

10 MR. MONHART: Thank you.

11 MR. DAVIS: I don't have many questions.

12 I did want to make one observation though and
13 I think it was, Mr. Smith, you talked about 35 years of
14 work that the Agency has done in this space. At the
15 same time, one of the premises of the regulation is
16 the marketplace as it changed appreciably over the
17 course of those 35 years and the kinds of conversations
18 now that happen weren't conversations that happened 35
19 years ago.

20 One of the conversations we had yesterday
21 with some members of the financial industry suggested
22 that at least in this case, they did think there was

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1 some value to revisiting at least the regular basis and
2 the primary basis requirements as promulgated in the
3 '75 reg.

4 I think I heard from Mr. Tate, my
5 understanding is I think that you guys are basically
6 saying that you would not support revisiting even those
7 two planks of the five-part test but for the rest of
8 the panel would you be in agreement that those are two
9 elements of the test that should be revisited given the
10 way the market operates today?

11 MR. SMITH: I'm not clear that I agree with
12 that point. Plainly the market, the -- you know, well
13 marked transition from a defined benefit universe to a
14 defined contribution universe, plainly there have been
15 changes in retirement plans in that respect.

16 It's not clear to me though that the nature
17 of the conversations or the need -- the -- kind of the
18 fundamental sorts of services that plans need from
19 financial service providers is materially different
20 just -- because of that transformation.

21 We continue to think, for the reasons we've
22 discussed, we continue to think that it's essential

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1 that there be an avenue for broker/dealers acting in
2 the ordinary course to continue to provide services to
3 -- on a non-fiduciary basis to plans. We think that
4 the consequences of going beyond that are potentially -
5 - are very significant in terms of what it would mean
6 for products and services necessary to plans that would
7 be available to them in the marketplace.

8 So our concern is primarily that there needs
9 to be a reliable and certain avenue to get to that
10 result. It does seem to us that there are -- there are
11 -- there's more than one way to get there. If you all
12 judge that you need a revision in the test for other
13 purposes but you can find a way to give us a certain
14 reliable way to structure appropriate arrangements
15 other than a fiduciary basis, you know, it's the --
16 kind of the certainty and the reliability of fairness
17 opinions, that outcome, I think is what's most important
18 to our members.

19 MR. DAVIS: Okay. And just -- one question
20 for the members from Primerica. It sounds like you
21 guys provide a tremendous service in knocking on the
22 doors that you knock on and talking to new entrants,

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1 new savers.

2 I did want to understand a little bit better
3 though in terms of -- you talked about the commission
4 structure, the -- so the brokers earn a commission for
5 opening the account. Is there also a commission earned
6 for the sale of certain products? And if that is the
7 case, are those arrangements disclosed in the
8 conversations? And if so, how are those compensation
9 arrangements disclosed?

10 MR. SCHNEIDER: So I'll start it and I'll let
11 Mr. Watts jump in. They do earn a commission. They do
12 earn a commission for the sale of the products. All of
13 our compensation is disclosed.

14 We also -- and this is where the prohibited
15 transactions issue comes in for us.

16 MR. DAVIS: I'm sorry, when you say it's
17 disclosed, what form of disclosure happens? Is it
18 within a contract, is there a conversation, typically,
19 how does that happen?

20 MR. WATTS: Well, it's disclosed in the -- in
21 the product prospectus initially. And we also
22 supplement that with our own disclosure documents that

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1 we deliver to the point of sale.

2 MR. DAVIS: Okay. Keep going.

3 MR. SCHNEIDER: And so, the -- the struggle,
4 I think, that firms like ours are going to have is we
5 also, for example, will receive a record keeping fee.
6 We keep the records. We have to have that
7 infrastructure. The mutual fund company doesn't want
8 to -- really want to do that for these small accounts.

9 And so we will receive a record keeping fee,
10 a set amount to -- from the fund company to help us
11 defray the expense, the fixed expense of maintaining
12 that account.

13 We -- again, we make disclosures about that
14 that's in our materials so we address it with the
15 client. But if that is taken away, and only the client
16 is the only source of those funds, it really becomes
17 cost prohibitive for the client to have an account.
18 That's what's going to -- that's what's going to
19 happen.

20 And, because if -- let's say, you're putting
21 away \$50 a month into a mutual fund and at the end of
22 the year it's \$600 if I've done my math right. You

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1 know, \$600 you're going to have at the end of that
2 year. Not bad, frankly, if you're a nurse or a laborer
3 or a plumber, you've gotten started. But if you have
4 to absorb all of the costs associated with the
5 maintaining that account yourself, and upfront, our
6 modeling shows that we would have to take hundreds of
7 dollars from that client in order to make that work
8 today. And that doesn't make any sense for the client.

9 Right now the fund company will help defray
10 that expense. Again, we deal with it, we deal with the
11 disclosure, someone's got to be that record keeper. So
12 someone's going to be paid for that. It could be a
13 third party and then you avoid any of the -- of what I
14 think you'd be concerned about, which is, you know, a
15 payment coming to us. So the payment would go to
16 someone else. But the trouble is when the payment goes
17 to someone else and we deal with the client, because
18 it's our call center and all that, we don't have any
19 source of revenue to defray that expense other than
20 that client. And that's the problem.

21 So there's got to be some flexibility on that
22 aspect of the rule for accounts of a size like ours.

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1 John, do you want to add anything to that?

2 MR. WATTS: No, no.

3 MR. SCHNEIDER: Okay.

4 MR. DAVIS: Last question.

5 Mr. Tate, you've already sort of dealt with
6 your concerns or the Roundtable's concerns about the
7 seller's exception. Just curious from other members of
8 the panel, there was a seller's exception in the reg as
9 codified and put forward, but I assume that you think
10 that the exception as it's currently drafted is too
11 restrictive.

12 And, first, is that the premise of what
13 you're saying? And two, what enhancements would you
14 make to the exception beyond what was promulgated?

15 MR. SMITH: I'll be glad to speak to that.

16 MR. DAVIS: Okay.

17 MR. SMITH: The -- in our judgment, the
18 exception as drafted seems to speak clearly to counter-
19 parties and is less clear to us than it speaks to
20 intermediaries.

21 It speaks in terms of -- of property it less
22 -- it less -- it clearly speaks to sales activity with

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1 respect to the management of plan assets.

2 It speaks -- it requires a statement of
3 adversity of interest that's -- it's not clear to me
4 why we'd want to be encouraging anyone to be thinking
5 in those terms. It seems to us that could be much more
6 effectively formulated as -- as not being in a position
7 to act as a risk fiduciary, go to the ultimate
8 conclusion.

9 So it seems to us that it is -- it is -- to
10 the extent that it, as drafted, it only applies to
11 counter-parties, it is too narrow. And to the extent
12 that it -- and it seems to use that you could improve
13 and refine the way you formulated a seller. If your
14 objective is to provide an exception in circumstances
15 where a service provider is well and truly acting in a
16 selling capacity as distinguished from a fiduciary
17 capacity. It seems to us that you can -- you can
18 improve the way that the exception has been drafted.

19 MR. TATE: I would like to add -- I agree
20 totally with what Mr. Smith just mentioned, but also
21 stating from -- if you're having a long-term
22 relationship, if you're Primerica or any other company

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1 that's going to someone's house or meeting someone in a
2 professional environment, you don't want to start your
3 relationship off as stating we have opposed interest in
4 this.

5 I mean, I don't know if you go to the store,
6 the store has, you know, an opposed interest, they want
7 to make money and you want to buy a product. If they
8 stated off -- you know, from the jump, that our
9 interests are opposed to each other, you're going to
10 sit there and pause and go why is he telling me this
11 before we go further into our relationship.

12 MR. DAVIS: And we took earlier testimony on
13 this point too, that there were some concerns expressed
14 about the use of the term "adverse." And I would make
15 the same request of you that if you have language that
16 you think sort of captures the concept in a way without
17 the use of that term, the record's going to be open
18 another 15 days after the hearing, we'd welcome your
19 input on that.

20 MR. TATE: Thank you. We'll definitely look
21 into it.

22 MR. DAVIS: Thanks.

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1 MR. STRASFELD: My turn?

2 MR. DAVIS: Yes.

3 MR. STRASFELD: Mr. Smith?

4 MR. SMITH: Sir.

5 MR. STRASFELD: Can you hear me? Can you
6 hear me now?

7 You seem to be our every go-to guy.

8 I had a couple of questions. So your -- your
9 small brokerage business is it -- what are the products
10 that they sell? Is it just stock, bonds, insurance?

11 MR. SMITH: No, they typically -- they most
12 typically sell mutual funds and variable insurance
13 products.

14 MR. STRASFELD: Right.

15 MR. SMITH: Sometimes fixed insurance
16 products. They may offer a variety of services, sort
17 of pertinent to that.

18 MR. STRASFELD: Right. So they're dual
19 registered as broker/dealers?

20 MR. SMITH: They are very often dual
21 registered, yes.

22 MR. STRASFELD: All right. And so in almost

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1 all those instances they receive commission income for
2 the --

3 MR. SMITH: When they're acting in their
4 broker/dealers capacity, that's correct.

5 MR. STRASFELD: And what about as an
6 insurance agent?

7 MR. SMITH: Typically, in a commission basis
8 as well.

9 MR. STRASFELD: All right. So at the -- so
10 all of that under -- like every -- well, everything
11 under ERISA is illegal. You start off with that
12 premise. So to the extent -- so the next hurdle would
13 be well, since it's illegal there are a bunch of
14 statutory exemptions. So I assume currently you're
15 relying on the statutory exemption for service
16 providers since, you know, you're of the view you're
17 not a fiduciary but for this proposal?

18 MR. SMITH: That or 75-1 or some other --

19 MR. STRASFELD: All right.

20 MR. SMITH: -- some other exemption that
21 doesn't -- that is not premised on fiduciary status.

22 MR. STRASFELD: So to the extent that you --

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1 you do become a fiduciary, and I guess it's one of the
2 reasons I'm up here, trying to gauge you know, what
3 exempt -- what class exemptions or individual
4 exemptions are available or what exemptions might have
5 to be considered by us to the extent this goes forward.

6 And so currently there are two exemptions for
7 fiduciaries which seem very relevant to you which is
8 86-128 for broker/dealer, you know, for a --

9 MR. SMITH: Exactly.

10 MR. STRASFELD: -- broker/dealer fiduciary
11 and 84-24 where the insurance agent becomes an
12 investment adviser.

13 Does that -- and those are -- you know, those
14 are -- at least in my view, which is, of course, I've
15 been doing this for a long time, do not seem
16 particularly onerous. They're basically, upfront
17 approval, disclosure and -- for instance, in the
18 broker/dealer universe there's be an annual portfolio
19 of turnover ratio which I always found to be relevant,
20 at least in my personal finance.

21 MR. SMITH: Yeah, I would agree other than
22 the -- the additional reporting that are 86-128 is

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1 somewhat -- is atypical for the way broker/dealers
2 typically do business and does entail some additional
3 costs. But I substantially agree.

4 MR. STRASFELD: So if -- besides those two
5 class exemptions what would -- what would be missing?

6 MR. SMITH: Well, I mean, to the extent that
7 we are engaged in Agency transactions other than in
8 mutual funds, you -- you are moving from 408(b)(2) or
9 75-1 to 86-128.

10 MR. STRASFELD: Right.

11 MR. SMITH: Principal transactions. That's
12 not a large part of our business but it is an
13 occasional part of our business. Principal
14 transactions if we're not a fiduciary we can rely on
15 75-1, if we are a fiduciary, we're out of business.

