

GROOM LAW GROUP

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By Electronic Mail to e-ORI@dol.gov

Office of Regulations and Interpretations
Employee Benefits Security Administration
Attn: Definition of Fiduciary Proposed Rule
Room N-5655
U.S. Department of Labor
200 Constitution Avenue, N.W.
Washington, D.C. 20210

Re: Definition of Fiduciary Proposed Rule

Ladies and Gentlemen:

Groom Law Group represents a coalition of firms engaged in the management of real estate assets and the business of valuing and appraising real estate (the "Real Estate Appraisal Coalition" or "Coalition"). On an annual basis, Real Estate Appraisal Coalition members are responsible for providing valuation services with respect to over \$500 billion in real estate assets belonging to thousands of employee benefit plans subject to the Employee Retirement Income Security Act of 1974, as amended ("ERISA").

The Department has proposed to amend its regulation interpreting when a person is deemed to be a "fiduciary" by reason of providing investment advice for purposes of section 3(21)(A)(ii) of ERISA.¹ The proposed regulation (the "Proposed Regulation") would amend DOL's existing interpretation of fiduciary status which has been in place for more than 35 years and would have a dramatic and negative effect on plan real estate investments. In addition to our written comments, provided below, the Coalition requests the opportunity to testify at the hearings scheduled to take place on March 1 and, if necessary, March 2, 2011.² In addition to submitting this comment letter, the Coalition will also submit to the Department a separate outline of the Coalition's proposed hearing testimony.

¹ 75 Fed. Reg. 65263 (Oct. 22, 2010).

² 76 Fed. Reg. 2142 (Jan. 12, 2011).

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I. Executive Summary

The Proposed Regulation fails to recognize the existence of a comprehensive set of standards governing all aspects of the real estate appraisal process. These standards, known as the Uniform Standards of Professional Appraisal Process ("USPAP") are important for a number of reasons. First, the strength and quality of the USPAP standards and the fact that these standards are subject to oversight by federal banking regulators means that the USPAP standards act as a safeguard against appraiser misconduct. In addition, the USPAP standards are explicitly incorporated into federal law. Because of this, it would be extremely difficult for appraisers and financial institutions who engage them (including when those institutions are acting on behalf of ERISA plans) to depart from the USPAP standards.

The Coalition recognizes that the Department may be concerned about proper valuation of hard-to-value assets, including real estate. If this is the case, the Coalition urges the Department to address this problem head-on, as recommended by both the ERISA Advisory Council and the General Accounting Office, and provide additional guidance to plan fiduciaries who are, by law, responsible for valuing plan assets. The Coalition strongly believes that increasing the number of persons who are subject to ERISA's fiduciary duties is a poor substitute for providing guidance to those who are properly characterized as ERISA fiduciaries.

Finally, if the Department insists on imposing fiduciary status on real estate appraisers, the Coalition recommends that the Department capitalize on the USPAP standards to limit the disruption the regulation will cause to employee benefit plans, financial institutions and real estate appraisers who follow USPAP standards.

II. Comments

A. It is not necessary for the Department to impose fiduciary status on real estate appraisers. The Uniform Standards of Professional Appraisal Practice, overseen by federal regulators, protect plans against appraiser misconduct, including fee conflicts.

Real estate appraisers are subject to a uniform set of standards governing all aspects of the appraisal process. These standards are designed to protect the interests of those receiving appraisals, including ERISA covered plans. For this reason, there is simply no need to impose ERISA's fiduciary standards on real estate appraisers. The Department does not appear to believe otherwise. In the Proposed Regulation, the Department failed to identify a single instance of harm to an employee benefit plan because of the actions of a real estate appraiser. In testimony before the ERISA Advisory Council in 2008 regarding enforcement activities related to hard-to-value assets, Virginia Smith, Director of Enforcement for EBSA did not identify any cases, initiatives or enforcement activities related to real estate valuation, or identify real estate

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valuation as an enforcement priority.³ The Real Estate Appraisal Coalition submits that the comprehensive uniform standards under which appraisers operate is one of the reasons the real estate appraisal process has generally not been identified as a problem in connection with valuation of ERISA plan real estate assets.

