The ESOP Association

Insist US Department of Labor Prioritize "Adequate Consideration" Notice and Comment Rulemaking this Fiscal Year (FY24)

BACKGROUND

- ESOPs are subject to the Employee Retirement Income Security Act of 1974 (ERISA), which is overseen, in part, by the U.S. Department of Labor (DOL).
  - ERISA imposes fiduciary duties on ESOP trustees and others and prohibits various non-exempt conflicts of interest.

- A key decision for an ESOP fiduciary is the approval to purchase or sell shares of stock for "adequate consideration" based upon a valuation, as required by law. The valuation sets the range of fair market value for a subject company at which the ESOP purchases or sells shares of stock.
  - Valuing ESOPs involves several different factors, and ESOP fiduciaries generally retain business valuation professionals to advise them on the range of fair market value of privately held stock.
  - ESOP appraisers currently follow longstanding methods developed in the business valuation profession and follow commonly accepted standards.

SUMMARY

- However, the DOL has not issued any definitive guidance to help ESOP fiduciaries make the determination as to whether the price paid or sold for employer stock is for "adequate consideration."
  - In 1988, DOL proposed a regulation to provide guidance regarding ESOP valuation by defining adequate consideration under ERISA, but that regulation was never finalized.

- Despite the absence of formal guidance, DOL has targeted ESOPs with an aggressive enforcement campaign, often relying on fundamentally flawed theories in its analysis of ESOP valuations which are often at odds with longstanding valuation practices.

- DOL's focus on enforcement and litigation to the exclusion of regulatory guidance has profoundly negative impacts on employee ownership.
  - It discourages owners and employers from the formation of new ESOPs and drives competent ESOP service providers out of the market.
  - It results in excessive and unnecessary costs, decreasing employee-owners' retirement holdings.
  - ESOP fiduciaries find it difficult and expensive to secure insurance policies, with many insurers exiting the market due to the DOL's approach.
  - As a result of regulatory ambiguity and likely enforcement and oversight, businesses are turning to other forms of employee ownership, which are outside of the regulatory process, and which provide few, if any, protections for the employees supposed to benefit from the ESOP.

- The SECURE 2.0 Act (P.L. 117-328) directs DOL to issue formal guidance on the issue, but the matter requires congressional oversight. Congress should ensure the DOL finally ends its regulatory avoidance.

- **ASK: Ensure language in the Labor, Health, Education Appropriations bill directs DOL to conduct notice and comment rulemaking in FY24 on adequate consideration.**

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