



Employee Stock Ownership Plans – Are They Worth the Risks?

By William K. Bortz

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Introduction

Enron, RadioShack, and United Airlines are a few of the many companies that have used employee stock ownership plans (“ESOPs”) to link employee retirement benefits with company performance through investments in employer securities. When these companies went bust, their employees lost more than \$1 billion dollars in retirement savings.ⁱ Despite this history of failure, the number of ESOPs has continued to increase,ⁱⁱ thanks to the special tax breaks ESOPs receive.ⁱⁱⁱ Given their role in business transitions for retiring business owners,^{iv} and the positive arguments that can be made for ESOPs,^v ESOP participation is likely to continue to grow over the next decade. Yet, little attention has been paid to the risks that ESOPs present.^{vi}

In good financial times, ESOPs have the appearance of being an excellent deal for employees, because ESOPs offer partial ownership over the company that employs them. However, ESOPs pose serious risks that employees may not recognize until it’s too late. This paper describes how ESOP participants do not face just a single risk, but a complex set of interrelated risks to their retirement security.

Unlike other retirement instruments, ESOPs are excessively invested in employer stock. This means that a financial decline for an employer that sponsors an ESOP equals a financial decline for its retirement plan. Moreover, employees are likely to lose their jobs and cash out their benefits at the exact time that their retirement plan has its lowest value. For a company whose stock is not publicly traded, the loss of cash flow because of benefit payments can accelerate the employer’s financial decline. Leveraged ESOPs, one of the three basic types of ESOPs, create additional opportunities for owners to abuse employee retirement benefits.

The question decision-makers and employees should ask themselves is: Are ESOPs worth the risks?

What is an ESOP?

An ESOP is a retirement plan in which **plan investments are invested primarily in stock of the employer.**¹ Each employee participating in the plan has an individual account and will see his or her account balance fluctuate according to the stock’s performance. Generally, an ESOP participant’s account will increase in value if the stock appreciates or, conversely, decrease in value if the stock depreciates. In baseball terminology, an employee can hit a home run or strike out, depending on the stock’s value at retirement.

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Three Fundamental Problems in ESOPs

There are three fundamental problems in ESOPs, each of which corresponds to three fundamental types of ESOP.^{vii}

1. Too Much Invested in a Single Stock

A fundamental principle of investing is to diversify so that too many eggs do not end up in a single basket.^{viii} The federal laws governing employer-sponsored retirement plans, such as pensions and 401(k) plans, require that the individuals in charge of investing plan assets diversify these investments.^{ix} But there is an exception for ESOPs, which are designed to be invested in employer stock.^x As a result, financial difficulty experienced by an employer sponsoring an ESOP will eventually be reflected in the stock price, causing participants' retirement savings to suffer because they will be disproportionately invested in a single, poorly performing stock. Furthermore, even when an ESOP allows participants to elect out of employer stock,^{xi} employees often do not do so.^{xii} This places at greater risk those loyal employees whose faith in their employers leads them to hold on to the bitter end.

A high-profile example of a company whose employees had the opportunity to diversify out of employer stock in an ESOP before the stock value collapsed is Enron, which declared bankruptcy in 2001. Enron's pension plan contained an ESOP feature that allowed employees to diversify out of Enron stock that had been held for more than five years, but many employees did not make any investment changes. That stock eventually became worthless, devastating employee retirement account balances.