1. Overview of USPAP Standards and Enforcement⁴

The Appraisal Foundation is a private, not-for-profit corporation overseen by the Appraisal Subcommittee ("ASC") of the Federal Financial Institutions Examination Council ("FFIEC"). All of the following Federal Agencies (the "Agencies") are part of the FFIEC: the Board of Governors of the Federal Reserve System ("FRB"), the Federal Deposit Insurance Corporation ("FDIC"), the National Credit Union Administration ("NCUA"), the Office of the Comptroller of the Currency ("OCC"), the Office of Thrift Supervision ("OTS"), the Bureau of Consumer Financial Protection and the Federal Housing Finance Agency. The mission of the ASC is to oversee state appraiser regulatory programs, monitor appraisal standards of federal financial institutions, maintain a registry of state certified and licensed appraisers, and monitor and review the operations of the Appraisal Foundation.

The Appraisal Foundation sponsors two independent boards: the Appraiser Qualifications Board ("AQB") and the Appraisal Standards Board ("ASB"). The AQB establishes minimum education and experience requirements for appraisers. The ASB issues USPAP, which provides industry standards for conducting real estate appraisals. The USPAP standards comprehensively address all aspects of the appraisal process. According to the USPAP preamble, the purpose of USPAP, "is to promote and maintain a high level of public trust in appraisal practice by establishing requirements for appraisers."⁵

USPAP includes specific rules governing the substantive knowledge and experience required of each appraiser, specific standards relating to the performance of appraisals, appraisal reviews, client communications and appraisers' ethical obligations.⁶ The ethical obligations of

³ 2008 Advisory Council Report, Report on Hard to Value Assets, <http://www.dol.gov/ebsa/publications/2008ACreport1.html>.

⁴ While a complete discussion of USPAP and enforcement of USPAP standards is beyond the scope of this comment letter, the Coalition is prepared to meet with the Department to provide an in-depth discussion of USPAP, including its substantive requirements and enforcement.

⁵ Appraisal Standards Board, Preamble to the Uniform Standards of Professional Appraisal Practice (2010-2011), <http://www.uspap.org/2010USPAP/USPAP/frwr/PREAMBLE.htm>.

⁶ USPAP also contains a jurisdictional rule intended to preserve the balance of USPAP to the extent that a federal law or regulation precludes compliance with USPAP standards. As discussed below, however, we think it questionable, as a matter of policy and as a matter of Congressional intent, that ERISA's fiduciary conduct rules should "preempt" USPAP's ethical standards requiring complete objectivity on the part of an appraiser.

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appraisers under USPAP include specific requirements addressing the areas of conduct, management, confidentiality and recordkeeping. These requirements provide that each appraiser, "must perform assignments with impartiality, objectivity, and independence, and without accommodation of personal interests."⁷ These principles are supported by specific prohibitions, including that an appraiser:

- Must not perform an assignment with bias;
- Must not advocate the cause or interest of any party or issue;
- Must not accept an assignment that includes the reporting of predetermined opinions and conclusions;
- Must not misrepresent his or her role when providing valuation services that are outside of appraisal practice;
- Must not communicate assignment results with the intent to mislead or to defraud;
- Must not use or communicate a report that is known by the appraiser to be misleading or fraudulent;
- Must not knowingly permit an employee or other person to communicate a misleading or fraudulent report;
- Must not use or rely on unsupported conclusions relating to characteristics such as race, color, religion, national origin, gender, marital status, familial status, age, receipt of public assistance income, handicap, or unsupported conclusion that homogeneity of such characteristics is necessary to maximize value; and
- Must not engage in criminal conduct; and must not perform an assignment in a grossly negligent manner.⁸

⁷ Appraisal Standards Board, Uniform Standards of Professional Appraisal Practice (2010-2011), http://www.uspap.org/2010USPAP/USPAP/frwr/ETHICS_RULE.htm.

⁸ In addition to the ethical rule's prohibition on gross negligence on performing an assignment which would be a violation of the conduct section of the ethics rule, USPAP's development standards address the requirement that "an appraiser must not render appraisal services in a careless or negligent manner." Appraisal Standards Board, Uniform Standards of Professional Appraisal Practice (2010-2011), http://www.uspap.org/2010USPAP/USPAP/frwr/ETHICS_RULE.htm.

