

ESOPs: It's More Than a Matter of Trust

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Agenda



Plan Trustees and Fiduciaries

Authority for a Plan
Trustee/Fiduciary

Legal Duties

Administrative Duties

Trustee/Fiduciary Selection

Conflicts of Interest & Their
Cost

Alternative Solutions

Authority for a Plan Trustee/Fiduciary

- ERISA requires each plan to have a Trustee
- **Plan documents** set out the duties and discretion
- **Case law** sets standards for breach of fiduciary duty
- **ERISA** sets standards for fiduciaries and imposes severe sanctions on the failure to meet those standards



Legal Duties of a Trustee/Fiduciary

- ERISA-Exclusive Benefit Rule
 - Duty of loyalty to participants
 - Duty of impartiality between participants
- “Prudent Expert” Rule
- Diversification Rule
 - Exception: Eligible Individual Account Plans
- Plan Conformity



Administrative Duties

- Determine the fair market value of assets
- Important records to keep
 - Detail decision process
 - Describe relevant circumstances
 - Engage counsel or experts to advise



Administrative Duties continued

Custodial duties of Independent or Directed Trustees

- Duties provided by institution, bank or trust company
 - Consolidate and hold assets
 - Collect income, dividends and capital gains
 - Settle trades
 - Provide trust statements with detail

Administrative Duties continued

- Provide information for the Form 5500
- Pay distributions to terminated participants
- Pay and report funds withheld to government
- Prepare and report 1099-R or W-2P forms
- Roll up asset information to recordkeeper



Trustee/Fiduciary Selection: More than a Matter of Trust

Types of Trustee/Fiduciaries

- Individual Trustees

Officers or employees of sponsor

- Directed Trustee

Outside party not responsible for investments

- Independent Trustee/Fiduciary

Outside party who assumes investment responsibility



Trustee/Fiduciary Selection: More Than a Matter of Trust continued

Pros and cons of hiring outside trustee/fiduciary

Pros

- Reduce significant personal liability
- Reduce ministerial duties to save time
- More experience or expertise with problem issues
- Provide oversight to catch non apparent problems
- Limited scope audit with over 100 employees
- Give IRS or DOL regulators more comfort
- Difficult for officer of company to distinguish best interest

Cons

- Creates additional approval layer
- Better understanding on part of officer
- High cost of Independent Trustee due to liability
- May take longer to make decisions

Conflicts of Interest and Their Cost

Where self-dealing and conflict of interest issues arise:

- Leveraging an ESOP
- Purchase of employer stock from a “party in interest”
- Special valuation issues including selection of an agent
- Voting stock
- Responding to tender offers
- Shareholder activism based on DOL pronouncements

Conflicts of Interest and Their Cost continued

Potential for having prohibited transaction with a
interest”

- Sale, exchange or lease of property
- Extending credit
- Transfer of plan assets
- Acquisition of employer securities that
are not qualified

“party in



Conflicts of Interest and Their Cost continued

Potential for having a prohibited transaction with a **fiduciary**

- Deal with plan assets in own interest or for own account
- Act on behalf of a party whose interests are adverse
- Receive any consideration for own account

Conflicts of Interest and Their Cost continued

The price to be paid: balance pros and cons against cost of potential penalties

- Law suits
 - Return profits
 - Pay attorney fees
 - Pay any plan losses
 - Bar from any future fiduciary roles under ERISA



Conflicts of Interest and Their Cost continued

DOL

- Civil penalties of up to 20% of amount recovered
- Prohibited transaction violations can result in 15% excise tax and up to 100% if not corrected
- Egregious prohibited transaction may cause the IRS to disqualify the plan



Alternative Solutions

- Hire Independent Trustee/Fiduciary just for transaction/question
- Select Independent Trustee/Fiduciary that is not a Bank or Trust company
- Abstain from a decision rather than resign