This problem is compounded by the fact that the dates when an employer lays off workers often correspond to dates when its stock value is down. This tends to result in situations in which employer stock has *low values* at exactly those times when participants have *the greatest likelihood of needing to sell the stock*. **No other retirement investment has this peculiar feature.**

For example, when RadioShack struggled financially, many of the company's employees lost their jobs and experienced corresponding problems for their retirement savings.^{xiii} RadioShack made matching contributions to its 401(k) plan in the form of RadioShack stock and, since 1990,^{xiv} also had a separate ESOP invested in RadioShack stock that was merged into the RadioShack 401(k) plan in 2002.^{xv} Thus, the company's 401(k) plan contained an ESOP component, causing participants who took advantage of this feature to become overinvested in employer stock. RadioShack's stock traded at about **\$50 per share 20 years ago**, at about **\$25 per share 10 years ago**, and was at about **25 cents per share around the time of its bankruptcy in February 2015**.^{xvi} That means that, of its approximately 27,000 employees, those whose retirement savings accounts remained invested in RadioShack stock are now left with very little. This collapse in the value of RadioShack stock has been a particular disaster for the company's most loyal employees, who continued working for the company throughout the decline.

Other high-profile examples of bankruptcies that led to dramatic losses of ESOP value are Polaroid in 2001^{xvii} and United Airlines in 2002.^{xviii}

2. Cash Distributions from ESOPs Holding Privately Traded Stock

For corporations whose ESOPs are invested in publicly-traded stock, problems are limited to the risks associated with overinvestment in a single stock (it might do well, or it might be a disaster, akin to gambling). But corporations whose ESOPs are invested in privately-held stock that is not readily tradable on an established securities market^{xix} face serious additional risks that can quickly escalate into a disaster for both the employees covered by the ESOP *and* the corporation itself, producing a vicious cycle.

An employee participating in an ESOP holding privately-traded stock will need to have the value of the stock in his or her account paid out in cash during retirement because there is no ready market in which to sell privately-traded stock. Tax law gives employees participating in these types of ESOPs the right to receive payouts in cash, along with the right to have the stock's value determined using a fair valuation formula.^{xx} This arrangement benefits employers because employees, presumably, are more productive when they have a stake in the employer's success.

What could go wrong?

First, the stock's value for purposes of the cash payouts must be determined by an independent appraiser.^{xxi} But the employer has a role in selecting the person who makes that calculation,^{xxii} which might create a conflict of interest, since that person owes his or her job to the employer. An employer may be tempted to manipulate the stock value to appear lower if it knows that an employee with a large balance will soon be making a distribution or if the employer is in a cash-flow crisis. Conversely, the employer may want to manipulate the stock value to be higher at the time the ESOP acquires the stock^{xxiii} or when a person controlling the plan is about to make a distribution.

Second, ESOP participants technically do not have ownership rights to the employer stock held in their accounts because the stock is held in trust. This means that, even though the stock is being held in the ESOP for the exclusive benefit of the participants, the trustee – who is typically selected by the officers of the company – is the actual shareholder and thus exercises voting rights under the stock, including selecting the board of directors.^{xxiv}

Third, existing legal requirements for cash payouts enable employers to delay making payouts for months or even years,^{xxv} which may cause some retiring employees to experience unexpected financial difficulty. While employers typically prefer former ESOP account balances to be paid out promptly, that attitude can quickly change if the corporation has a cash-flow problem. ESOPs holding privately-traded stock are exempt from the rule that prevents other private retirement plans from cutting back on lump-sum payout rights. As a result, an employer with cash-flow difficulties can amend its ESOP at any time, without notice, to immediately shift from lump-sum payouts to five-year installments for recently-retired employees. In some cases these installments may not even begin until seven years

later.^{xxvi}

Moreover, corporations experiencing severe financial difficulty often reduce their workforces. In these cases, laid-off workers have the right to be paid eventually, *but the obligation to pay them would accelerate the corporation's cash flow challenges*. This creates a vicious cycle in which an employer's financial problems compel it to lay off employees, requiring the employer to pay those employees their retirement benefits, further exacerbating the financial problem, and likely leading to additional layoffs.