16 MR. STRASFELD: Right. Now, what kind of
17 principal transactions are they? Is this equity or
18 debt primarily?

19 MR. SMITH: I don't know the answer to that.

20 MR. STRASFELD: All right. Just one last
21 observation. You said -- I believe you suggested that
22 you would -- you would like it if you could -- if the

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1 service provider could disclose to the plan that he's
2 not a fiduciary.

3 MR. SMITH: Yes.

4 MR. STRASFELD: Now, that works under
5 securities laws but it does not work under ERISA since
6 ours is a functional definition. So you could say
7 you're not but if you are, you are. And there's
8 probably not much we could do about that. That's --

9 MR. SMITH: Well, I'm not sure I agree with
10 you on that. The -- we have an existing definition
11 under the existing rule. Certainly, it's black letter
12 law that we have a functional definition.

13 MR. STRASFELD: Right.

14 MR. SMITH: But the expectations and
15 understandings and the services that are provided by
16 the parties under the existing definition informs the -
17 - helps to inform the outcome on this, correct?

18 MR. STRASFELD: But you're really talking --
19 you're limiting yourself to the construct of an
20 investment advice fiduciary, you're not talking about
21 the other functional --

22 MR. SMITH: No.

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1 MR. STRASFELD: Right. So that's -- all
2 right. That's fine.

3 MR. SMITH: That's right. Exactly right.

4 MR. STRASFELD: All right. I got you.

5 MR. SMITH: You know, and our suggestion on
6 this point is that there's a value to certainty on this
7 issue, a value for plans and participants, the
8 certainty on the investment advice fiduciary issue.

9 MR. STRASFELD: Right. But in that context
10 only?

11 MR. SMITH: Specifically in that context,
12 correct.

13 MR. STRASFELD: Primerica, I still don't
14 actually understand what you do once you get in
15 someone's house?

16 MR. SCHNEIDER: Well --

17 MR. STRASFELD: What is it you're selling
18 them? You know, obviously I've been looking at
19 products for 30 years so I'm -- from my vantage point,
20 what kind of products are you selling them, you know,
21 and how -- you're obviously compensated by and large
22 through commissions of some sort. Well, what is it

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1 you're actually selling them?

2 MR. SCHNEIDER: Well, I'll go -- first of
3 all, we have many reps who are willing to come to your
4 home and help you understand this.

5 But what -- what we're selling, is --

6 MR. STRASFELD: My father was a broker and I
7 barred him from my house.

8 MR. SCHNEIDER: Well, what we're selling,
9 first of all, we sell term life insurance. So
10 Primerica owns a life insurance company.

11 MR. STRASFELD: Right.

12 MR. SCHNEIDER: We are opening an IRA for the
13 client and so in that IRA we exclusively sell mutual
14 funds. We do not sell equities, we do not do options.
15 We're sort of more defined by what we don't do. So we
16 will sell mutual funds.

17 Of course, we also will do non-IRAs so, you
18 know, non-qualified funds --

19 MR. STRASFELD: Right. Now, the mutual funds
20 --

21 MR. SCHNEIDER: -- you can open with us.

22 MR. STRASFELD: -- they can't be no-load

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1 cause there's be no way you could get compensated.

2 MR. SCHNEIDER: Correct.

3 MR. STRASFELD: So what kind of mutual --
4 they are -- they're just load funds?

5 MR. SCHNEIDER: Yeah, so you -- American
6 funds, Fidelity, Van Kampen, Legg Mason, AIM, Pioneer,
7 all the major funds. And the problem that we have and
8 going back a little I think in a way to Mr. Davis'
9 question, the variable -- the variable nature of the
10 compensation is an issue under the Department of Labor
11 rules. So we actually levelize compensation at the rep
12 level.

13 So from a representative's standpoint, the
14 representative is indifferent to what's sold. They're
15 going to get the same comp no matter what the client
16 buys.

17 MR. STRASFELD: How does that work, because
18 that's actually pretty interesting? Because most
19 brokers -- just like my dad, most broker/dealers, you
20 know, if you don't generate commissions by the end of
21 the month, you don't eat. And you -- you know, you can
22 only eat what you kill.

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1 So how -- your model seems different. How
2 does -- how does it work?

3 MR. SCHNEIDER: Well, our model is different
4 because we will allow representatives to be part-time.
5 So we don't have any quotas. So they'll still eat if
6 they don't sell.

7 MR. STRASFELD: Right.

8 MR. SCHNEIDER: So, but they're -- but in
9 order to reach this market, this demographic, what
10 we've got to do is put a -- get a part-time
11 representative. Think a teacher.

12 MR. STRASFELD: Right.

13 MR. SCHNEIDER: Nine months out of the year
14 in teaching, during the summer they can be a Primerica
15 representative earning income.

16 MR. STRASFELD: But how exactly are they
17 compensated if they're not getting commission income?

18 MR. SCHNEIDER: They are getting commission
19 income.

20 MR. STRASFELD: But how is it leveled out?

21 MR. WATTS: Well, it's not -- it's not
22 leveled from -- the firm is getting variable payments

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1 from the mutual funds.

2 MR. STRASFELD: No. That I understand. But
3 how is it translating --

4 MR. WATTS: We have leveled within the firm
5 by establishing what we call commissionable dealer re-
6 allowance. We have capped it where the cap -- we've
7 capped it at a percentage so that everybody gets paid
8 the same no matter what fund they sell.

9 MR. STRASFELD: So, for instance, if -- they
10 would get 30 basis points if they sold the American
11 funds or Van Kampen or whatever. Whatever fund they
12 sold, their piece of the action would always be the
13 same across-the-board?

14 MR. WATTS: Yeah, if they sold an equity fund
15 that had a 5 percent load and they -- and somebody else
16 sold an equity load that had a 5-1/2 percent load, both
17 reps are only going to get paid on the 5 percent.

18 MR. STRASFELD: Right. But they would get
19 different amounts for selling a bond fund or an equity
20 fund?

21 MR. WATTS: Correct.

22 MR. STRASFELD: Although it would be the same

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1 for all bond funds and all equity funds?

2 MR. WATTS: Correct.

3 MR. STRASFELD: All right. And, again, the
4 same question as I asked earlier, you're -- I assume
5 you're relying on our service provider statutory
6 exemption based on the assumption that to date you're
7 not a fiduciary?

8 MR. SCHNEIDER: Right. We don't -- we do not
9 consider ourselves a fiduciary.

10 MR. STRASFELD: Right. So you comply with
11 our service provider statutory exemption, which is
12 available for non-fiduciaries? Cause you are -- I
13 mean, you acknowledge you're providing a service to a
14 plan or in this case an IRA? It's not a trick
15 question.

16 MR. SCHNEIDER: No, I know. We're not a --
17 we're not ERISA lawyers. We're not ERISA lawyers. We
18 do have an ERISA lawyer in the audience.

19 MR. STRASFELD: Let me go -- that's even
20 better.

21 Let me rephrase it because that could be
22 somewhat confusing. You're -- you're -- as far as IRAs

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1 go, they're -- the transactions are still prohibited
2 but they're looked at in terms of the Internal Revenue
3 Code. They have their -- their parallel-prohibited
4 transaction provisions and they have parallel statutory
5 exemptions.

6 So for our Title I plan there's a statutory
7 exemption for providing services to the plan and
8 there's a parallel provision under the Code. So in the
9 absence of your compliance with that regardless of
10 whether you are a fiduciary or not, you would be
11 engaging in prohibited transactions.

12 So I'm asking and assuming that you're
13 complying with the same statutory exemption under the
14 Internal Revenue Code for the provision of services to
15 IRAs.

16 MR. WATTS: We believe so.

17 MR. STRASFELD: I'll answer it.

18 MR. SCHNEIDER: Yeah, I mean --

19 MR. STRASFELD: The answer has to be "yes,"
20 to --

21 MR. SCHNEIDER: Yeah, I'm sure the answer the
22 answer is "yes." We're not going to -- we're not going

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1 to -- in that respect, we're not going to be any
2 different than tons of broker/dealers.

3 MR. STRASFELD: Right. So that's --

4 MR. SCHNEIDER: We're going to look just like
5 them.

6 MR. STRASFELD: Because it was just -- like,
7 my point earlier, if you're not a fiduciary you still
8 have prohibited transactions and you need to use a
9 statutory exemption. If you do have -- if you are a
10 fiduciary, then chances are, as I noted, you'll have to
11 turn to a class exemption. And you would have to --
12 obviously, you -- you know, to the extent you do become
13 a fiduciary under our reg as ultimately proposed, you
14 will be forced into using class exemptions as well or -

15 -

16 MR. WATTS: You do have the option of --

17 MR. SCHNEIDER: And I understand -- my
18 understanding is -- again, without being an ERISA
19 lawyer, my understanding is those exemptions will be
20 problematic that -- for example, one I heard if you're
21 an insurance agent and also an investment adviser.

22 Our representatives have series 6 mutual fund

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1 licenses, they're not investment advisers. It becomes
2 a problem to make them an investment adviser.

3 MR. STRASFELD: Well, no, no, no. You don't
4 -- under -- our term "investment adviser is different.

5 So the question is: If you come -- if you --
6 for instance, if you came in under our old or actually,
7 it's our current investment adviser, you would be a
8 fiduciary by reason of providing investment advice but
9 it would require no special designation under insurance
10 or securities law. You would just functionally be a
11 fiduciary and you would need to comply with that
12 exemption.

13 And that exemption is basically kind of
14 disclosure generated with approval and there's
15 disclosure of commissions and fees and stuff and mutual
16 funds and insurance.

17 So it seems to me there really should be no
18 reason you couldn't comply with that. It doesn't
19 require a special designation of fiduciary. You are --
20 if you're functionally an investment adviser you're
21 forced into that exemption.

22 MR. SCHNEIDER: I'll take that as good news,

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1 but that's not -- our understanding is it's
2 problematic. Perhaps we can address it with, you know,
3 a supplemental comment.

4 MR. DAVIS: That's what I was going to
5 suggest.

6 MR. SCHNEIDER: That precise point.

7 MR. DAVIS: If you want to go back and talk
8 to your ERISA staff that --

9 MR. STRASFELD: Yeah, as to why it doesn't
10 fit. And I guess, Mr. Smith --

11 MR. SMITH: Yeah.

12 MR. STRASFELD: -- can do the same.

13 MR. SMITH: Yeah, Ivan, and the other point,
14 of course, is I mean, the choice is either to observe
15 the exemptions or leave the market.

16 MR. STRASFELD: That's right.

17 MR. SMITH: And I was talking to a -- last
18 month to a -- a broker/dealer of substance, it's a
19 regional firm, operates in multiple states, is --
20 doesn't have Primerica's 20,000 representatives, but
21 probably is somewhere between 500 and 1,000
22 representatives. They probably have a gross revenue of

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1 about 75 million a year.

2 Their conclusion is they can't afford the
3 risk. This is -- it's a privately held firm, they have
4 about \$3 million of net capital under FINRA
5 requirements. They just can't -- they just can't see -
6 - even if we can give them prohibited transaction
7 solutions, they just can't see taking on the risk of
8 becoming a fiduciary and they're doing good things for
9 people in IRAs and the micro and small plan market.

10 MR. STRASFELD: I'm questioned out.

11 MR. DAVIS: Okay. Thanks.

12 MS. PERLMAN: I really only have one short
13 question and I apologize if this has been asked before.
14 But everybody's talking about the cost of compliance,
15 but have any of you actually quantified what it would
16 cost?

