



February 3, 2011

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, NW
Washington, DC 20210

Re: Definition of the term “Fiduciary” under the Employee Retirement Income Security Act of 1974, as amended, Proposed Rule

Ladies and Gentlemen:

Reliance Trust Company (Reliance) is one of the largest independent trust companies in the United States and is a leading provider of trustee and independent fiduciary services to qualified retirement plans including Employee Stock Ownership Plans (ESOPs). Reliance’s comment is in response to the recently proposed regulation issued by the Employee Benefits Security Administration of the U.S. Department of Labor (EBSA) regarding the definition of “fiduciary” (Proposed Regulation) under the Employee Retirement Income Security Act of 1974, as amended (ERISA). This comment relates solely to those provisions of the Proposed Regulation that relate to ESOPs.

Reliance has issued this comment because we believe the Proposed Regulation will have a significant detrimental impact on the number and classes of vendors that will provide fiduciary services to ESOPs in the future. For the reasons stated below, Reliance is of the opinion that the Proposed Regulation will not only drive some excellent valuation firms out of the ESOP marketplace, but also, in the long term, has the potential to eliminate professional independent fiduciaries — both institutional trustees and registered investment advisers — (Independent Fiduciaries) from the ESOP service-provider landscape. In other words, two very plausible unintended consequences of the Proposed Regulation would be both to reduce the number of quality valuation firms servicing ESOPs and to leave only valuation firms and internal trustees as the last groups willing or able to serve as fiduciaries to ESOPs.

Reliance strongly recommends that the Proposed Regulation eliminate any language that would apply specifically to ESOPs. Alternatively, Reliance proposes that the Proposed Regulation be limited in certain respects to allow EBSA to ensure that an Independent Fiduciary is responsible for the accuracy of the ESOP valuation (and further the EBSA’s enforcement efforts in this area) while reducing, if not eliminating, possible negative unintended consequences the Proposed Regulation might have on the ESOP service provider marketplace.

The Current State of Affairs

Reliance agrees that out of a population of over 10,000 ESOPs, a certain percentage of the valuations performed would be deemed inadequate by any objective observer. We believe that the reasons for these inadequate valuations include:

- Valuations that are performed by casual appraisers not well versed in ESOP valuations.
- Conflicted internal trustees and/or valuation firms that may have loyalties that are divided between the ESOP and the company sponsoring the ESOP.
- Inexperienced internal trustees who are not well versed in valuation theory in general or ESOP valuation methodology specifically.

Likewise, Reliance understands EBSA's frustration in attempting to enforce the current five-part test during investigations of 401(k) advisers who hold themselves out as providers of objective advice only to claim that they are not ERISA fiduciaries when the timing proves convenient. The Proposed Regulation goes to great lengths to describe this frustration and the potential negative impact this has on EBSA's enforcement efforts.

However, it should be noted that no such confusion is present in the ESOP marketplace. ERISA section 3(18)(B) and practically every ESOP trust agreement provide that it is the responsibility of the ESOP trustee to make investment decisions for the ESOP and specifically that for a closely held corporation, fair market value (for adequate consideration purposes) is as determined in good faith by the plan fiduciaries, i.e., the ESOP trustees. In addition, numerous federal courts that have considered the issue have concluded that it is the ESOP trustee's responsibility to evaluate an appraisal and the ESOP trustee is not to rely blindly on an appraisal report without inquiry. *Donovan v. Hairell*, 716 F.2d 1455 (5th Cir. 1983), *Keach v. U.S. Trust Company* 313 F. Supp.2d 818 (DC CD Illinois 2004), *Eyler v. Commissioner of Internal Revenue* 88F.3d 445 (7th Cir. 1996).