If an employer simply does not have the cash to make a required payout, it will have violated the tax laws governing ESOPs.^{xxvii} The only action currently available to the IRS would be to eliminate the ESOP's tax-favored status and charge taxes on all of the ESOP's assets.^{xxviii} But this would not solve the problem. It could, however, cause a company to terminate its ESOP, negatively impacting the innocent employees relying on the ESOP for retirement income. And this would leave the plan in the same situation: unable to distribute money it doesn't have. If a participant in this situation were to sue the plan in an attempt to obtain benefits, that lawsuit would achieve nothing if the employer has no money to pay the participant after the lawsuit.

3. Abuses Particular to Leveraged ESOPs

Retirement plans exist for the exclusive purpose of providing benefits to the employees participating in the plan. Employers generally cannot use retirement plan assets to finance employer operations.^{xxix} This means that retirement plan assets must be used to provide additional retirement benefits or to pay fees related to the administration of the retirement plan. However, an employer with a leveraged ESOP may circumvent this requirement by having its ESOP borrow from a bank (with the employer's guarantee, since the ESOP is not creditworthy by itself). The ESOP can then use that loan to purchase employer stock, and then use the revenue from that stock sale to finance employer operations.^{xxx}

For example, an employer that thinks the market has undervalued its publicly-traded stock could establish an ESOP which takes a bank loan and then uses that loan to buy its own stock, thus enabling the employer to pay off the debt by making periodic contributions to cover the ESOP's debt repayments.^{xxxi} Likewise, an ESOP could borrow money to buy out the company's current owner when he or she retires with the shares allocated over the loan repayment period. If the company stock fares poorly,^{xxxii} that becomes the problem of the employees participating in the ESOP rather than the previous owner, who has already been bought out.

Using a leveraged ESOP as a tool for these types of corporate finance purposes can significantly harm the retirement security of the employees participating in that ESOP. While federal law requires that an ESOP loan be primarily for the benefit of the employees,^{xxxiii} this has not prevented employers from abusing the ESOP rules when it is beneficial to the employer's owner. Employers with leveraged ESOPs have been known to use favorable loan repayment rules to delay paying benefits to retiring participants.

An example is a situation where an ESOP loan had a 20-year term, with loan repayments limited to interest only until the final payment, so that the principal was not due until the end of the 20 years. At

the end of the 20-year term, instead of repaying the principal, the loan was refinanced for an additional 10-year period (with principal still not required to be repaid until the end of the loan term). In a leveraged ESOP, the employer does not have to pay any retirement benefits until the debt has been fully repaid.^{xxxiv} So, in this case, the participants would not have the right to receive any of their ESOP payments for 30 years.

Ways to Address Problems with ESOPs

The use of ESOPs has grown rapidly in recent years, thanks to the special income tax subsidies they enjoy. But little attention has been paid to the set of interrelated problems that ESOPs present. These problems begin with excessive concentration in a single equity-based stock, which then tends to be sold when its value is at its lowest. For privately-traded companies, the resulting future cash-flow drain of benefit payments can accelerate an employer's financial decline, while leveraged ESOPs present numerous opportunities for owner abuses.

The following simple yet modest measures could protect employees whose retirement savings are held in ESOPs.

For all ESOPs:

- Direct a study of ESOPs by the Government Accountability Office (GAO) investigating, among other things, the rate of failure among ESOPs.^{xxxv}
- Require that participants in all ESOPs have the same right to diversify out of employer stock as participants in ESOPs that hold publicly-traded stock as part of a 401(k) plan.
- Encourage participants to elect out of employer stock if they have the right to do so. For example, require that a notice be given to participants encouraging them to invest no more than 10 percent of their total retirement savings in a single stock and warning them of the problems of investing in stock of the employer (such as those identified above in this paper, including the potential for payout delays).^{xxxvi}
- Require that, when an employer amends its ESOP to remove participants' rights to accelerated payouts, such an amendment shall not take effect for at least 90 days after participants are notified of the amendment. This will give eligible employees the opportunity to terminate employment and cash out their ESOP benefits under the old rules.
- Eliminate the very generous tax benefits for ESOPs, so there is not such an extreme government-provided incentive in favor of ESOPs. This would also eliminate government involvement in competitive business structures.

