

Fiduciary Process Agreement

Sources: NCEO and www.wsj.com

In June of this year, the DOL Fiduciary Process Agreement became public, and the ESOP community has embraced it as a list of suggested guidelines. While the agreement technically applies only to GreatBanc (a firm that serves as a third-party trustee), it does illustrate what the DOL would like to see when it comes to ESOP valuations.



Over the past few years, the DOL has continually stepped up its scrutiny of ESOP companies and their valuation experts. It has filed 28 lawsuits involving ESOPs since 2009, which is twice as many filed in the prior 6 years. Most of these have involved challenges to valuations.

The NCEO reports that, for the most part, the Fiduciary Process Agreement is not ground-breaking or particularly difficult to comply with, as many valuers already institute similar practices.

A few of the key points in the agreement include:

- Trustees must investigate advisor qualifications and document why an advisor was chosen
- The chosen valuation advisor must not value the stock for any party but the trustee
- The trustee or appraiser should show how the company will handle repurchase obligations
- The trustee must document its consideration of 16 standard elements of an appraisal
- Trustees must document that all information given to the advisor is “reasonable”
- Audited financials are preferred, and unaudited financials need documentation as to why they are adequate

The myriad documentation requirements may increase paperwork and overall cost for valuations, but following the guidelines may help to safeguard against DOL action.

ESI remains committed to complying with all current regulatory standards, and requests and subsequently reviews a comprehensive checklist of items in order to meet due diligence requirements. ■

Revised NCEO Data

Source: NCEO

In 2013, the NCEO changed the way it counts ESOP plans, and now uses a more conservative method. Although the revised number of plans appears lower than prior estimates, both the number of participants and the value of plan assets have actually been revised up--these numbers are more relevant to the economy than the actual number of plans. The latest data available (2011) show that ESOP plans total \$942.5 billion in assets.

Previously, estimates for ESOP plans typically ranged from 10,000 and 12,000. The old method of estimating did not separate ESOP plans from ESOP-like plans, and used the DOL Form 5500. With the new method, which works off a new research file from the DOL, the NCEO estimates that (as of 2011), there are 6,941 ESOPs and 1,985 ESOP-like plans (mostly profit sharing plans with 20% or more of their assets in company stock).

Also, to keep the estimate conservative, the NCEO no longer estimates the number of plans created in years for which there is no DOL data available, which accounts for the lag in years reported. ■

Year	Number of ESOPs	Total Participants	Active Participants
2002	8,874	10,230,000	7,946,000
2003	7,934	10,049,000	7,570,000
2004	7,348	10,243,000	7,826,000
2005	7,198	11,998,000	9,448,000
2006	7,384	12,584,000	9,850,000
2007	7,326	13,219,000	10,174,000
2008	7,305	13,038,000	10,055,000
2009	6,690	12,997,000	10,015,000
2010	7,138	13,477,000	10,307,000
2011	6,941	13,463,000	10,288,000

Restated using current NCEO analysis. Data Source: DOL 2011 PPP Research File

*“Remember
This December,
That love weighs more than gold!”
– Josephine Dodge Daskam Bacon*

Employees Want Company Stock

Source: NCEO

A recent report by Fidelity Investments shows that 40% of surveyed employees consider a company stock plan a “must have” when they are considering moving to a new job. A large majority (86%) of employees 40 years old or younger want prospective employers to offer company stock, while 10% ranked company stock plans as even more important than health care and 401(k) plans. 54% of respondents stated that company stock increases their loyalty to the company, and 57% stated that company stock encourages them to work harder.

The survey concentrated on public companies, but private firms can offer similar benefits. Implementing an ESOP is one way that a private company can offer company stock-based benefits that workers are looking for.

Fidelity’s survey supports other research showing that productivity and employment grow when companies implement ESOPs. The value that such plans have for employees will, in turn, grow the business. And while some of the survey respondents felt that employee stock was more important than a 401(k) plan, companies that have ESOPs are also more likely to have a second retirement plan in place.

Employee-owned companies have long known the benefits of offering company stock, and job searchers are also recognizing the value of owning it. ■

Reanalyzing Your ESOP Plan

By: Nicola Giordano

Every once in a while, it is important to step back and think about what you want from your ESOP plan, and how it has been working for the company so far. Many times no big changes are necessary, and the plan can continue as it has been. However, there may come a point (planned or not) when changes need to be made.

If you are considering increasing the ESOP’s ownership, consider how the change will affect the company’s tax obligations, ownership status (minority or majority), and current participants.

On the other hand, it might be better to decrease, or even eliminate, the ESOP’s ownership. For example, it may be necessary if there is not enough cash to meet repurchase obligations, or if there is a lack of support from management.

ESI is ready to assist any time you may need to reassess your ESOP situation. ■

Increased Standard of Prudence

Source: NCEO

A recent Fourth Circuit Court ruling (*Tatum v. RJR Pension Inv. Comm*) overturned a lower court’s finding that proving a prudent fiduciary “could have” made a decision was enough to show prudence in accordance with ERISA standards. The Fourth Circuit ruled that the “could have” definition was too lenient, and stated that the standard should be that a prudent fiduciary “would have” made that decision.

The “would have” standard is in wide use, but strictly limits the range of choices that are considered prudent.

The *Tatum* case involved dropping company stock from a 401(k) plan; it did not pertain specifically to ESOPs. However, since ESOP fiduciaries are no longer afforded “presumption of prudence,” this ruling could impact future ESOP cases as well. ■

Get to Know Our Team

By: Nicola Giordano

Sandy Paavola has been a key member of the ESI team for 16 years and wears many hats. She is our Chief Operating Officer, Vice President, and a Principal; in addition, she is accredited in business valuation by the NACVA, and is one of about 80 professionals to have earned the Accredited in Business Appraisal Review (ABAR) designation. The ABAR is the only accreditation that certifies competence in the review of valuation reports and analysis performed by others.



Sandy Paavola,
CVA, ABAR

Sandy has more than 30 years experience in public and private firms, and having served as a senior officer in both spheres, she has excellent insight into practically all phases of strategic planning, financial administration, operations, and other aspects of management.

In addition to her business experience, Sandy also served as an officer of The ESOP Association, where she was recognized and received awards for her contributions and particular involvement in government relations activities.

Among her many responsibilities are leading and managing ESI’s strategic planning, marketing, and overall operations as well as working with hundreds of companies on ESOP valuations, fairness opinions, estate and gift tax reporting, buy-sell agreements, mergers and acquisitions, and general corporate planning. ■