The current definition of "fiduciary", found at Labor Regulation section 2510.3-21 (Current Regulation), through DOL Advisory Opinion 76-65, specifically excludes ESOP valuation firms:

"The advice is limited to a valuation of the employer securities to assist in determining, inter alia, the 'adequate consideration' for such securities. Investment in employer securities is an inherent element of an ESOP and the decision to invest in employer securities is an integral part of the process by which an ESOP is established. Under these circumstances, the advice...would not involve an opinion as to the relative merits of purchasing the particular employer securities in question as opposed to other securities. If so limited...advice to the sponsor of an...ESOP or to the ESOP itself would not sever as a 'primary basis for investment decisions with respect to plan assets,' nor would it constitute advice as to

the ‘value of securities’ within the meaning of “ERISA section 3(21).”
DOL Ad. Op. 76-65.

Additionally, the Internal Revenue Code of 1986, as amended (Code) requires that all valuations of securities that are not readily tradable on an established securities market be issued by an appraiser that is independent from both the company sponsoring the ESOP and the ESOP itself. Code section 401(a)(28)(c). Further, through its cross-reference to Code section 170¹, Code section 401(a)(28) provides a readily accessible solution. Rather than converting ESOP valuers to ERISA fiduciaries, EBSA could work with the Treasury Department to further delineate the requirements that must be met to serve as an ESOP valuator. Finally, ESOP valuation firms in almost every instance specifically disclaim (which the engaging fiduciary specifically agrees to) any fiduciary status in their engagement letters with the fiduciary engaging their services.

The consequence of this confluence of statutes and regulations, at least as is generally the case where an Independent Fiduciary serves as the ESOP trustee or named fiduciary, is a system of checks and balances where the ultimate decision-maker as to the valuation is the Independent Fiduciary. The resulting interplay among the company, the valuation firm and the Independent Fiduciary creates an effective procedural structure for analyzing valuation reports.

Potential Negative Consequences of the Proposed Regulation

Reliance believes that the Proposed Regulation will result in several unintended (and possibly negative) consequences for the ESOP marketplace as set forth below and

¹ Code section 170(E) Qualified appraisal and appraiser

For purposes of this paragraph—

(i) Qualified appraisal The term “qualified appraisal” means, with respect to any property, an appraisal of such property which—

(I) is treated for purposes of this paragraph as a qualified appraisal under regulations or other guidance prescribed by the Secretary, and

(II) is conducted by a qualified appraiser in accordance with generally accepted appraisal standards and any regulations or other guidance prescribed under subclause (I).

(ii) Qualified appraiser Except as provided in clause (iii), the term “qualified appraiser” means an individual who—

(I) has earned an appraisal designation from a recognized professional appraiser organization or has otherwise met minimum education and experience requirements set forth in regulations prescribed by the Secretary,

(II) regularly performs appraisals for which the individual receives compensation, and

(III) meets such other requirements as may be prescribed by the Secretary in regulations or other guidance.

(iii) Specific appraisals An individual shall not be treated as a qualified appraiser with respect to any specific appraisal unless—

(I) the individual demonstrates verifiable education and experience in valuing the type of property subject to the appraisal, and

(II) the individual has not been prohibited from practicing before the Internal Revenue Service by the Secretary under section 330 (c) of title 31, United States Code, at any time during the 3-year period ending on the date of the appraisal.

strongly urges EBSA's careful analysis of these consequences prior to taking any action with respect to the Proposed Regulation.