For ESOPs holding privately-traded stock:

- Require that participants have the corporate voting rights of any shareholder, especially the right to select the members of the board of directors (so they actually have this principal power of an owner).^{xxxvii}

- Require that the ESOP trustee be an independent bank, not an officer of the corporation.^{xxxviii}
- Require that valuations be done by an independent professional who is in the business of valuing privately-traded stock, and that this person be appointed by the bank trustee.
- Require some free cash to be held in the plan as a reserve for cash payouts. For example, the amount held could be the greater of 10 percent of the ESOP's assets or the amount projected to be required to make cash payouts for a period in the near future, such as over the next five years.
- Give all participants the right to receive prompt cash payouts (e.g., in installments over three years, beginning within six months after termination of employment).
- Impose a penalty (such as an excise tax or personal liability) on the responsible corporate officer or the trustee (to the extent the trust holds free cash) if there is a failure to satisfy the cash payout rules.
- Organize the formal protections for participants in ESOPs to be located in both the tax law and in ERISA so that participants can sue to obtain their rights (instead of having to depend on the IRS to take action).

For leveraged ESOPs:

- Strengthen the requirement that an ESOP loan be primarily for the benefit of plan participants and beneficiaries. This could be achieved, for example, by limiting the length of the loan to a reasonable term, such as 15 years; requiring level debt payments so that a significant portion of the debt is paid off every year rather than leaving the payment of principal to the very end of the loan term; and allowing changes to lengthen the loan term only in cases in which an independent professional determines that the employer is in severe financial distress.

Eliminate the special payout delay described above for leveraged ESOPs. The simplest (non-modest) change for all ESOPs would be to simply eliminate the exception which allows statutorily imprudent overinvestment in employer stock.^{xxxix}

ⁱ The value of Enron's retirement plan declined by \$1.3 Billion. See David K. Millon, "Enron and the Dark Side of Worker Ownership," 1 Seattle J. For Soc. Just. 113 (2002). United Workers agreed to wage cuts and a \$4.9 billion loan in exchange for a 55 percent stake in the company. See Rachel Beck, "United Airlines' Employee Stock Ownership Program Doomed from Start," *Peninsula Clarion* (December 13, 2002), available at http://peninsulaclarion.com/stories/121302/bus_121302bus0050001.shtml#.VtR06IYG6A (last visited May 3, 2016). Radio Shack securities in its 401(k) tumbled from \$142 million in June 2007 to \$3.5 million in June 2014. Mitchell Schnurmann, "Employees Net Their Future on RadioShack Shares," *The Dallas Morning News* (February 2, 2015), available at <http://www.dallasnews.com/business/columnists/mitchell-schnurman/20150202-schnurman-employees-bet-their-future-on-radioshack-shares.ece> (last visited May 3, 2016). Also see RadioShack form 5500 for plan years 2009 and 2013, which can be found through the Department of Labor at <https://www.efast.dol.gov/portal/app/disseminate?execution=e1s1> (last visited May 3, 2016).

ⁱⁱ According to The ESOP Association, a non-profit organization representing companies that sponsor ESOPs, approximately 10,000 ESOPs covered 10.3 million employees in the United States as of 2015, or 10% of the U.S. private-sector workforce. <http://www.esopassociation.org/explore/employee-ownership-news/resources-for-reporters#statistics> (last visited April 1, 2016).

ⁱⁱⁱ The tax benefits afforded to companies sponsoring ESOPs include Internal Revenue Code (I.R.C.)/26 U.S.C. §§:

- 402(e)(4) (nonrecognition of gain for the appreciation on the employer stock when distributed in kind),
- 404(k) (permitting a corporation to deduct dividends it pays to an ESOP),
- 409(p) and 512(e)(3) (permitting deferred taxation of an S corporation's business income to the extent it is owned by an ESOP)
- 415(c)(6) (permitting larger allocations to a participant's ESOP account), and
- 1042 (no tax due on sale of privately traded stock to an ESOP).