17 MR. SCHNEIDER: We have not.

18 MR. WATTS: We have not.

19 MR. SCHNEIDER: Well, we've quantified what
20 we would have to do to go to an advisory model. And
21 what we've looked at is we would have to have a minimum
22 account size of \$25,000 for that to work. So, and, you

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1 know, we're still doing -- which is basically not
2 serving our market, because to get to that level that's
3 very difficult for any middle market person to get to
4 that level. So we've looked at that.

5 In terms of the compliance and cost, I mean,
6 obviously you're going to have increased cost, but I
7 think from our standpoint that's not the issue. It
8 goes back to can we afford, can we structure the
9 compensation from the client in a way that allows the
10 client to get the service from a representative? Can
11 you do that?

12 We don't think we can do that under the rule
13 as the Department of Labor has proposed it. That's why
14 we're very anxious to have the dialogue with the
15 Department to see what can be done. Because I have to
16 believe it's not your intent to force out of the market
17 firms that are opening standard IRAs for, you know,
18 kind of regular folks. I'm sure that's not what you're
19 interested in doing.

20 And so there's got to be a -- I would think
21 there's got to be a solution to that. I would hope.

22 MR. PIACENTINI: So, my question is also for

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1 Mr. Schneider. And I'm the economist on the panel so
2 I'm going to ask about the economics, I think, of what
3 we've been talking about for more of the legal
4 dimensions of it.

5 And in a way I think your explanation of the
6 compensation arrangements and so forth in your market
7 segment have really helped me get my head around a
8 theme that's been going on this morning which is that
9 some business models compensation arrangements work
10 where others don't.

11 But I still don't quite have it, so I'm
12 hoping you can help me just a little bit more. So you
13 couldn't service small accounts if you had to use a
14 flat fee model or an asset-based model. And you said
15 if you tried to it would be exorbitant. And, yet,
16 clearly you are generating the revenue you need to
17 cover your costs now. The business model does work.

18 So whatever that exorbitant revenue --
19 whatever revenue would be exorbitant in one sense is
20 not in another sense, the same revenue I guess, cause
21 you have to generate the same amount of revenue.

22 MR. SCHNEIDER: There's really two reasons.

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1 And let me try and -- our time -- I guess we still have
2 time.

3 First of all, part of it is legal. So under
4 -- as I understand -- again, we're not ERISA, but as I
5 understand it under the Prohibited Transactions Rule,
6 you can only get compensation from the client. You
7 can't -- it would be a violation of your fiduciary
8 standard to take compensation from the fund or at least
9 unequal compensation, revenue sharing, for example.

10 MR. PIACENTINI: This is revenue sharing
11 we're talking about?

12 MR. WATTS: Record keeping.

13 MR. SCHNEIDER: Record-keeping fees. So if
14 you cut all that out, then the client needs to pay
15 that. So that client -- and the client needs to pay
16 that upfront.

17 MR. WATTS: Or annually.

18 MR. SCHNEIDER: Or annually. And it needs --
19 and they're a small account when they start.

20 MR. PIACENTINI: Right.

21 MR. SCHNEIDER: And the account is so small
22 it can't absorb those expenses.

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1 MR. PIACENTINI: But if that piece of the
2 revenue is being filled in now by revenue sharing back
3 from the fund, then it sounds like that is in some
4 sense being allocated to the larger accounts, right?
5 And that that's cross subsidizing to help you open
6 small, open new accounts and incubate small accounts?

7 MR. SCHNEIDER: So that's the other reason I
8 was going to get to.

9 MR. PIACENTINI: That's kind of what's going
10 on. So if you charged a -- an asset-based fee that was
11 similar to the revenue sharing, then that would perform
12 the same function?

13 MR. SCHNEIDER: You would have to be a 30
14 percent fee.

15 MR. WATTS: But nobody would open the
16 account.

17 MR. SCHNEIDER: Yeah.

18 MR. PIACENTINI: No, no. I'm saying -- I'm
19 saying if you had in the same proportion as revenue
20 sharing is now -- and, again, it would fall
21 disproportionately out of larger accounts, but wouldn't
22 that end up being essentially the same money coming

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1 from the same place?

2 I mean, if it's revenue sharing now it's
3 built into the expense structure of the mutual funds,
4 it's reducing the net return, right? I mean, that's
5 how that works?

6 MR. SCHNEIDER: But the structure today helps
7 accounts, smaller accounts before they're bigger
8 accounts because the mutual fund company is going to
9 pay us a record keeping fee, let's say \$18 and they're
10 going to pay Merrill Lynch a record keeping fee of say
11 \$18. Merrill Lynch has \$200 billion of assets under
12 management. We have \$20 billion of assets under
13 management.

14 And so in a way, we're aided by that
15 structure. That helps companies open small accounts.
16 And so we're the beneficiary from an economic
17 standpoint of that.

18 Think of it like a -- I hate to use the
19 analogy, but going through a buffet line. Everyone
20 pays the same price. Some people really load up their
21 plate and the small investor is a very -- that's a
22 costly account to have. The guys who load -- so we're

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1 the load-up-the-plate guys.

2 Then some go through a buffet line and
3 they'll just take a little bit. They help defray the
4 expense of the small investor. And so because it's
5 sort of a -- more of fixed fee that you'd get. And
6 that works for everybody. Once you take that away and
7 you need to fully allocate the expense on just that
8 IRA, just that investor, that expense becomes
9 prohibited.

10 What the -- what the revenue sharing and
11 other payments do for us is it basically helps us to
12 pay for our platform, our fixed costs, that's what that
13 helps. And once that's taken away and the full load
14 goes on the investor, it's too big a load.

15 MR. WATTS: And the expenses of that account
16 are actually allocated to that investor. It is
17 prohibited for that investor to open the account.

18 MR. SCHNEIDER: Yeah, it just does it for --

19 MR. PIACENTINI: Right.

20 MR. SCHNEIDER: And it's got to be upfront.
21 So the other thing is -- in a way it's financed over
22 time otherwise.

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1 MR. PIACENTINI: Thank you.

2 MR. SCHNEIDER: I mean, the economics are
3 interesting and it may be worth addressing in more
4 detail. I suppose we're out of time.

5 MR. DAVIS: Yeah, but again, you can
6 supplement the record if you'd like to.

7 MR. PIACENTINI: Thanks.

8 MR. WATTS: If you have questions for us that
9 we haven't answered, then we will.

10 MR. PIACENTINI: All right.

11 MR. WATTS: If you want to get them to us,
12 we'll to our best to answer them.

13 MR. PIACENTINI: Yeah, great. Thank you.

14 MR. DAVIS: Thank you.

15 We'll call Panel 12 to the stage. Jennifer
16 Eller, Real Estate Appraisal Coalition. Charles Tharp,
17 Center on Executive Compensation and Vincent Vernuccio,
18 Competitive Enterprise Institute.

19 Let's go ahead and get started. We'll start
20 with Ms. Eller.

21 MS. ELLER: Thank you. Good afternoon. My
22 name is Jenny Eller and I'm a principal at Groom Law

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1 Group.

2 I'm testifying today on behalf of the Real
3 Estate Appraisal Coalition, a group of firms that value
4 and appraise real estate assets. On an annual basis,
5 this coalition is responsible for providing valuation
6 services with respect to over half a trillion dollars
7 in real estate assets belonging to ERISA plans.

8 We appreciate the opportunity to comment on
9 this important proposed rule.

10 At the end of the day the debate over the
11 proposed rule is a discussion about whether and how
12 broadening the definition of fiduciary will better
13 protect pension plans. It's the view of Coalition
14 members that as it relates to appraisal and valuation
15 of real estate held by plans, the proposed rule would
16 not provide enough additional protections to plans to
17 justify the additional cost.

18 Under the proposed regulation, a person
19 providing advice on an appraisal or a fairness opinion
20 about the value of real estate held by a plan may be
21 deemed a fiduciary.

22 In the Preamble to the proposed rule, the

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1 Department specifically notes that including real
2 estate appraisal activities within the definition of
3 fiduciary activities would be a change from current
4 law. I can think of two reasons why the Department
5 might consider broadening the definition of fiduciary
6 to include real estate appraisal activities.

7 The first would be to impose a set of conduct
8 standards on real estate appraisers. And the second
9 would be to prohibit fee conflicts.

10 In the Coalition's view, this reasoning would
11 be justified if there were no existing standards of
12 conduct for real estate appraisers or if existing
13 standards were inadequate or non-uniform, and if there
14 were evidence of misconduct or fee conflicts on the
15 part of appraisers. However, just the opposite is
16 true.

17 First, there is an existing comprehensive
18 uniform set of appraisal standards known as the Uniform
19 Standards of Professional Appraisal Practice or USPAP
20 that applies to all real estate appraisal activities.
21 These standards govern all aspects of the appraisal
22 process, including substantive knowledge and experience

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1 required of each appraiser, the performance of
2 appraisals, appraisal reviews, appraisal report
3 content, including client disclosures and appraisers'
4 ethical obligations.

5 The ethical obligations in the standards are
6 thoroughly defined and specifically prohibit the
7 performance of an appraisal with bias or an intent to
8 mislead or defraud. The standards also prohibit
9 appraisers from receiving compensation contingent upon
10 the reporting of a predetermined result or upon the
11 amount of a value opinion.

12 The Department has now identified appraiser
13 misconduct or fee conflicts in the context of real
14 estate appraisals undertaken for employee benefit plans
15 as an area of focus let alone an enforcement priority.
16 The Department's been very clear about its enforcement
17 priorities in recent years and has stated that it is
18 focusing enforcement resources on areas where the
19 Department perceives the greatest threats to
20 participants' retirement security. However, the
21 Department has no enforcement initiatives involving
22 real estate appraisal activities.

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1 As recently as 2008, in testimony to the
2 ERISA Advisory Council on hard to value assets, the
3 Department did not identify real estate appraisal and
4 valuation as a concern. The Department's lack of
5 findings identifying problems in this area demonstrates
6 that additional regulation is unnecessary and will add
7 little value for plans.

8 Now, I'd like to talk a little bit more about
9 the USPAP standards because we think it's important
10 that you understand the degree to which federal
11 government regulators oversee the establishment and
12 enforcement of these standards and the extent to which
13 the standards are already incorporated into federal
14 law.

15 The Federal Financial Institutions
16 Examination Council or FFIEC is the inter-agency body
17 of federal financial regulatory agencies and includes
18 the Board of Governors of the Federal Reserve, the
19 FDIC, the National Credit Union Administration, the
20 OCC, OTS, the newly created Bureau of Consumer
21 Financial Protection and the Federal Housing Finance
22 Agency.

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1 The FFIEC includes the Appraisal Sub-
2 Committee which oversees state appraiser regulatory
3 programs, monitors appraisal standards of federal
4 financial institutions, maintains a registry of state
5 certified and licensed appraiser and monitors and
6 reviews the operations of the Appraisals Standards
7 Board, the entity responsible for issuing the USPAP
8 standards.

9 The original goal of establishing federal
10 agency oversight of appraisal standards in 1989 was to
11 ensure that appraisers acted under uniform standards.

12 In 2010, as part of the Dodd-Frank Act,
13 Congress updated and strengthened FFIEC oversight of
14 appraisal standards in response to the financial
15 crises.