- Fewer qualified ESOP valuers and less competition for their services.
 - The Proposed Regulation will almost certainly result in increased insurance costs and increased litigation exposure for ESOP valuation firms due to their status as an ERISA fiduciary. Heightened risk and greater costs will result in many of the most qualified valuation firms exiting the ESOP marketplace. The loss of these independent and qualified appraisers to the ESOP community will only further exacerbate the identified problem EBSA is attempting to remedy: an unacceptable incidence of incorrect valuations in the ESOP context.
- Fewer qualified Independent Fiduciaries and less competition for their services.
 - As noted above, current law already places responsibility for accuracy of the ESOP valuation squarely at the feet of the named fiduciary, who, in almost all instances in the ESOP context, will be the ESOP trustee. As more fully set forth below, increased co-fiduciary liability will almost certainly be a by-product of the Proposed Regulation. The increased risk posed by greater co-fiduciary liability could result in institutional trustees leaving the business. At a minimum, if the Proposed Regulation does establish that ESOP valuation firms will be ERISA fiduciaries alongside the ESOP trustee, it should be expected that insurance carriers issuing policies to Independent Fiduciaries will raise their premiums charged for ERISA fiduciary liability coverage.
- ESOP sponsors might react to increased costs by no longer retaining Independent Fiduciaries for their company's ESOPs.
 - Like ESOP valuers and Independent Fiduciaries, it is likely that premiums for fiduciary liability insurance coverage will increase for ESOP sponsors. These additional costs, along with the new costs associated with securing ERISA liability coverage at the ESOP valuation firm and Independent Fiduciary level, will be passed along to the ESOP sponsor. A likely consequence of these combined cost increases will be that the ESOP sponsor decides to retain either the valuation firm or the Independent Fiduciary but not both as a cost saving measure — with the likely choice being the valuation firm.
- Unmanageable ERISA section 405 co-fiduciary liability.
 - Almost every ESOP trust agreement we encounter as a professional trustee contains language that prohibits co-trustees from being engaged on the same ESOP. This prohibition recognizes the significant liability presented

by ERISA section 405. As previously noted, under current law an ESOP valuation must be determined by the trustee or other named fiduciary. The Proposed Regulation will result in at least two fiduciaries for each ESOP. Because valuations are the life blood of ESOPs, internal disputes over the most accurate valuation of the ESOP will likely arise. In that case who would have the superior claim, the third-party valuation firm that routinely performs valuation reports or the internal trustee who knows the company inside and out? Under the Proposed Regulation, neither party would truly have control, although they would both have significant risk.

- Creation of a Conflict between the Preamble for the Proposed Regulation and the Code.
 - In the Proposed Regulation preamble the DOL sets forth its expectation as to a fiduciary appraiser's determination of value and specifically states that the DOL "expects...[it] to be unbiased, fair and objective, and to be made in good faith and based on a prudent investigation under the prevailing circumstances known to the appraiser." Taking this statement in two parts, first, there is no way for the fiduciary appraiser to be "unbiased, fair and objective" as ERISA requires that a fiduciary "discharge his duties with respect to a plan...solely in the interests of the participants and beneficiaries...for the exclusive purpose of providing benefits to participants and their beneficiaries." This fiduciary duty negates the ability of the fiduciary appraiser to be unbiased, fair and objective. Given these duties, the EBSA's stated objective does not appear to be achievable through the conversion of ESOP valuator to ERISA fiduciaries. Additionally, the Proposed Regulation, as discussed above, conflicts with the Code's requirement that ESOP valuator be independent from both the ESOP and the ESOP sponsor. Secondly, the requirement that the ESOP valuation be made in good faith and based upon a prudent investigation under the prevailing circumstances is already required of the named fiduciary charged with the duty of making the adequate consideration determination, i.e., the ESOP trustee.

The outcomes listed above would likely constitute a significant detriment to both the implementation of new ESOPs and the maintenance of existing ESOPs. On a macro level, the long-term result of the Proposed Regulation could very well be fewer qualified valuator and the elimination of a current class of professional fiduciaries (i.e., Independent Fiduciaries) without a corresponding gain in the quality of valuation reports.

As a result, Reliance respectfully urges EBSA not to alter the definition of fiduciary under ERISA as it relates to ESOPs and other non publicly traded qualified plan assets. Reliance feels that continued examination and enforcement methods employed by EBSA under the Current Regulation, along with actively partnering with the professionals serving the ESOP community will, in the long term, result in an improvement in the



quality of valuation reports issued on behalf of ESOPs without the need for the Proposed Regulation.