The Treasury Department values these tax benefits at more than \$25 billion over fiscal years 2016-2025. Department of the Treasury, Office of Tax Analysis, *Tax Expenditures*, Table 3 (published November 11, 2015), available at <https://www.treasury.gov/resource-center/tax-policy/Documents/Tax-Expenditures-FY2017-11132015.pdf> (last visited May 2, 2016).

^{iv} See articles by National Center for Employee Ownership on business continuity and business transitions through ESOPs. For example, NCEO, "Using an Employee Stock Ownership Plan (ESOP) for Business Continuity in a Closely Held Company," <https://www.nceo.org/articles/esop-business-continuity> (last visited Feb 29, 2016).

^v See, e.g., Corey Rosen, *Do ESOPs need Reform? A Look at What the Data Tell Us*, 147 TAX NOTES (2015), available at <https://www.nceo.org/assets/pdf/articles/Do-ESOPs-Need-Reform-Rosen.pdf> (last visited May 3, 2016). Rosen argues, for instance, that ESOPs are better than 401(k)s for low-income and younger employees because they do not require employee contributions, and that employer contribution rates in ESOPs are higher than in 401(k)s. Rosen also notes that employers sponsoring ESOPs are more likely to have a second retirement plan in addition to an ESOP, rather than substituting an ESOP for other types of retirement plan.

^{vi} See, however, Karla Walter & Danielle Corley, *Mitigating Risk to Maximize the Benefits of Employee Ownership*, Center for American Progress (2015), <https://www.americanprogress.org/issues/economy/report/2015/10/28/124511/mitigating-risk-to-maximize-the-benefits-of-employee-ownership/> (last visited May 3, 2016).

^{vii} The three types of ESOPs are:

- (i) ESOPs where most of the plan is invested in publicly traded employer stock.
- (ii) ESOPs that hold privately traded stock (often S corporation stock).
- (iii) Leveraged ESOPs, where the plan acquires stock from a principal owner using funds borrowed from a bank or other commercial lender.

Each of these three types can overlap with one another.

^{viii} See, for example, the Securities and Exchange Commission's "Beginner's Guide to Asset Allocation, Diversification and Rebalancing," available online at <http://www.sec.gov/investor/pubs/assetallocation.htm> (last visited April 1, 2016).

^{ix} ERISA § 404(a)(1)(C), 29 U.S.C. § 1104(a)(1)(C). The law also contains a rule prohibiting a retirement plan to invest more than 10 percent of its assets in employer stock. ERISA § 407(a)(3), 29 U.S.C. § 1107(a)(3).

^x ERISA sections 404(b) and 407(b), 29 U.S.C. §§ 1104(b) and 1107(b).

^{xi} While a participant has a right to elect to liquidate any employer stock held in his or her account in an ESOP holding *publicly traded stock* that is *part of a 401(k) plan*, that right does not apply in other ESOPs until after the employee has attained age 55 and participated in the ESOP for at least 10 years. ERISA § 204(j), 29 U.S.C. § 1054(j), I.R.C. § 401(a)(35), 26 U.S.C. § 401(a)(35) gives participants in an ESOP holding publicly traded stock that is part of a 401(k) plan the right to diversify generally after three years of service. By contrast, participants in any other ESOP (i.e., an ESOP holding publicly traded stock that is not part of a 401(k) plan and an ESOP holding privately traded stock) only have the right to diversify a portion of their account over a six-year period (25 percent cumulative during the first five years and 50 percent cumulative in the 6th year) and only after attaining age 55 and 10 years of participation. I.R.C. §§ 401(a)(28) and 401(a)(35)(E)(ii), 26 U.S.C. §§ 401(a)(28) and 401(a)(35)(e)(ii).