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The USPAP ethical requirements also specifically address and prohibit fee conflicts. Under USPAP, appraisers are prohibited from receiving compensation contingent on:

- The reporting of a predetermined result, (*e.g.*, opinion of value);
- A direction in assignment results that favors the cause of the client;
- The amount of a value opinion;
- The attainment of a stipulated result (*e.g.*, that the loan closes, or taxes are reduced);
or
- The occurrence of a subsequent event directly related to the appraiser's opinions and specific to the assignment's purpose.⁹

The goal of USPAP is to provide a single, uniform set of standards. These standards are used in licensing and registering appraisers in all 50 states.¹⁰ In addition, to promote uniformity in enforcement, the Appraisal Foundation issues guidance to assist state appraiser regulatory agencies in enforcing compliance with USPAP.¹¹

The Coalition believes that given the strength of the USPAP standards, the fact that the Appraisal Foundation is subject to oversight by federal regulators, and the fact that compliance with the standards is enforced in a uniform manner across the United States, the Department cannot reasonably determine that imposing ERISA fiduciary standards would add a meaningful level of protection for ERISA plans investing in real estate. As discussed below, imposing fiduciary standards on real estate appraisers is not only unnecessary, it would also disrupt the process by which financial institutions, including those acting on behalf of ERISA plans, select, evaluate and monitor real estate appraisers.

⁹ Id.

¹⁰ <http://netforum.avectra.com/eweb/StartPage.aspx?Site=TAF>.

¹¹ The Appraisal Foundation, Voluntary Disciplinary Action Matrix (August 26, 2010), <https://www.asc.gov/documents/misc/2010.08.26%20cetf%20matrix%20final%20rev%20121010.pdf>.

B. The Uniform Standards of Professional Appraisal Practice are thoroughly incorporated into the standards that financial institutions use in selecting, evaluating and monitoring real estate appraisers. Imposing ERISA standards on real estate appraisers would be disruptive and contrary to the practice of other federal regulatory agencies.

Over the last twenty-five years, the goal of uniformity in appraisal standards has been achieved as USPAP has been incorporated into federal and state regulation of real estate appraisers and the financial institutions that hire them. The Proposed Regulation would disrupt this uniformity and expose appraisers and financial institutions to conflicting requirements. The USPAP standards are subject to oversight by federal regulators and as a result, are heavily relied upon by financial institutions. Because of this, financial institutions hiring real estate appraisers could be forced to choose between requiring appraisers to comply with federal guidelines governing appraisals and requiring appraisers to comply with ERISA's fiduciary standards.

1. Federal Law Incorporation of USPAP Standards

In 1989, as part of FIRREA, Congress established the ASC as part of the FFIEC specifically to address the lack of regulation in connection with appraisals performed for federally regulated institutions.¹² In 2010, as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") Congress updated FIRREA to address real estate appraisal reform in light of the recent financial crisis.¹³

As updated by the Dodd-Frank Act, the ASC is empowered by law to monitor the requirements established by the States for the certification and licensing of individual appraisers and registration and supervision of appraisal management companies, to monitor the requirements for appraisal standards for transactions involving federally regulated financial institutions and maintaining a national registry of State certified and licensed appraisers eligible to conduct appraisals for federally regulated financial institutions, and to report to Congress with respect to ASC's oversight function.¹⁴

All of the FFIEC member agencies must establish rules relating to appraisal standards and appraiser qualifications for every real estate-related financial transaction engaged in by any entity regulated by the Agencies.¹⁵

¹² <https://www.asc.gov/About-the-ASC/ASCHistory.aspx>.

¹³ Dodd-Frank Act §§ 1101-1126.

¹⁴ Dodd-Frank Act § 1103.

¹⁵ 12 U.S.C. §§ 3339 and 3341, as amended by the Dodd-Frank Act.

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On December 10, 2010, the FRB, the FDIC, the NCUA, the OCC and the OTS¹⁶ issued final "Interagency Appraisal and Evaluation Guidelines" (the "Guidelines") intended to "provide further clarification of the Agencies' appraisal regulations and supervisory guidance to institutions and examiners about prudent appraisal and evaluation programs."¹⁷ Essentially, the Guidelines are intended to convey to federally-regulated financial institutions, the standards the institution should use in its own program of obtaining and evaluating appraisals.

