ESI ENTERPRISE SERVICES, INC.

BEYOND THE NUMBER$

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Partial plan terminations typically more common during periods of economic recession.

Adapted from SES Advisors.

Typically the termination of a retirement plan is a decision made by a Company's Board of Directors. When the Board terminates a plan, its participants become fully vested, the assets of the trust are liquidated and benefits are distributed. Partial terminations are similar in some respects, but they're the result of other business decisions or events (sale of a division, layoff or early retirement offer). These are more common during periods of economic recession. Partial terminations cause the accounts of affected participants to immediately vest. This increases the ESOP sponsor's repurchase obligation (usually at an unfavorable time). It's important to be aware of the criteria used to evaluate whether a partial termination occurred.

Partial termination may be caused by a plan amendment that causes a significant reduction in benefits, discontinued contributions, reversion of plan assets to the employer, or a significant reduction in the number or percentage of plan participants. This last category of termination is often the result of a layoff, sale, or closing of a division or business location, but also may occur when the employer experiences an unusual employee turnover rate.

Determining whether a partial termination has occurred is based on a facts and circumstances analysis. The Internal Revenue Service (IRS) provides some guidance in their procedure 2007-43. Tax courts also provide guidance via rulings which indicated that a turnover rate of under 10 percent is not considered a partial termination, while a turnover rate of more than 40 percent is presumed to be a partial termination.

Turnover rate is evaluated based on the number of participants terminated by the employer; participants who left voluntarily may be disregarded. Good documentation supporting the circumstances of an employee's termination is important. While these employees may be excluded form the turnover rate calculation, once a partial plan termination occurs, all participants who terminated during the period are fully vested (regardless of their reasons for leaving). Partial terminations should be evaluated at least annually and over longer periods of time when the cumulative turnover rate is greater than 20 percent.

Typically ESOP fiduciaries decide that a partial plan termination has occured, although the company has the option of requesting a formal IRS determination. The IRS may also evaluate whether partial terminations occurred when a plan is fully terminated, through its plan audit program, or during the routine determination letter process.

Partial terminations have a significant impact on the size of an ESOP sponsor's repurchase obligation. It is important for employers to consult with their counsel and/or their third party administrator whenever they're considering or experiencing a significant reduction in workforce.

The important thing is not to stop questioning. Curiosity has its own reason for existing.

Albert Einstein

Go Green!

As part of ESI's commitment to make environmental stewardship a part of its business strategy, beginning this year you will notice several changes in the materials we send. For example, in an effort to reduce waste, we are eliminating the folder with your year-end materials, and we plan on making additional changes throughout 2009. This type of green initiative is part of the ESI team's desire to look at projects and decisions with an eye toward the environment.

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Is what you get in your plan fair?

Adapted from Employee Ownership Report.

ESOPs are governed by the same law that governs other retirement plans, such as 401(k) plans and pension plans. The basic rule is that you cannot discriminate in favor of more highly paid employees. That is defined to mean that ESOP contributions can be based on relative pay, but pay over $245,000 (for 2009) does not count. So, for example, if you have 1% of the pay in the plan, you get 1% of the contributions. If you make $300,000, and there is $3 million in total pay in the plan, you don't get 10%, you only get 8.2% ($245,000/$3 million). The rest gets reallocated to everyone else. Companies can have flatter allocations than this as well. The basic idea is that pay is a good measure of employee performance and a fair way to base the contribution.

ESOPs are a lot more favorable for ordinary employees than 401(k) plans. In most 401(k) plans, most or all of what you get is based on what you contribute to the plan. The company matches your deferrals at some percentage. For example, if you put in a dollar, the company might put in 50 cents. If you defer nothing into the plan, you often get nothing. So people at higher income levels tend to get a higher percentage of their pay contributed because they tend to defer more of their pay. Moreover, 401(k) plans, along with other retirement plans, can be age weighted so that more senior employees get a higher percentage, and 401(k) plans can be "cross-tested," regulatory speak for allowing higher paid employees to get much higher percentages of pay contributed if certain rules are met. ESOPs don't allow any of these provisions and everyone gets the same percentage of pay, except those making more than $245,000, who get less.

Part of the reason **ESOPs are so much more equal** than other plans is that they offer a lot of tax advantages to employers and employees. Other kinds of ownership are largely taxed the same way ordinary wages are. So Congress felt it had a lever to make different rules for ESOPs.

There are pros and cons for various types of retirement plans, but the limits and guidelines on ESOP contributions are meant to be fair to all who help in contributing to the company's success.

Communicating value in an economic downturn.

Do your employees understand how the ESOP works and where all the numbers on their year end statement come from? As long as the yearly balances are increasing, most employees are content and don't usually ask questions. During an economic downturn, when the balances could drop 10%, 20% or even more, questions will likely start coming.

The value of your company relies on *internal* and *external* factors because the three key drivers of value are (1) normalized net income (*internal*), (2) debt (*internal*), and (3) private and public market multiples (*external*).

What factors can management and employees control? Efficiencies in your processes, planning, marketing, customer service, employee and management retention.

What factors can't you control? Recession (general economy), industry declines, regulatory changes, loss of a significant customer (unless customer service related).

Remember, you have an advantage over most other companies. Several studies indicate ESOP owned companies experience increased productivity, profitability, and longevity over their non-ESOP counterparts. Competitors can duplicate many things you do - technology, buildings, equipment - but they can't copy the foundation of your firm's competitive edge, your employees! When employees are educated and informed about the ESOP, the stock valuation, and the current business environment, they tend to take steps to help their companies succeed. Build upon that foundation and distance yourself from the competition.

Don't let short term setbacks get in the way of the long term outlook

Set simple milestones and communicate

Create a plan to deal with the foreseeable future

Develop best case/worst case/ most likely scenarios

Don't cut costs without a plan

Cut once and deep - don't cut costs in stages

Make sure trustee is aware and possibly involved

STAY POSITIVE! Tough times will pass