^{xii} Dugas, Christine, "Enron's Dive Destroys Workers' Pensions," *USA Today* (February 5, 2002), available at <http://usatoday30.usatoday.com/money/energy/2002-02-06-enron-pensions.htm> (last visited May 3, 2016).

^{xiii} Thornton, Nick, "RadioShack Facing 401(k) Suits," *BenefitsPro* (February 6, 2014), available at <http://www.benefitspro.com/2015/02/06/radioshack-facing-401k-suits> (last visited May 3, 2016).

^{xiv} RadioShack Annual 10-K report for 1993 filed with SEC on March 30, 1994, <http://www.sec.gov/Archives/edgar/data/96289/0000096289-94-000029.txt>.

^{xv} RadioShack Annual 10-K report for 2002 filed with SEC on March 28, 2003, available at <http://www.sec.gov/Archives/edgar/data/96289/000009628903000003/0000096289-03-000003.txt> (last visited May 3, 2016).

^{xvi} Historical Radio Shack (RSH) prices taken from 10-K reports for 1995, 2005, and 2015, available at <http://www.sec.gov/cgi-bin/browse-edgar?action=getcompany&filenum=001-05571&owner=include&count=100> (last visited May 3, 2016).

^{xvii} Krasner, Jeffrey, "Polaroid Retirees Pay Price," *SFGate* (October 25, 2001), available at <http://www.sfgate.com/business/article/Polaroid-retirees-pay-price-2865832.php> (last visited May 3, 2016).

^{xviii} Ransom, Diana, "Giving Employees a Share," *Wall Street Journal* (November 17, 2009), available at <http://www.wsj.com/articles/SB10001424052748704431804574540161152220116> (last visited May 3, 2016).

^{xix} An ESOP can hold privately traded stock only if the employer has no publicly traded stock. I.R.C. § 409(l)(1), 26 U.S.C. § 409(l)(1), 26. There are exceptions for convertible, noncallable preferred stock. I.R.C. § 409(l)(3), 26 U.S.C. § 409(l)(3) and for a newspaper that has multiple classes of stock. I.R.C. § 409(l)(5), 26 U.S.C. § 409(l)(5).

^{xx} I.R.C. § 409(h)(1)(B), 26 U.S.C. § 409(h)(1)(B).

^{xxi} I.R.C. section 401(a)(28)(C), 26 U.S.C. 401(a)(28)(C).

^{xxii} The plan documents would typically allocate selection of the independent appraiser to the trustee, and the plan trustee is permitted to be an officer of the company. Alternatively, the plan document could allocate selection of the evaluator to an administrative body, such as the plan administrator (typically an employee or committee of employees of the company). Even if the evaluator is a professional selected by an independent bank trustee, the evaluator knows that the trustee that hired the evaluator serves at the pleasure of the employer.

^{xxiii} See, for example, *Reich v. Valley National Bank* 837 F. Supp. 1259 (S. D. NY 1993).

^{xxiv} I.R.C./26 U.S.C. §§ 401(a)(22) and 409(e) require that participants in ESOPs holding privately traded stock have the right to vote only on limited issues relating to major corporate mergers, sales, and reorganizations.

^{xxv} ESOPs that offer lump-sum distributions can delay distributions for months. Payouts in stock can be delayed until after the plan's next annual valuation, and cash does not have to be made available until a 60-day period after distribution of the stock. For example, an employee terminating employment in September of a calendar year would generally not be entitled to be paid until the middle of the next year. I.R.C. § 409(h)(4), 26 U.S.C. § 409(h)(4). Further, an employee terminating employment by reason of normal retirement age (such as after age 65), disability, or death only has a right to be paid in installments over five years commencing within one year after the end of the plan year of termination, which results in a delay of up to two years after the employee retires before the installments even begin. I.R.C. § 409(o)(1)(A)(i), 26 U.S.C. § 409(o)(1)(A)(i). Distributions to any other former employee can be delayed so that similar installments over five years do not even begin until up to seven years after the employee terminates employment. I.R.C. § 409(o)(1)(A)(ii), 26 U.S.C. § 409(o)(1)(A)(ii).