The Guidelines incorporate the minimum standards established by the Agencies for the preparation of an appraisal. The first of these standards is that the appraisal must, "Conform to generally accepted appraisal standards as evidenced by the USPAP promulgated by the Appraisal Standards Board of the Appraisal Foundation unless principles of safe and sound banking require compliance with stricter standards."¹⁸

If the Proposed Regulations are adopted as drafted, financial institutions hiring appraisers with respect to real estate assets held by ERISA plans would face very difficult legal questions in determining which set of legal requirements to follow or how to harmonize multiple applicable legal requirements imposed with respect to appraisals. At the very least, a financial institution would be required to determine: (a) whether the principles of safe and sound banking would include compliance with ERISA; and (b) if so, whether ERISA's fiduciary conduct rules and prohibited transaction provisions constituted a "stricter" standard than USPAP, and if so, in what ways.

It is the view of the Coalition, that, for example, a national bank administering a collective investment trust investing in real estate would be required to administer the collective fund in accordance with the "principles of safe and sound banking" *and* in accordance with ERISA. We believe this view is shared by the Department and the OCC.¹⁹ Thus, if real estate appraisers are deemed fiduciaries under ERISA by reason of providing investment advice when delivering appraisal services, a financial institution hiring an appraiser could be forced to determine whether and how to incorporate the fiduciary and prohibited transaction provisions of ERISA into the standards applied to appraisals.

¹⁶ As far as we are aware, the newly-created Agencies (i.e., Bureau of Consumer Financial Protection and the Federal Housing Finance Agency) have not yet established the required guidelines.

¹⁷ 75 Fed. Reg. 77450 (Dec. 10, 2010).

¹⁸ 75 Fed. Reg. 77450, 77459 (Dec. 10, 2010).

¹⁹ Section 514 of ERISA is not intended to supersede other federal law, including federal banking law, nor to preempt state banking law. *See also*, Comptroller's Handbook, Collective Investment Funds, October 2005 (describing federal laws applicable bank-maintained collective investment funds, including federal securities law, ERISA and tax laws, as well as OCC regulations), <http://www.occ.gov/static/publications/handbook/CIFfinal.pdf>.

As an example, a financial institution would be in the position of comparing ERISA section 406(b)(1), which prohibits a fiduciary from using its fiduciary authority to cause itself to receive an addition fee, with the USPAP ethical requirements, which prohibit, for instance, an appraiser receiving compensation based on the value of an opinion. A similar exercise would have to be undertaken with respect to ERISA's fiduciary duty provisions and all of the USPAP ethical conduct standards. ERISA requires a fiduciary to act with an "eye single" to the interests of the plan.²⁰ In short, ERISA fiduciaries are expected to focus solely on the interests of participants and beneficiaries. Conversely, USPAP requires objectivity and neutrality. Currently, it is unclear whether these requirements can be harmonized. In any event, the Coalition submits, that the Department has not adequately investigated the burden the Proposed Regulation would place on financial institutions or on appraisers themselves, and therefore that any changes to the Proposed Regulation should take into account the extent to which federal and state law already rely on and incorporate the USPAP standards.

C. Rather than imposing ERISA fiduciary standards on real estate appraisers, the Department should provide guidance to plan fiduciaries to whom the law already assigns fiduciary responsibilities with respect to valuation of plan assets.

ERISA imposes fiduciary duties with respect to valuation of plan assets, including real estate investments, upon a plan's "administrator." Specifically, the administrator of an ERISA plan is required to report "current value" of the plan's assets on the Form 5500.²¹ In letters to ERISA plan fiduciaries, the DOL's regional office in Boston has stated that "It is incumbent upon the Plan Administrator to establish a process to evaluate the fair market value" of plan assets, including "hard-to-value" assets.²² The Department has also alleged that failure to have such a documented process (including a process for evaluating values received from other sources) is a violation of fiduciary duty.²³

The Department has published guidance to investment fiduciaries regarding the duty of prudence, requiring, among other things, that a fiduciary give "appropriate consideration" to relevant facts and circumstances, including the role the investment plays in the part of the plan's investment portfolio.²⁴ For investment fiduciaries, "appropriate consideration" includes factors such as the investment's risk and return characteristics, the impact of the investment on

²⁰ *Donovan v. Bierwirth*, 680 F.2d 263, 271 (2d Cir. 1982), cert denied, 459 US 1069 (1982) (Describing the duties imposed on fiduciaries under ERISA section 404(a)(1)).

²¹ *See, e.g.*, ERISA §§ 103(a)(3)(A) and (b)(3).