16 Federal agency oversight of appraisal
17 standards also means that the standards are
18 incorporated into federal regulations. For example,
19 regulations issued in December 2010 by all of the FFIEC
20 agencies require any federally regulated financial
21 institution to have standards in place for monitoring
22 real estate appraisers. The regulations specifically

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1 incorporate the USPAP standards.

2 As a result, federal, and as a practical
3 matter, state regulated financial institutions rely on
4 USPAP standards to select, evaluate and monitor real
5 estate appraisers, including when these institutions
6 are acting on behalf of employee benefit plans. The
7 USPAP standards require impartiality, objectivity and
8 independence. Appraisers are not permitted to advocate
9 the cause or interest of any party.

10 A significant concern for appraisers is
11 whether and how this focus on objectivity can be
12 reconciled with the fiduciary duty under ERISA section
13 404 to act solely in the interest of participants and
14 beneficiaries.

15 The requirement that appraisers act with
16 strict objectivity is also at odds with the assumption
17 in ERISA section 406(b)(2) that a fiduciary is always
18 acting on behalf of a plan.

19 Appraisers are also concerned about ERISA's
20 co-fiduciary liability provisions and the extent to
21 which this new source of liability will mean that
22 appraisers are required to monitor the actions of a

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1 fiduciary to whom the appraiser provides services.

2 The limitation in the proposed regulation
3 that specifically addresses appraisal activities is
4 also problematic. First, the limitation puts the
5 burden on the appraiser to demonstrate the
6 understanding of the recipient of appraisal information
7 about the appraiser's role. This is difficult in any
8 case but it's particularly difficult where as the
9 proposed rule appears to envision, the appraiser is
10 working for a party with "adverse interests" to the
11 plan. And the limitation would require that the
12 appraiser communicate the fact that it is not an
13 undertaking to be impartial.

14 It would be difficult, if not impossible, for
15 an appraiser to comply with USPAP and to comply with
16 this limitation.

17 Fiduciary status and the accompanying
18 expansion of the scope of appraisal firm liability
19 would necessarily result in increased costs to plans.
20 Most real estate appraisal firms are simply not
21 organized they cannot conduct business as an ERISA
22 fiduciary. To undertake this responsibility would

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1 require firms to incur additional expenses associated
2 with insurance and legal compliance among other things.

3 Given the ubiquity of the USPAP standards and
4 the fact that these standards are intended to promote
5 uniformity in appraiser regulation, we submit that
6 layering ERISA fiduciary responsibility on top of USPAP
7 would be costly, disruptive and burdensome without
8 adding meaningful value or protection for plans.

9 ERISA imposes fiduciary duties with respect
10 to valuation of plan assets including real estate
11 investments upon a plan's administrator. Specifically,
12 the administrator of an ERISA plan is required to
13 report current value of the plan's assets on the Form
14 5500.

15 The Department has advised plan fiduciaries
16 of their duty to understand and evaluate valuation
17 information received about plan investments. If the
18 Department is concerned about valuation issues, it
19 should provide guidance to plan administrators and
20 investment fiduciaries on their duties in connection
21 with the valuation process.

22 Valuation guidance would be consistent with

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1 the recommendations made by the 2008 ERISA Advisory
2 Council Working Group on hard to value assets and by
3 the U.S. GAO in a 2008 report on Pension Plan
4 Investment and Hard to Value Assets.

5 The Coalition does not believe that a real
6 estate appraiser undertaking traditional appraisal
7 activities should be entered as a fiduciary. To the
8 extent that the final regulation could impose fiduciary
9 status on appraisers we recommend that the Department
10 include a specific limitation such that real estate
11 appraisers who conduct an appraisal subject to the
12 Uniform Standards will not be treated as providing
13 investment advice under ERISA.

14 Incorporating these standards would leverage
15 off of existing uniform standards to ensure that
16 employee benefit plans and participants are protected.

17 We appreciate the opportunity to testify on
18 this proposal and we look forward to working with the
19 Department to craft a workable solution.

20 Thank you.

21 MR. DAVIS: Thank you.

22 Mr. Tharp.

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1 MR. THARP: Good afternoon. My name is
2 Charlie Tharp and I'm the Executive Vice President for
3 Policy at the Center on Executive Compensation here in
4 Washington.

5 The Center is a research and advocacy
6 organization that seeks to provide a principles-based
7 approach to executive compensation.

8 In my testimony today I'll hit on three key
9 points. The first point is that we believe that the
10 proposed regulations are overly broad and would have an
11 unintended consequence of imposing costs and perhaps
12 limiting access to valuable information and services to
13 plans.

14 Secondly, we advocate that if someone is
15 considered a proxy adviser is considered a fiduciary
16 today under the rules, that that shouldn't change.

17 And the third recommendation we have is that
18 we'd like to have the Department of Labor undertake a
19 comprehensive study of the proxy advisery industry, and
20 I'll give you some details as to why we think that is
21 important.

22 The Preamble of the proposed regulations

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1 notes that the definition of a fiduciary would include,
2 for instance, advice and recommendations as to the
3 existence of rights that are pertinent to shares of
4 stock and that would cover voting proxies.

5 First, with respect to the regulation itself
6 as I've indicated, we believe that the proposed
7 definition of fiduciary is too broad and would not --
8 should not be adopted as it's currently drafted. The
9 fear, again, is as been mentioned by others, is that
10 there would be individuals who currently are considered
11 to be fiduciary advisers, would be swept under that and
12 would increase the cost to plan participants and to
13 sponsors of plans. Merely providing information
14 without more we don't believe should be deemed to be a
15 fiduciary adviser.

16 It may be helpful for a second just to
17 provide some background of the proxy advisory industry
18 because that's where the bulk of our comments are
19 focused. Because the voting of proxies is an important
20 fiduciary duty and the annual volume of proxy
21 information has increased tremendously, institutional
22 investors rely on proxy advisers for advice.

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1 The proxy advisory industry has undergone
2 significant consolidation at the same time their
3 influence has increased due to the following factors:

4 First, the share ownership on the part of
5 institutional investors has increased from 47 percent
6 of the fortune 1000 in 1987, to over 76 percent today.
7 The expansion by the SEC of permissible proposals that
8 may be included in shareholder resolutions has also
9 increased. In the growth and the volume of information
10 that must be analyzed has caused companies to rely high
11 heavily on proxy advisory firms who must analyze
12 hundreds of thousands of pages of information just on
13 compensation alone.

14 The influence of the proxy advisory firms on
15 the exercise of voting rights is projected to increase
16 as regulatory changes, such as we've just witnessed
17 under Dodd-Frank, further increase the number of votes
18 that must be cast and hence, the influence of the proxy
19 voting process.

20 Proxy advisory firms today are scarcely
21 regulated through a patchwork of regulations that do
22 not clearly cover the activities of the proxy advisory

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1 industry. The patchwork, in fact, was part of the
2 motivation for the SEC's 2010 concept release, which
3 requested input on proxy advisory industry. The
4 release notes that some have argued the proxy advisory
5 firms are controlling or significantly influencing
6 shareholder voting without appropriate oversight. There
7 are many conflicts in the proxy advisory industry but
8 the most serious problem facing the industry is a
9 conflict of interest. As noted in the 2007 GAO report
10 the largest and most influential proxy advisory firm,
11 ISS, provides services to companies to help them gain
12 favorable votes on their resolutions and proposals
13 while at the same time, selling the services of
14 recommendations on those very votes to their clients.

15 Proxy advisers also have a conflict of
16 interest when they provide voting recommendations on
17 shareholder initiatives that are backed by their owners
18 or institutional investors who are offering their
19 clients such as pension funds. This economic
20 relationship does give the impression of a favorable
21 analysis of those proponents' resolutions.

22 In particular, Glass Lewis, which is the

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1 second largest of the proxy advisory firms, is owned by
2 the Ontario Teacher Pension Plan Board, which is one of
3 the largest activist institutional shareholders.

4 There's an increasing parallel interest between the
5 conflicts that were noted in credit rating agencies and
6 those of the proxy advisory firms. Just as the credit
7 agencies would receive fees for rating a company this
8 is similar to the proxy advisory firm selling their
9 fees and then recommending votes on those same
10 companies.

11 Proxy advisory firms are not accountable for
12 the inaccuracies in their analysis and we did a survey
13 just in 2010 of the 300 companies and the Human
14 Resource Policy Association and our subscribers in the
15 Center, and we found that 53 percent of the respondents
16 had experienced inaccuracies in the final published
17 report on their compensation programs.

18 Perhaps due to industry pressures we're
19 seeing more of these inaccuracies. To increase
20 profitability, the proxy advisory firms have outsourced
21 the proxy data mining and research activities to low
22 cost countries such as the Philippines and have hired

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1 seasonal temporary employees with little or no business
2 or proxy experience. We believe that solutions to this
3 inaccuracy problem would include the enhancement of the
4 quality control procedures, including giving companies
5 a chance and sufficient time to comment on the reports
6 so they can help identify and correct inaccuracies
7 currently, at best you give 24 hours off and over a
8 weekend, establishing protocols for dealing with
9 inaccurate reports.

10 There's also another concern and it is in
11 part due to the economics of the proxy advisery
12 industry that they use a one-size-fits-all approach to
13 governance voting. We believe that they should take
14 into account differences in company situations,
15 strategies and approaches and have a tailored informed
16 recommendation on voting proposals.

17 The ERISA requirements enforced by the
18 Department of Labor and the investment advisery
19 requirements enforced by the SEC fail to provide a
20 comprehensive regulatory structure for the proxy
21 advisery firms.

22 Starting with the Avon letter in 1988 the

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1 Department of Labor has held that the voting of proxies
2 is an important fiduciary activity and a valuable plan
3 asset under ERISA. Therefore, the fiduciary duties of
4 loyalty and prudence apply to voting. Moreover,
5 pension fund fiduciaries including those that delegate
6 proxy-voting responsibilities to their investment
7 managers have a responsibility to monitor and keep
8 accurate records of their proxy voting activities.

9 To the extent that proxy advisory firms do
10 exercise discretion over the voting of proxies, they
11 are considered fiduciaries under existing regulation
12 and the term of fiduciary. However, only one of the
13 firms ISS actually votes proxies and would fall under
14 that fiduciary responsibility, not Glass Lewis.

15 While the Department of Labor seeks to
16 preserve plan assets through more protective measures,
17 the SEC aims to protect investors by providing them
18 with material information upon which to make informed
19 decisions. The SEC puts the responsibility on
20 investors to utilize available information properly and
21 to monitor the quality of that information. The
22 Investment Advisers Act of 1940, is the principal

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1 regulatory scheme that applies to advisory firms and
2 the SEC is responsible for its enforcement.

3 The fiduciary duties imposed by the SEC are
4 dramatically different than those fiduciary duties
5 imposed by ERISA. Instead of providing prohibiting
6 conflicts of interest, the SEC simply provides that
7 such disclosures must -- such conflicts must be
8 disclosed. Even though the SEC regulatory scheme
9 incorporates a fiduciary concept it has been scarcely
10 enforced and even then, it does not provide sufficient
11 protection for ERISA plan assets.

12 The Center asserts that the proposed
13 regulation, to be clear, is overly broad and we believe
14 that the right solution is to engage the Department of
15 Labor to engage in a comprehensive and detailed study
16 of the proxy advisory industry. Given that your charge
17 in the Department of Labor is to protect plan assets
18 and those that hopefully will have a long-term value
19 for plan participants, the Center believes that it's
20 appropriate that the Department of Labor initiate
21 greater oversight over the proxy advisory industry.