^{xxvi} ERISA § 204(g)(3), 29 U.S.C. § 1054(g)(3), I.R.C. § 411(d)(6)(C), 26 U.S.C. § 411(d)(6)(C), and 26 C.F.R. § 1.411(d)-4, Q&A-2(d)(1)(i).

^{xxvii} An ESOP typically does not hold free cash. As a result, cash payouts are made either (1) by the trustee by selling the stock to the employer or (2) by the employer after the stock has been distributed to the employee or his/her beneficiary under the put option rules at I.R.C. § 409(h)(1)(B) and (4), 26 U.S.C. § 409(h)(1)(B) and (4).

^{xxviii} Failure to comply with the terms of the plan causes plan disqualification. See also I.R.C. §§ 401(a)(23) and 4975(e)(7)(A), 26 U.S.C. §§ 401(a)(23) and 4975(e)(7)(A).

^{xxix} ERISA §§ 404(a)(1)(A) and 406(a)(1)(B), 29 U.S.C. §§ 1104(a)(1)(A) and 1106(a)(1)(B).

^{xxx} For more information on leveraged ESOPs and a helpful flowchart depicting how leveraged ESOPs work, visit the ESOP Association website at <http://www.esopassociation.org/explore/how-esops-work/learn-about-esops/leveraged> (last visited April 1, 2016).

^{xxxi} The purchased stock is held in the ESOP initially in a separate account (called a suspense account) for the benefit of no particular participating employees, and those shares are allocated annually from the suspense account to the ESOP accounts of participating employees as the debt is repaid. The shares released from the suspense account for a year are based on how much the debt repayments for the year are as a percentage of all current and future debt repayments, which results in the same number of shares of the acquired stock being released every year assuming the debt is repaid in level repayments over more than 10 years. 26 C.F.R. § 54.4975-7(b)(8).

^{xxxii} Or not as well as assumed by the valuator hired by the owner to determine the purchase price.

^{xxxiii} ERISA § 408(b)(3)(A), 29 U.S.C. § 1108(b)(3)(A), I.R.C. § 4975(e)(3)(A), 26 U.S.C. § 4975(e)(3)(A).

^{xxxiv} I.R.C. § 409(o)(1)(B), 26 U.S.C. § 409(o)(1)(B).

^{xxxv} There will of course be ESOP successes too, but how high does the rate of successes have to be to justify the failures? Retirement investments should minimize the risk of large losses. ERISA section 404(a)(1)(C), 29 U.S.C. § 1104(a)(1)(C).

^{xxxvi} IRS Notice 2006-107, 2 C.B. 1114, includes a model notice recommending diversification. Unfortunately, the notice is only required (under ERISA section 101(m), 29 U.S.C. § 1021(m)) to be provided to participants with diversification rights under ERISA section 204(j). 29 U.S.C. § 1054(j), I.R.C. § 401(a)(35), 26 U.S.C. § 401(a)(35) (i.e., ESOPs that are part of a 401(k) plan), not to ESOPs to which I.R.C. § 401(a)(28) / 26 U.S.C. § 401(a)(28) applies). In addition, the notice only includes a weak warning that more than 20% “may not be properly diversified.”

^{xxxvii} Well-run companies with ESOPs communicate regularly with plan participants, including sometimes providing detailed financial information about how the company is doing.

^{xxxviii} Having an independent trustee is already widespread practice for ESOPs holding privately traded stock.

^{xxxix} Note that Fifth Third Bankcorp v. Dudenhoefer, 134 S. Ct. 2459, 189 L Ed. 2nd 457, 58 EBC 1405 (June 25, 2014), rejected a judicially-created presumption of prudence for retirement plan investments in employer stock.