²² 2008 Advisory Council Report, Report on Hard to Value Assets, <http://www.dol.gov/ebsa/publications/2008ACreport1.html>.

²³ *Id.*

²⁴ 29 C.F.R. § 2509.08-1 (2010).

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diversification of the plan's portfolio, the liquidity characteristics of the investment and the projected return relative to the funding objectives of the plan.²⁵

In testimony before the ERISA Advisory Council in 2008, witnesses from the Department emphasized that a prudent investment process for hard to value assets should include "how the investment fits in the plan's investment policy; the role of the investment in the plan's portfolio; and the plan's potential exposure for losses, for example, is the investment subject to extreme price fluctuations and a high degree of leveraging."²⁶ With respect to valuation, the testimony noted that the analysis should include, "a review of the methodology for valuing the investment."²⁷

ERISA clearly assigns fiduciary responsibility with respect to valuation to the plan's administrator and to the plan's named fiduciary for investments (or to a properly appointed investment manager). Moreover, nothing in the Department's recent pronouncements on valuation issues has indicated that the Department is concerned that the fiduciary duty of valuing plan assets is not properly assigned under the statute. Given this, the Coalition does not believe that there is any basis for the Department to impose fiduciary status on appraisal professionals who are in the business of providing impartial information (including value opinions), and not recommendations, to plan fiduciaries that may be used in carrying out the fiduciaries' valuation responsibilities.

The Coalition believes that if the Department is concerned about valuation of real estate and other assets that may be considered "hard to value" it should provide guidance to plan administrators and investment fiduciaries on their duties in connection with the valuation process. The Coalition is not alone in making this recommendation. In a report released in 2009, the 2008 ERISA Advisory Council Working Group on Hard to Value Assets (the "Advisory Council Report") specifically recommended as follows:

"The Department of Labor should issue guidance which addresses the complex nature and distinct characteristics of Hard to Value Assets. This guidance should define Hard To Value assets and describe the ERISA obligations when selecting, valuing, accounting for, monitoring and disclosing/reporting these assets."

Similarly in August 2008, the U.S. General Accounting Office ("GAO") issued a report addressing investment by defined benefit pension plans in private equity funds and hedge funds. While the report did not address real estate investments, the recommendation was very similar to

²⁵ Id.

²⁶ 2008 Advisory Council Report, Report on Hard to Value Assets, <http://www.dol.gov/ebsa/publications/2008ACreport1.html>.

²⁷ Id.

the recommendation provided by the Advisory Council, specifically, that the Department provide guidance to fiduciaries on investing in these types of funds.²⁸

D. To the extent that the Department's final regulation relates to real estate appraisal activities, the Department should revise the "limitations" to provide a workable framework within which real estate appraisal services can be provided to plans.

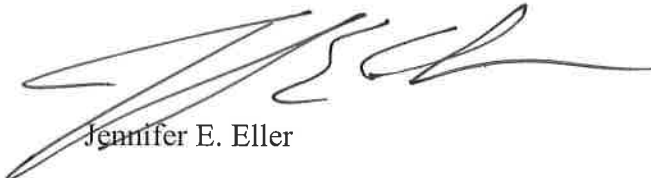
As discussed above, the Coalition does not believe that a real estate appraiser undertaking traditional appraisal activities should be deemed to be an ERISA "fiduciary" by reason of providing investment advice. However, to the extent that the Department's final regulation could impose fiduciary status on such appraisers, the Coalition recommends that the Department include a specific limitation such that real estate appraisers who are providing an appraisal subject to USPAP standards will not be treated as providing "investment advice" within the meaning of 3(21)(A)(ii) of ERISA.

Incorporating the USPAP standards would be consistent with other federal regulations, and would provide appraisers, financial institutions and plans with a clear understanding of the activities and standards under which appraisers may act while still maintaining a non-fiduciary role. This approach would also provide significant protections for plans against appraiser misconduct and conflicts of interest.

III. Conclusion

The Real Estate Appraisal Coalition appreciates the opportunity to provide comments to the Department and looks forward to further discussions about these matters.

Sincerely,



Jennifer E. Eller

²⁸ 2008 GAO Report, Defined Benefit Pension Plans - Guidance Needed to Better Inform Plans of the Challenges and Risks of Investing in Hedge Funds and Private Equity, <http://www.gao.gov/new.items/d08692.pdf>.