22 The Department should also provide guidance

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1 to plan fiduciaries about how to properly evaluate the
2 information provided by proxy advisory firms which they
3 use and rely on heavily in discharging their already
4 established fiduciary duties of voting proxies. The
5 Center seeks uniform and consistent treatment of proxy
6 advisory firms as the current regulatory oversight
7 differs based upon whether a firm is a registered
8 investment adviser or not, and only one of the proxy
9 firms is and that's ISS not Glass Lewis.

10 The Center also requests that Department of
11 Labor prohibit proxy advisory firms from providing
12 consulting services to corporate issuers if they also
13 provide an independent analysis on those same
14 companies.

15 Additionally, the Department should require
16 that proxy advisory firms disclose the financial
17 relationship with issuers so that institutional
18 investors and pension plans can make an informed
19 decision as to the credibility of recommendations and
20 whether a conflict exists or not.

21 Thank you for the opportunity to testify here
22 today and I'd be happy to answer any questions. And we

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1 would be happy to meet with the Department to discuss
2 additional questions you may have.

3 MR. DAVIS: Thank you so much, Mr. Tharp.

4 Mr. Berlau.

5 MR. BERLAU: Yes. If I may borrow your mic.

6 Thank you.

7 I'd like to thank Assistant Secretary Borzi
8 and members of the panel for the opportunity to testify
9 at this hearing regarding the proposed regulation
10 defining the term fiduciary in connection with the
11 provision of investment advice under ERISA.

12 My name is John Berlau. I am the Director of
13 the Center for Investors and Entrepreneurs at the
14 Competitive Enterprise Institute. The Competitive
15 Enterprise Institute is a nonprofit public policy
16 organization dedicated to advancing the principles of
17 limited government free enterprise and individual
18 liberty. Founded in 1984, our mission is to promote
19 both freedom and opportunity.

20 We make the case for economic freedom because
21 we believe it is essential for entrepreneurship
22 innovation and prosperity to flourish including

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1 prosperity for middle-class investors both in 401(k)s
2 and other pensions and IRAs and within individual
3 brokerage accounts.

4 In January, President Obama issued Executive
5 Order 13563 intended to reemphasize the principles of
6 President Clinton's Executive Order 12866 that governed
7 the regulatory development and review process.

8 Regarding his new Executive Order, the
9 President wrote: "We are seeking more affordable, less
10 intrusive means to achieve the same ends, giving
11 careful consideration to benefits and costs. This
12 means writing rules with more input from experts,
13 businesses and ordinary citizens. It means using
14 disclosure as a tool to inform consumers of their
15 choices rather than restricting those choices.

16 I am directing federal agencies to do more to
17 account for and reduce the burdens regulations may
18 place small businesses."

19 And unfortunately, and with all due respect,
20 the proposed regulation we are discussing today fails
21 to meet any of those objectives.

22 The proposal does not utilize in the

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1 President's words, "More affordable, less intrusive
2 means." Instead, the proposal dramatically expands the
3 applicability of the highest and most restrictive
4 standard of fiduciary conduct in federal law to entire
5 classes of market participants never before considered
6 ERISA fiduciaries. In fact, the Department did not
7 even consider less restrictive alternatives to the
8 proposal in its economic analysis.

9 The proposal does not, in the President's
10 words, "give careful consideration to benefits and
11 costs." In fact, the economic analysis does not
12 quantify costs or benefits, it admits that both are
13 subject to significant uncertainty and that the rule
14 could have a large market impact. And it fails to
15 consider any impact at all on the more than 4 trillion
16 individual retirement account marketplace.

17 The proposal does in the President's words,
18 "use disclosure as a tool to inform consumers of their
19 choices rather than restricting those choices." In
20 fact, the proposal, we argue, would limit the choices
21 of consumers especially in the IRA marketplace by
22 making it difficult or impossible for consumers to keep

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1 the service agreements they now have with providers
2 they personally selected.

3 Furthermore, the Department recently
4 completed regulations, the Service Provider Disclosure
5 Rules that will take effect next January, providing for
6 new disclosure tools for plans and participants which
7 could alleviate many of the concerns about hidden
8 conflicts of interest that are said to justify the
9 proposal we are discussing today. But the Department
10 intends to finalize this more burdensome fiduciary rule
11 before these disclosure regulations may even take
12 effect.

13 The proposal does not, in the President's
14 words, "account for and reduce the burdensome
15 regulations that may be placed on small business." In
16 fact, the Department decided it could not determine the
17 number of small entities affected by the proposal,
18 though the available hard data from the Form 5500
19 showed that 98 percent of service providers to plans
20 with 100 or more participants have total revenues
21 attributed -- attributable to ERISA plan clients that
22 are below the small entity threshold.

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1 Based on our review of this proposal and its
2 economic justification, we are deeply concerned that
3 the Department has failed to abide by the requirements
4 of the regulatory process from conducting a thorough
5 and required analysis of the impact of the regulation
6 to denying the public a meaningful opportunity to
7 comment on its contents.

8 We are also very concerned that the effect of
9 the proposal will be to reduce the availability of
10 choice options and freedom to individual Americans who
11 own IRAs, to employers offering workplace retirement
12 plans and to workers participating in those plans.

13 Individual choice is the hallmark of IRAs and
14 defined contribution plans such as 401(k)s and we
15 believe the proposal will make it more difficult for
16 workers to get the information or advice they seek to
17 make informed decisions.

18 Plan sponsors and workers should be free to
19 select service providers on a non-fiduciary basis to
20 assist them in making their own decisions. We believe
21 the likely effect of the proposal would be to limit the
22 ability of plans and workers to make that choice.

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1 As noted by other commenters, the proposal as
2 written will likely cause, under the may be considered
3 standard, attorneys, accountants and actuaries who
4 provide their services to plans to be defined as
5 fiduciaries. As a result, the cost of the new
6 liability of falling under this new definition as a
7 result of that, these professionals may sharply
8 increase their fees for these services or many may
9 decide it's simply not worth the cost to provide their
10 expertise to ERISA covered plans, concentrating instead
11 on segments of the financial market that serve only
12 wealthy investors.

13 Either way, middle-class workers with -- in
14 ERISA plans would lose out as they would either be
15 deprived of or pay much more for the skills of these
16 professionals.

17 Let me try to sum up in one sentence why we
18 are so concerned with the economic analysis in this
19 case.

20 The proposal would redefine one of the
21 fundamental concepts of an entire body of law governing
22 roughly 10 trillion in retirement savings for the

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1 benefit of more than 100 million workers, retirees and
2 their families.

3 And in our view, when the Agency is proposing
4 to make changes on this scale that would affect so many
5 individuals, it is incumbent on the Agency to
6 demonstrate that it has fully considered the impact of
7 the proposal and can, with some reasonable degree of
8 certainty, justify the transition and ongoing costs it
9 may impose. We do not believe the Agency has met this
10 burden.

11 Economic analysis is supposed to inform and
12 shape regulatory policy, not serve as a rubber stamp
13 for a predetermined policy view. That's why we were
14 very troubled to read a report yesterday quoting an
15 Agency official saying that the testimony at these
16 hearings asking the Department to go back to the
17 drawing board is not going to be well received. And at
18 the risk of not being well received, that is exactly
19 what we request.

20 We believe the Department must revise,
21 reanalyze and re-propose this rule for public comment.
22 Let me be clear, we support the Department's effort to

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1 review this regulation and we are open to the
2 Department's concerns about the need to revise the
3 current rule. However, we do not believe the proposal
4 as written can be determined to achieve the
5 Department's goals.

6 In our formal comment letter we provided a
7 number of comments for the Department to consider, but
8 in the interest of time I will focus on a few concerns
9 in my testimony today.

10 The impact on IRAs. And we acknowledge that
11 the Tax Code gives the Department the ability to
12 interpret the prohibited transaction rules for IRAs;
13 however, we do not believe it would be wise to apply
14 the proposed fiduciary definitions to IRAs.

15 First, as I already mentioned, the Department
16 does not appear to have considered how this rule might
17 impact IRAs. This alone causes concern because it is
18 not at all clear the same cost considerations apply
19 given the structural differences between IRAs and ERISA
20 plans and also because IRAs hold more than 4 trillion
21 in assets.

22 Second, IRAs simply are fundamentally

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1 different from ERISA plans, they are individual
2 financial products, individual retirement accounts and
3 should be regulated as such. Department has recognized
4 these differences in the past as it has previously
5 addressed prohibited transaction issues differently for
6 plans and IRAs.

7 ERISA's fiduciary provisions serve to protect
8 workers from decisions made on their behalf by others.
9 It provides a standard of conduct and a series of
10 rights and remedies designed to ensure that the people
11 making decisions for you, the worker, do so in your
12 best interest.

13 In an IRA, however, the individual makes her
14 own decisions. She decides which service provider to
15 hire and how much to pay. There is no relationship
16 requiring ERISA fiduciary intervention to protect her
17 interest. In effect, the actual decision-making
18 process for the individual is the same as in a personal
19 brokerage account or similar non-ERISA vehicle.

20 Applying the proposal to IRAs would have the
21 affect of limiting her choices and second-guessing her
22 decisions. If her IRA provider can be a fiduciary for

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1 providing her with a buy/sell/hold recommendation from
2 the research department the provider will stop
3 providing her with information or change its business
4 model to comply with prohibited transaction concerns.
5 In either circumstances, the terms of the agreement she
6 made with her provider are now being changed because
7 the government has decided she was not capable of
8 making her own decisions.

9 We are also very concerned that the
10 Department has relied on non-public data in developing
11 and justifying the proposal. While the Department
12 states that its enforcement experience leads it to take
13 action and that the proposal is necessary to solve the
14 Department's identified problems, the public has no way
15 of evaluating these statements.

16 For example, the Department did not consider
17 any less restrictive alternative in its economic
18 analysis. Why? Is it because literally nothing less
19 than the full scope of the proposal will work? The
20 answer is, we don't know. The public is limited in
21 understanding and reviewing the proposal until it can
22 see and evaluate the data on which the Department

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1 relied.

2 Accordingly, we request that the Department
3 provide a summary of the violations and resolution of
4 each consultant and adviser's project investigation it
5 undertook. The Department, of course, should redact
6 the names of the parties involved as appropriate to
7 protect the subjects of the investigations. Only by
8 doing this can the public understand whether the
9 proposal is narrowly tailored to achieve the
10 Department's objectives based on its enforcement
11 experience.

12 The Department should also develop and
13 analyze new alternative regulations that narrow the
14 scope of the proposal to determine if these
15 alternatives would achieve the Department goals of less
16 cost or greater efficiency.

17 In our comment letter we express concern that
18 the Department appeared to be double counting the
19 benefit of its prior disclosure, the service provider
20 disclosure regulations. The concern is due to the fact
21 that the service provider and participant disclosure
22 regulations were never mentioned on the proposal and,

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1 in fact, on page 65365, the Preamble incorrectly states
2 that non-fiduciary service providers, "need not
3 disclose to the plan fiduciaries payments received from
4 other parties without mentioning the new service
5 provider disclosure rules going into effect."

6 Further, such disclosure requirements have
7 already been promulgated by any rules by the
8 Department, the Department's economic analysis of these
9 regulations claim their benefits would exceed their
10 costs because disclosure would improve decision-making
11 and deter inappropriate behavior.

12 However, both these arguments are also
13 claimed as benefits of the fiduciary proposal without
14 regard to the other proposal. Thus, the Department
15 should answer a question, what is the additional
16 benefit of fiduciary status, if any, that exceeds the
17 benefits of disclosure? This incremental benefit, if
18 any, is highly relevant to the cost benefit analysis of
19 the proposal.