For Independent Fiduciaries, EBSA examinations are just one of the many areas of regulation that we face as part of our chosen profession and we welcome the opportunities afforded by EBSA's audit activity to review and evaluate our processes and procedures and to continually improve our processes and procedures through this regulatory oversight. We believe this regulatory oversight coupled with the efforts of the nonprofit organizations serving the ESOP community, e.g., the ESOP Association, the National Center of Employee Ownership and Employee Owned S Corporations of America, to educate and establish best practices within the ESOP community, will create an efficient structure of self-regulation.

Even so, neither continued enforcement activities under the Current Regulation nor the Proposed Regulation itself would have as much of a direct impact on the quality of ESOP valuations as would clearly articulated standards for determining fair market value issued by EBSA as a final regulation. To that end, Reliance respectfully requests that EBSA consider issuing such a regulation.

The DOL's proposed regulation setting forth the definition of "adequate security" (Proposed Labor Regulation section 2510.3-18 is the only authority the ESOP community has that evidences the DOL's opinion as to how shares of a closely held corporation should be valued. It should be noted, however, that as a proposed regulation (versus a final regulation) the opinions set forth therein are not binding but rather merely good evidence of the DOL's position in this regard. Further, this proposed regulation has not been updated in twenty-three years and fails to provide exhaustive guidance on this issue or reflect the current state and organizational complexity of today's closely held corporations. Accordingly, the DOL's issuance of final binding regulations in this area should be a prerequisite to the implementation of the Proposed Regulation. This appears to us the most direct, efficient and predictable means of addressing the DOL's expressed concern with respect to inaccurate valuations.

The Independent Fiduciary Limitation

Reliance asks that EBSA, in the event it moves forward with implementation of the Proposed Regulation, add a limitation to those found at Labor Regulation section 2510.3-21(c)(2) of the Proposed Regulation that exempts any person from the definition of those persons described in Labor Regulation section 2510.3-21(c)(1) if the qualified retirement plan that contains assets that require valuation services has retained an Independent Fiduciary to serve as a fiduciary for those same assets. For example, a valuation firm, and its employees providing valuation services to an ESOP, would not be a fiduciary under ERISA to that ESOP if an Independent Fiduciary (that has agreed to determine the value of ESOP shares pursuant to ERISA section 3(18)) has also been appointed to serve as a trustee to that ESOP.



The definition of “Independent Fiduciary” could be the same as that employed under other EBSA proposed and final regulations — such as “Investment Manager” under ERISA section 3(38), for example.

This alternate approach has several advantages:

- ESOP valuation firms, in an effort to avoid fiduciary status, would likely insist that their clients retain an Independent Fiduciary for their ESOP.
- The current system, where an experienced Independent Fiduciary determines adequate consideration for an ESOP with input from a knowledgeable valuation firm that is independent from all parties, would be preserved.
- ESOP valuation firms, Independent Fiduciaries and ESOP sponsors would not experience higher insurance premiums as valuation firms would not serve as fiduciaries for any of their accounts where an Independent Fiduciary served in the role of ESOP trustee.
- Large, reputable valuation firms would continue to perform ESOP valuations, thus eliminating the concern over an overall decline in the accuracy of ESOP valuations.
- There would be no co-fiduciary liability created between the ESOP trustee and the ESOP valuator, which would avoid significant confusion that could lead to the contrary result of only further hampering the DOL’s enforcement efforts in this area.
- The DOL would have a party to hold responsible (utilizing currently existing law), in either the ESOP valuation firm or the Independent Fiduciary, for the accuracy of the ESOP valuation and against which to pursue legal remedy should there be a problem with the ESOP valuation.

We certainly hope that this alternate approach is considered by EBSA. Please do not hesitate to contact me should you have any questions regarding this comment.

Respectfully submitted,

A handwritten signature in blue ink, appearing to read "A. Guthrie".

Anthony A. Guthrie
President & Managing Principal, Reliance Trust Company

A handwritten signature in black ink, appearing to read "Lance Studdard".

Lance Thomas Studdard
Vice President, Reliance Trust Company