20 Conclusion. We believe the regulatory impact
21 analysis accompanying the proposal overstates the
22 proposal's benefits and understates its costs and does

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1 not comply with the intent of President Obama's
2 Executive Order 13563 or the previous Executive Order
3 12866 or OMB Circular A4. This is especially
4 significant because of the broad scope of the proposal.
5 We need better information demonstrating we will not be
6 making the current situation worse by --

7 MR. DAVIS: Mr. Berlau, are you almost
8 finished? You're over your time.

9 MR. BERLAU: I am. I'm sorry. I was
10 listening -- was the buzzer -- I'm sorry about that.

11 MR. DAVIS: About five minutes ago.

12 MR. BERLAU: I'm sorry. Oh, I'm sorry. I'm
13 terribly sorry.

14 MR. DAVIS: Yeah.

15 MR. BERLAU: I'll be happy to answer if there
16 are any questions you may have.

17 Thank you so much.

18 MR. DAVIS: Thank you.

19 So, Jeff.

20 MR. MONHART: Thanks, Michael. I have a
21 question for Ms. Eller.

22 I understand your testimony to be that the

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1 real estate appraisers are already regulated and that
2 they're subject to the USPAP, which is reassuring but
3 could you tell us is there an enforcement mechanism
4 under USPAP specifically if an appraiser does not abide
5 by one or more the standards, what are the implications
6 for the appraiser?

7 MS. ELLER: Sure. The enforcement is at the
8 state level. All 50 states have appraiser licensing
9 bodies. The appraisal standard -- Appraisal Institute
10 and Appraisal Standards Boards coordinates that
11 enforcement. They put out, for instance, guidelines
12 that help the state regulatory bodies know what the
13 other states are doing on enforcement for specific
14 infractions and violations.

15 So it's a state level enforcement but it is
16 very -- also very well coordinated at the federal
17 level.

18 MR. MONHART: Okay. Thank you.

19 MR. DAVIS: I really don't have any questions
20 but I did want to just for the record, Mr. Berlau, the
21 official you were referring to is not here to defend
22 herself. The quote that you made, but just to be

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1 clear, one of the reasons that we're having this
2 hearing is to hear comments on all sides with respect
3 to this regulation and we're open to all views no
4 matter how much they may be in sync with what we have
5 proposed. So just to be clear.

6 MR. BERLAU: And I appreciate that. I hope
7 you will consider my recommendations -- our
8 recommendations to revise and re-propose the rule.

9 MR. DAVIS: We'll certainly take that under
10 consideration. Thank you.

11 Mr. Strasfeld?

12 MR. STRASFELD: Yes, sir.

13 You had -- well, I -- maybe I'm
14 misunderstanding but you had two positions that seemed
15 to be seemed to be somewhat in conflict at least to my
16 understanding. You said the reg is over broad, which I
17 understood. You said the same thing. But then you
18 focused more narrowly on these proxy votes advisory
19 companies that service pension plans and other
20 institutions who want to be given direction as to how
21 to vote their proxies.

22 So I understand that your -- the concerns you

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1 expressed with respect to those institutions but --
2 which is a -- kind of a narrow focus, but what is --
3 what is your focus as to why the reg is over broad?

4 MR. THARP: Yeah. The -- our members who are
5 in the Center are also sponsors of ERISA plans and for
6 many of the reasons that have been indicated that it
7 would implicate people who just provide information and
8 nothing more, would be concerning fiduciaries. And the
9 fear is that it would increase the costs and let's say,
10 voluntary benefit system.

11 And, as you know, there are -- there's this
12 tension of wanting to make sure that we're providing
13 benefits but at the same time being conscious of cost.

14 The other is to have access to valuable
15 information and if it precludes the ability to access
16 people who heretofore have provided that information
17 but weren't deemed to be fiduciaries, it would probably
18 be to the disadvantage of firms trying to maintain
19 these plans.

20 MR. STRASFELD: Because the -- I think the
21 proposal goes to some extent to make it clear that
22 investment, education and that type of information will

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1 continue to be non-fiduciary in nature.

2 So is there -- is there information you're
3 concerned that -- that's sort of in between investment
4 advice? I mean, what would be an example of something
5 that seemed okay in the past but might be problematic
6 under this proposal?

7 MR. THARP: Yeah. When I actually served on
8 a pension committee when I was -- a board appointed
9 pension committee when I was head of human resources in
10 a company, I would have various employees provide
11 information to me that would inform some of my voting
12 and my decisions on the committee. And the questions
13 would be would those people now be considered to be
14 fiduciaries if they're providing that information and
15 nothing more?

16 And you might imagine the implications of
17 that for how we would treat not only potential
18 liability of employees and to cover them, but just the
19 -- the issue of who we could turn to get information
20 without inadvertently pulling them into the coverage of
21 being a fiduciary.

22 MR. STRASFELD: Ms. Evans.

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1 MS. EVANS: Ms. Eller, with respect to your
2 point about impartiality. If the reg made clear that
3 appraisers aren't expected to slant their valuations or
4 opinions one way or the other, would that allay some of
5 your concerns about the reconciliation between being a
6 fiduciary under ERISA and applying with some of the
7 rules under the Code?

8 MS. ELLER: I think it would help, but I
9 think up to now appraisers have not been considered
10 fiduciaries in part because their information is
11 individualized as to the needs of the plan and doesn't
12 take into account the sort of broader range of things
13 that a fiduciary making a decision that's maybe based
14 in part on an appraisal is -- has to take into account.

15 So the objectivity piece would help but I
16 think they'd still be concerned about co-fiduciary
17 liability and they'd still be concerned with sort of
18 the nuts and bolts of how you reconcile. Now I've got
19 three things to reconcile, the USPAP standards, the
20 kind of fiduciary light, objectivity is okay, if you're
21 an appraiser type fiduciary and the standard 404 and
22 406.

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1 So I think it would be a step in the right
2 direction but I'm not sure it would solve the concerns.

3 MS. EVANS: And what is your understanding of
4 the ability of a participant in a plan to be able to
5 bring an action against an appraiser? Some previous
6 witnesses said well, trustees can always bring an
7 action in state court, there's already enforcement
8 actions again appraisers. What's your understanding of
9 a participant to be able to bring an action if they
10 believe that an appraisal is inadequate or do you
11 believe that participant should be able to bring
12 actions in court if they believe that inadequate
13 appraisals led to losses to plans?

14 MS. ELLER: Well, I think the structure that
15 ERISA has set up is that participants have the ability
16 to bring an action against a fiduciary who's breached
17 their duties. And the person who's responsible for
18 keeping watch over the participants -- the
19 participants' money is the fiduciary who's responsible
20 for hiring the appraiser or purchasing the asset. So I
21 think that's the structure that's been set up for
22 participants.

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1 As to whether participants could bring an
2 action in state court directly against an appraiser for
3 a faulty appraisal, I think there might be some -- some
4 difficulty in that given that the appraiser and the
5 participant don't have any direct relationship, but I
6 think there's an awfully good proxy for participants
7 who are concerned about a fiduciary having relied on a
8 poor appraisal.

9 MS. EVANS: So you think it will be
10 appropriate for a participant to be able to bring an
11 action against appraiser in state court?

12 MS. ELLER: Well, I guess I don't know why
13 they'd need to. They've got a fiduciary in front of
14 them.

15 MS. EVANS: Mr. Berlau, do you have any -- I
16 guess -- you kept saying that the reg constricts
17 choices for investors in the IRA market. Do you --
18 what's the basis of that statement?

19 MR. BERLAU: I think the basis is just if an
20 IRA provider were a fiduciary and had to do the -- with
21 the definition of the highest standard of what is the -
22 - I know it's slightly different from the SEC

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1 definition of single best interest there might be some
2 different types of products, things like that that may
3 not meet that standard that -- where the individual
4 would still want -- they might not be able to provide.

5 MR. PIACENTINI: Okay. I would like to thank
6 Mr. Berlau for helping highlight some of the areas
7 where we can strengthen the impact analysis that we've
8 undertaken so far. I do think that you've pointed some
9 places where we really would benefit the public by
10 further explaining some of our thinking and maybe
11 digging deeper in some places, so thank you for that.

12 I do want to get on the record by way of
13 observation that, you know, certainly it is our
14 intention to satisfy the requirements of the applicable
15 Executive Orders and other applicable requirements when
16 we do our analyses and I think we crossed that
17 threshold this time but that doesn't mean that there's
18 not always room for improvement. So I do thank you for
19 that.

20 You know, I think certainly for those who
21 have looked at the economic analysis, we do confess to
22 some uncertainty there, both with respect to cost and

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1 benefits of this proposed rule and, in fact, that's
2 something we're supposed to do under the applicable
3 requirements is point out where some of the
4 uncertainties are. So to the extent that you or any of
5 the others who we've heard from today can help us
6 resolve some of those uncertainties, that's always,
7 always helpful.

8 So I guess I'll just -- I'll just highlight
9 one dimension of that invitation, if you will, where I
10 would like to encourage everybody who can to help us
11 out. Certainly, you know, the question of -- that's
12 being investigated now in behavioral economics and
13 other strands of literature about how you deal with
14 business relationships where one party has more
15 expertise or more information than the other party.
16 It's an area where our research is still evolving.

17 There's some disagreement, I think, about how
18 much disclosure by itself can protect a consumer when
19 they're dealing with an expert. In fact, there's some
20 research that -- I won't go into the details right
21 here, but there's some research that suggests that
22 disclosure science can be counter-productive. So

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1 there's a lot to consider.

2 So that's what we're struggling with. I
3 think that we have drawn some reasonable conclusions
4 based on the information available to us. But to the
5 extent we can have better information and draw firmer
6 conclusions, I'll be very happy.

7 So I'm sorry, that probably seemed more like
8 an observation than a question, but I do invite you if
9 there's anything that you'd like to share at this point
10 to help us with that, that would be great.

11 MR. BERLAU: Well, thank you. And thank you
12 and we will be happy to provide you some more
13 information and some more suggestions after the hearing
14 if you'd like to hear from some more of us.

15 I would just say that a lot of this involves
16 -- involves disclosure, not just to the plan
17 participants but to the administrators, the sponsors of
18 what a broker/dealer or an attorney can -- accountant
19 can provide there. And they're already the experts and
20 they have the fiduciary duty on behalf of the worker.

21 So maybe having something where the same
22 investor education exemption applies to the worker

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1 where it also applies on the level of the service
2 providers to the plan administrator where if it's
3 simply general education that could -- for the
4 administrator as well as the worker and that in turn it
5 gets passed on. That could -- that could help solve
6 this problem and benefit the workers as well.

7 MR. PIACENTINI: Thank you.

8 MR. BERLAU: I think Great West Insurance
9 Company suggested something along those lines in its
10 comments.

11 MR. PIACENTINI: Thank you.

12 MR. WONG: I just have one follow-up question
13 for Ms. Eller. It's sort of a follow-up to your
14 earlier question about state law causes of action
15 against an appraiser.

16 My question is in the context of say the plan
17 fiduciary who got the appraisal report and relied on
18 it. What's the nature of the state law cause of
19 action? For example, is it state -- some professional
20 malpractice suit? Is it some contractual claim? And
21 if so, would the appraiser be able to utilize something
22 like a hold harmless clause to effectively have the

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1 fiduciary waive any potential liability or cause of
2 action?

3 MS. ELLER: I think I got all that.

4 Yes, I think there are contractual claims and
5 the equivalent of appraisal malpractice claims. There's
6 also the economic reality which is appraisers who don't
7 do a good job, don't get hired again, which is, I
8 think, a very much a factor that we should pay
9 attention to.

10 And then the second part of your question
11 specific to the hold harmless clause, I mean, I think
12 the Department's guidance to fiduciaries on
13 indemnification and disclaimers of liability when
14 they're hiring non-fiduciary service providers would
15 hold true here. I think what that guidance says is
16 there's nothing per se imprudent about hiring a non-
17 fiduciary service provider and limiting their
18 liability; however, the standards under which they
19 should provide services that the disclaimer standards
20 shouldn't include things like gross negligence, fraud
21 and willful misconduct.

22 And I would say that would be a good guidance

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1 here and is applicable.

2 MR. WONG: Okay. Thank you.

3 MR. DAVIS: Thank you.

4 We'll call the last panel. Panel 13. Lucky
5 13 in this case.

6 The last panel includes Marta Bascom, with
7 the National Retiree Legislative Network. And Charles
8 Yocum and Justin Tomevi.

9 Panel 13, we appreciate your stamina. And
10 welcome to the Panel. So I think we'll start with Ms.
11 Bascom.

12 MS. BASCOM: Thank you. Thank you all very
13 much.

14 This is a very important issue for the
15 retirees who are members of the National Retiree
16 Legislative Network. For those of you who aren't
17 familiar with the NRLN, it is a non-partisan grassroots
18 coalition representing over two million members,
19 retiree members from 30 retiree associations as well as
20 individual members.

21 Our members have retired from 125 U.S.
22 companies and public entities. They have

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1 grave concerns about present and future retirees'
2 financial security with particular trepidation about
3 the state of their pension plans now and in the future.

4 The NRLN strongly supports EBSA's efforts to
5 update the scope of ERISA's fiduciary duty protections
6 and specifically the proposed rule on the definition of
7 the term fiduciary.

8 The changing marketplace has made several
9 aspects of the current regulatory structure obsolete
10 and ineffective. EBSA's proposed changes are necessary
11 to provide needed protection for pension plan
12 participants.

13 The NRLN applauds these efforts and thanks
14 the Assistant Secretary and the entire staff for moving
15 forward on this issue. But the NRLN also remains
16 hopeful that this proposed rulemaking process will take
17 into consideration the increasing role of foreign
18 fiduciaries in this global marketplace.

19 The NRLN believes that the definition of the
20 term fiduciary as proposed must be expanded in this
21 proceeding or one in the near future to address
22 situations where fiduciary duty is breached by a

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1 foreign fiduciary and results in depleted plan assets.
2 Specifically, the NRLN recommends that the proposed
3 rule include a requirement that at a minimum, all named
4 fiduciaries under ERISA be subject to the jurisdiction
5 of U.S. District Courts with respect to the enforcement
6 of judgments for potential breaches of fiduciary duty.

7 In addition, named fiduciaries should be held
8 jointly liable for the fiduciary breaches of other
9 fiduciaries who they designate under section 405(c)(1)
10 and who they know or reasonably should have known are
11 not subject to the jurisdiction of U.S. courts for the
12 purpose of enforcing judgments under ERISA. Increasing
13 globalization dictates that this should be so. The
14 environment has changed dramatically since the rules
15 defining fiduciaries were originally established. In
16 the 1970s, the marketplace in the U.S. was still
17 largely comprised of U.S. based companies with assets
18 and fiduciaries in the U.S., all within the
19 jurisdiction of our courts.

20 The expansive globalization of the
21 marketplace was not envisioned then. Now,
22 globalization through mergers and acquisitions has

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1 changed the makeup of fiduciaries charged with the care
2 taking of the pension plan assets of millions of
3 retirees in this country.

4 We are increasingly seeing more and more
5 foreign companies merging with or acquiring U.S.
6 companies with pension plans and more will be
7 coming.

8 As part of a common business strategy, for
9 example, foreign entities often strategize to combine
10 pension plans into similar businesses they acquire in
11 the U.S. in order to leverage the management of
12 combined assets. These actions magnify the potential
13 impact of an arm's length foreign fiduciary and thus
14 the need to make named fiduciaries subject to U.S.
15 legal jurisdiction.

16 Within the NRLN's membership, retirees have
17 seen this with the acquisition of Lucent Technologies
18 by France based Alcatel. In addition, there are
19 numerous media accounts of foreign entities looking to
20 acquire U.S. companies in the technology sector and the
21 automotive industry just to name two. Those are just
22 examples from among the former employers of NRLN

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1 members. Examples of other U.S. companies that have
2 been acquired over the last three decades are too
3 numerous to name here.

4 The fact is that the regulatory structure
5 currently in place does not address the realities of
6 the global marketplace nor the vulnerability of U.S.

7 plan participants should there be a breach in
8 the foreign fiduciaries duty. Unless our government
9 examines the current regulatory structure with a
10 proactive strategy, U.S. plan participants remain
11 dangerously vulnerable due to the lack of legal
12 recourse.

13 Under these circumstances, it is an
14 incomplete exercise to determine that an individual or
15 a firm is an ERISA fiduciary and liable for breach of
16 fiduciary duties if that party is not required to be
17 subject to the jurisdiction of U.S. courts. Liability
18 for breach of fiduciary duty is a clear objective of
19 ERISA. That objective is circumvented if a fiduciary
20 is not subject to the jurisdiction of U.S. courts.

21 In addition, without enforceability in U.S.
22 courts a foreign buyer of a U.S. entity with

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1 pension obligations can circumvent ERISA's protections
2 by simply locating beyond the reach of U.S. courts,
3 thus insulating a bad actor from legal action. Without
4 this additional protection foreign fiduciaries are able
5 to participate in management decision to move fungible
6 assets offshore, out of the reach of U.S. bankruptcy
7 courts, thus making such assets unavailable to be
8 liquidated and applied to highly under-funded U.S.
9 defined pension plans.

10 Including this requirement is not a far reach
11 when considering the rationale Congress devised for
12 establishing the regulatory framework for ERISA at its
13 inception. The prospect of holding named foreign
14 fiduciaries liable for missing assets due to a breach
15 of fiduciary duty is consistent with the congressional
16 intent of maintaining the indicia of plan asset
17 ownership under the jurisdiction of Federal District
18 Courts.

19 As you know, section 404(b) of ERISA
20 prohibits a fiduciary from maintaining plan assets
21 beyond the reach of U.S. District Courts. While
22 Congress in 1974 could not foresee a situation where

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1 named fiduciaries could be foreign nationals beyond the
2 reach of our courts it is highly likely that those same
3 lawmakers would see the consistency in requiring all
4 named fiduciaries to be subject to Federal Court
5 jurisdiction.

6 The goal of the two requirements would be the
7 same, to have the law allow for both obtaining and
8 enforcing judgments in all cases where a named
9 fiduciary is found to be in breach of duty in order to
10 protect plan participants.

11 The U.S. government, through the Department
12 of Labor and the PBGC needs to have the ability to rely
13 on the jurisdiction of U.S. Courts to enforce judgments
14 against breaching fiduciaries acting on behalf of a
15 foreign entity. Specifically, they need the ability to
16 both obtain and enforce judgment in an action for
17 fiduciary breach against any fiduciary not just those
18 that choose to maintain sufficient assets within the
19 jurisdiction of U.S. Courts.

20 Recent upward trends in foreign acquisitions
21 and in spin-offs of divisions of U.S. based firms to
22 foreign based investors will become more common and

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1 plans arising after these transactions resulting in
2 foreign fiduciaries will increase as well. That will
3 pose a significant challenge to both the Department of
4 Labor as well as the PBGC if they are unable to hold at
5 least all named fiduciaries accountable in U.S. Courts.

6 Perhaps most importantly for retirees, plan
7 participants rely on the ability of U.S. courts and
8 regulators to enforce judgments and to deter bad
9 actors. This is an essential protection for plan
10 participants. In fact, the Department of Labor website
11 advises plan participants that they may bring a civil
12 action in court to among other actions, attain
13 appropriate relief from a breach of fiduciary duty.

14 In general, this private right of action has
15 greatly benefited plan participants in both providing
16 access to U.S. Courts as well as in deterring potential
17 bad actors. This private right of action should be
18 available in cases of breaches of fiduciary duty
19 against all named fiduciaries regardless of
20 nationality.

21 The global marketplace has created a new
22 paradigm which calls for the U.S. government to

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1 continue to provide the same standard of recourse and
2 deterrence with a progressive framework to protect plan
3 participants and indeed millions of retirees from
4 losses that can have a devastating impact on their
5 already fragile financial security.

6 I thank you all very much for this
7 opportunity and look forward to working with you and
8 answer any questions you may have.

9 MR. DAVIS: Thank you, Ms. Bascom.

10 Mr. Yocum, Mr. Tomevi, is that the way to
11 pronounce it?

12 MR. TOMEVI: Right.

13 MR. DAVIS: Is that correct?

14 MR. TOMEVI: Yes.

15 MR. DAVIS: Okay. Thanks.

16 MR. YOCUM: Thank you for allowing us the
17 opportunity to speak today. My name is Charles Yocum
18 and I am here today with my classmate, Justin Tomevi.
19 Both Justin and I are students at the Earle Mack School
20 of Law at Drexel University.

21 We share an interest in the issues related to
22 employee benefits and are working on a research project

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1 on the meaning of fiduciary under ERISA.

2 Prior to law school, I spent eight years
3 working in the retirement services industry, seven of
4 which with one of the nation's leading retirement
5 service providers, although we are testifying here on
6 our own behalf.

7 We'd like to use our allotted time to address
8 an issue raised by the Department in the Preamble of
9 the proposed regulations, that is, whether and to what
10 extent the final regulation should define the provision
11 of investment advice to encompass recommendations
12 related to taking a plan distribution.

13 We believe the final regulation should treat
14 such recommendations as investment advice. Doing so
15 will further the Department's stated desire to protect
16 participants from conflicts of interest and self-
17 dealing. Furthermore, it may be important for the
18 Department to use its enforcement powers in this area
19 because there may be limits to the effectiveness of
20 remedies that a participant can obtain a private civil
21 action under ERISA.

22 Recommending to a participant that he or she

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1 take a distribution from a plan could harm the
2 participant's interest in a variety of ways. Most
3 employer sponsored retirement plans provide payment
4 options that would not be available to the participant
5 outside of the plan. While it is true that the
6 retirement community has drastically changed over the
7 past 35 years the joint and survivor annuity remains
8 the default payment option for all defined benefit and
9 defined contribution money purchase plans.

10 In addition, as of 2007, an additional 21
11 percent of 401(k) plans also offer an annuity option to
12 participants.

13 Advising participants to forego an investment
14 that would ensure them against longevity risk is a type
15 of investment advice and should be treated as such.

16 Another relevant consideration for some
17 participants is that under Code section 72(t), a
18 participant who has attained the age of 55 and has
19 separated from service can avoid the 10 percent early
20 withdrawal penalty, an option that would be unavailable
21 if the same distribution was made from the IRA.

22

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1 Another important change in the industry is
2 that as the baby boom generation begins to retire,
3 financial service companies are facing the prospect
4 that more money will be paid out, employer plans need
5 to be replaced by the inflow of new contributions from
6 younger workers. For an industry that seeks to
7 maximize assets under management, this shift has
8 presented some service providers and some financial
9 planners to encourage terminating participants to
10 invest their accounts in proprietary assets.

11 The Department has previously stated that
12 when a non-fiduciary advises a plan participant to
13 request an otherwise permissible plan distribution,
14 such a recommendation does not constitute investment
15 advice under the existing regulations. We think it
16 appropriate that the Department revisit this position
17 in light of the proposed regulation.

18 Some may argue that advising a participant to
19 roll over her retirement account balance to a like
20 investment simply is not investment advice. Even
21 assuming that the participant would not be forfeiting
22 the annuity option or the plan by doing so, we would

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1 suggest that in many cases, such recommendation should
2 still be considered investment advice. In many cases
3 the assets of an employer sponsored retirement plan
4 might be invested in low fee institutional shares as
5 opposed to relatively higher fee retail shares often
6 found in an individual retirement account.

7 In addition, the administrative costs related
8 to assets left in the plan will often at least
9 partially be subsidized by the employer. Others may
10 argue that the -- that by providing distribution
11 advice, serious providers can alleviate the problem of
12 leakage by retaining retirement savings and a deferred
13 -- tax deferred retirement account. Leakage is most
14 pronounced when a participant's employment status
15 changes and by intervening early, service providers are
16 in a position to help the participant maintain their
17 retirement savings in some kind of tax advantaged
18 investment vehicle.

19 While efforts to prevent pre-retirement cash
20 distributions are laudatory, there is no reason why
21 this cannot be accomplished through a program of
22 rigorous investment education consistent with what the

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1 Department outlined in Interpretive Bulletin 96-1.

2 Moreover, we think that the Department could
3 clarify through guidance or in the Preamble to the
4 final regulations that advising an individual
5 participant to consider retaining assets in a tax
6 deferred solution when the participant plans to take a
7 lump sum distribution without attempting to sell the
8 participant on particular products is itself -- is in
9 itself investment education rather than investment
10 advice.

11 We're not advocating that serious providers
12 be prohibited from recommending that participant
13 request an available distribution from his retirement
14 plan or how those proceeds should be reinvested.
15 However, we do believe that the final regulation should
16 deem anyone providing such advice to be an ERISA
17 fiduciary for purposes of the transaction. By doing
18 so, the Department can encourage serious providers to
19 provide distribution advice as prudent and in the
20 interest of the participant.

21 MR. TOMEVI: Hello, my name is Justin Tomevi.
22 As Charles has explained, we urge the Department to

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1 regulate distribution advice as investment advice
2 because of the profound impact it has on retirement
3 security.

4 A reclassification should be considered in
5 the context of judicial decisions that may make it
6 difficult for participants to obtain meaningful relief,
7 to redress harms caused by conflicted distribution
8 advice.

9 There are two obstacles to such relief.
10 First, once investment assets are moved from a plan to
11 an individual retirement account, they may no longer be
12 plan assets and thus, subsequent losses may not be
13 addressable under section 502(a)(2) of ERISA.

14 Indeed, this appears to have been the primary
15 basis for the Department's position in the Advisory
16 Opinion 2005-23A in which it wrote that the proceeds of
17 a distribution would be advice with respect to funds
18 that are no longer assets of the plan.

19 Second, it may also be difficult for a
20 participant to obtain meaningful equitable relief under
21 section 502(a)(3) to redress harms such as investment
22 loss or the higher cost of annuitization outside of a

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1 plan.

2 We suggest that the Department in thinking
3 through these remedial problems consider the thoughtful
4 District Court Opinion in Young v. Principal which is
5 cited at 54 -- 547 F.Supp. 2d, 965, a 2008 Iowa case.
6 In Young, retiring participants received a letter from
7 the Principal Financial Group instructing them to take
8 immediate action because changes in their employment
9 status affected their retirement account. The
10 participants contacted the 800 number on the letter,
11 which directed them to sales counselors who were
12 required to solicit the high fee plan which resulted in
13 plaintiffs earning less than if they maintained their
14 original plans.

15 The District Court held that only appropriate
16 equitable relief was available to the participants. So
17 participants could not receive compensation for their
18 lost opportunity or profits they would have achieved if
19 the funds remained with the original plan.

20 However, the court took an important step by
21 holding that if the sales counselors were fiduciaries
22 and they breached their duty the participants could

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1 pursue disgorgement of Principal's profits and transfer
2 their accounts back into the original plan.

3 While this was an important step,
4 participants may still not be made whole as a
5 disgorgement remedy will not reach lost opportunity,
6 just the financial service providers' fees. As a
7 result distribution advisers still may not have
8 significant incentives to halt strong and perhaps
9 misleading sales pitches that target important sources
10 of retirement income for participants and their
11 spouses.

12 Moreover, the remedy presumably would be
13 available only in cases where a participant's plan is
14 willing to accept back the participant's distribution,
15 which can be particularly problematic in defined
16 benefit plans. But the District Court's holding that
17 disgorgement in a return of assets to the plan is a
18 form of equitable relief may also have implications for
19 the first question, whether the plan continued to
20 constructively hold the assets and thus, the assets
21 remained plan assets even after distribution.

22 In any event, given the potential obstacles,

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1 the courts fashion a meaningful relief for
2 participants, we believe it is important for the
3 Department to monitor this area and use its own
4 enforcement powers when appropriate.

5 I want to conclude by noting, as the Supreme
6 Court recognized in LaRue and the Department of Labor
7 recognized in the Preamble to these proposed
8 regulations that the employee benefit landscape has
9 changed from the 1974 enactment of ERISA and the rules
10 should evolve to reflect those changes. The
11 personalization of defined contribution plans and the
12 power and risk shift to individual participants
13 requires better and equally important unbiased advice.

14 We urge the Department to take steps to
15 ensure that distribution advice is treated as
16 investment advice and to consider how the Department
17 can ensure that participants do not have a right
18 without a remedy.

19 Thank you for giving us the opportunity to
20 speak with you today and we'll be happy to answer any
21 questions.

22 MR. DAVIS: Thanks so much. We'll turn to

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1 the government panel starting with Jeff.

2 MR. MONHART: I have no questions. Thank you
3 for your testimony.

4 MR. DAVIS: Okay. I just want to recognize
5 the students here. It's the first panel I've been a
6 part of where we've actually had students testify. I
7 just think it's terrific that you're willing to step
8 forward and express a point of view on the record as
9 students. I just think that's absolutely terrific.

10 Now, you said that the fiduciary definition
11 is the topic that you're looking at as part of your
12 overall prac -- I'm just curious, how did you happen to
13 select that topic among other things that you could
14 have looked at in this area?

15 MR. YOCUM: Well, I think for one it's
16 topical. I mean, it's -- these hearings were -- we're
17 in an employee benefits course together and we started
18 a month ago that this is in the news, it's something at
19 least, I mean, interested both of us.

20 MR. TOMEVI: Yeah, I think Charles -- some of
21 Charles' background working in one of these
22 organizations also kind of allowed him to see the other

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1 side and see both sides in this case.

2 MR. DAVIS: Ms. Bascom, you focused primarily
3 on the foreign jurisdictional issues. Were there any
4 other thoughts you had with respect to the Regs, any
5 other issues that we asked about up -- one of the areas
6 we asked comment around was this issue of this rollover
7 advice. Any perspective there as well?

8 MS. BASCOM: No, not at this time, but we are
9 very supportive of the proposed rule and just again,
10 feel that it needs to be expanded to make sure that
11 plan participants are fully protected.

12 MR. DAVIS: Thanks.

13 MR. STRASFELD: I just have an observation
14 for Ms. Bascom. I'm in charge of the EBSA's Office of
15 Exemptions and the issue you raised, which I think is a
16 great issue, has been relevant to our consideration of
17 a lot of exemptions where there are foreign affiliates.
18 And we've attempted in a number of instances,
19 especially we've provided 406(b) relief to make someone
20 responsible in the U.S..

21 So, I mean, one possibility is we routinely
22 have the foreign entity agree to submit to jurisdiction

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1 of the U.S. Courts to be served here, but in instances
2 where there's actually fiduciary issues we generally
3 try to have someone who we could sue here or agrees
4 that if there's liability, you know, the American
5 affiliate will pay as a way of -- I guess the way we're
6 looking at it the plan should not have to go overseas
7 to sue. It works out a lot better -- obviously, you
8 know, you have ERISA here in Federal Court so we try to
9 structure an exemption where that happens and I think
10 we've been successful in a number of cases.

11 But you're right, it is an important issue.
12 It's one we will consider in the future.

13 MS. BASCOM: Thank you. We appreciate that.

14 MR. STRASFELD: I appreciate you bringing it
15 up.

16 And great to see you too.

17 MR. YOCUM: Thank you.

18 MS. EVANS: Mr. Yocum and Mr. Tomevi, one of
19 the witnesses from one of the financial institutions
20 yesterday testified that they have a number of reps in
21 these call centers and so a participant might call up
22 and say, you know, what are my options? And it seems

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1 like you too would support just generally being able to
2 say these are your options, these are your tax
3 consequences if you leave your money in the plan, if
4 you roll it over. It seems like you all are saying
5 that that should be investment advice. Is that
6 correct?

7 MR. YOCUM: That -- in -- I'm just going over
8 the, you know, tax consequences what the process is,
9 yeah, I would argue that is investment advice. But I
10 still don't see why, I mean, again, we're not saying
11 that they -- that they shouldn't be giving, you know,
12 be steering these individuals into a product outside of
13 their 401(k) plan if that's what they're looking for.
14 It's just that you do it in a way that's prudent and in
15 the interest of the participant.

16 MS. EVANS: Right. So at the point when a
17 rep at one of these call centers says, well, are you
18 interested in learning more about how to take advantage
19 of, sort of --

20 MR. YOCUM: X, Y --

21 MS. EVANS: -- rollover. At that point, you
22 would say, well, that's crossing the line from

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1 education to investment advice?

2 MR. YOCUM: Yes.

3 MS. EVANS: Thank you.

4 MR. PIACENTINI: I have no questions.

5 MR. DAVIS: Anything else from the panel?

6 Nothing? Okay. Well, thank you Panel 13, our last

7 panel. And thank you for the audience for your

8 attention through the last two days of testimony.

9 Just a few administrative announcements.

10 One is that we, the government panel, may

11 have additional questions for some of the witnesses,

12 which if we do we would submit for the record, get the

13 responses on the record.

14 And speaking of the record, the record will

15 be open an additional 15 days after the hearing so if

16 there's supplemental materials, clarifications to

17 testimony that's been provided, you'll have 15 days to

18 do that.

19 We are going to post the transcript of these

20 proceedings on our website and it should be up in about

21 two weeks.

22 So with that, we're going to conclude and

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1 thank you so much for your time.

2 (Hearing concluded at 2:18 p.m.)

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1 CERTIFICATE OF NOTARY PUBLIC

2 I, NATALIA KORNILOVA, the officer before whom the
3 foregoing meeting was taken, do hereby certify that the
4 witness whose testimony appears in the foregoing pages
5 was recorded by me and thereafter reduced to
6 typewriting under my direction; that said hearing is a
7 true record of the proceedings that I am neither
8 counsel for, related to, nor employed by any of the
9 parties to the action in which this hearing was taken;
10 and, further, that I am not a relative or employee of
11 any counsel or attorney employed by the parties hereto,
12 nor financially or otherwise interested in the outcome
13 of this action.

14

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19

Natalia Kornilova

20

Notary Public in and for the

21

District of Columbia

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My commission expires: April 14, 2012

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