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ESOP Valuation Issues During the COVID-19 Crisis

On Friday, March 27, 2020, Husch Blackwell partner Mark Welker participated in a webinar titled “Pandemic Valuations: 2019 Year End and Post Crisis Issues,” presented by The ESOP Association. Below, we have summarized some of the key takeaways of the presentation.

Back at the turn of the new year, few people imagined the havoc that the COVID-19 outbreak would cause during the first quarter of 2020. The broad financial outlook has worsened, and the valuations of many companies might be dramatically affected. Where ESOPs are concerned, this means that the 12/31/19 valuation—the value communicated in 12/31/19 participant statements and used to report the fair market value of employer securities on 2019 Form 5500—does not account for the public health crisis that has transpired since then.

1. It might be possible to base 2020 diversifications and distributions on a different value that does account for pandemic effect.

If the plan already provides for the ability to declare an interim valuation (which most plans do), then deciding whether or not to declare a new valuation date for processing 2020 diversifications and distributions will probably be a fiduciary decision for the plan administrator (not the trustee). The key consideration for that decision will be to use a value for 2020 processing that is fair to all participants taken as a whole.

If the plan does not already provide for interim valuations, some case law suggests that an amendment now to declare or authorize an interim valuation might not be enforceable against a participant who terminated before the date of the amendment, so your ability to do that should be discussed with legal counsel.

2. What to consider if you have the option to declare a new valuation date for 2020 processing?

First and foremost, buy time. It is probably premature to make that decision now given the uncertainty. While many of you are optimistic about the future, the truth is that we don't know what is going to happen. As a Chief Investment Officer for a large financial institution commented to us recently, "We've never shut down a world economy before, we don't know what is going to happen—we don't know how long the shutdown will last, we don't know how long it will take to restart the economy, and we don't know what the lasting effects will be."

With this bit of wisdom in mind, seeking to delay diversification and distribution elections as long as possible might be prudent, and in that event waiting as long as possible to decide whether to declare an interim valuation date that would affect those elections is appropriate. In any event, ESOP plans should create documentation that memorializes the reasons for that decision.

If you decide to buy time, you might want to delay delivery of participant statements. In particular, if you have been an ESOP for more than 10 years and are subject to statutory diversification, many plans provide that the participant has 90 days after delivery of the valuation amount to them to make an election. There are then 90 days after the election deadline to process diversification; therefore, the amount of time you can buy will for some of you be based on the date of delivery of statements. Also, if you perform an interim valuation, it would be best to communicate that message with those statements so as to control expectations. In certain circumstances, diversifications can be extended further out, and legal counsel should be consulted in these instances.

You might also want to extend the due date of your 2019 Form 5500. That extension is filed on IRS Form 5558 and must be filed by 7/31/20 for a calendar year plan. That automatically extends the due date of the 5500 to 10/15/20 for a calendar year plan.

Declaring an interim valuation should be considered an extreme solution to an extreme need to maintain fairness for all participants taken as a whole. While we anticipate that some plans will decide to declare an interim valuation, our best guess right now based on our conversations with many clients is that the majority will probably not do so. For example, if the impact is that you think value has gone down 10%, we suspect you won't declare an interim valuation. However, we believe that most, and perhaps all of you would be wise to buy time to see how this plays out before making that decision.

3. Conserving cash.

Delaying diversifications and distributions so as to buy time to decide whether to declare an interim valuation would also conserve cash for the short term, which is an objective of concern for many

plans. In the longer term, it will be difficult to delay statutory diversification if you have been an ESOP for more than 10 years; however, it might be possible to amend your plan to delay distributions.

4. Communicate, communicate, communicate.

Nature abhors a vacuum. If you don't communicate, your employee-owners will fill the void with their imaginations, and you will lose control of the message. We are aware that this runs counter to the suggestion above that you consider delaying delivery of 12/31/19 statements; however, a delay in statements doesn't mean you should not send a communication letting participants know what is going on.

Additionally, communication with the Trustee is vital. The trustee is not the one to decide whether to declare an interim valuation; however, you should keep the trustee informed of what you are thinking and doing. Likewise, be sure to communicate with the recordkeeper. As a key business partner, it needs to know your intentions so it can act consistently therewith.

Contact us

For more information on ESOPs during this unprecedented public health crisis, please contact Mark Welker or your Husch Blackwell attorney.

Husch Blackwell has launched a COVID-19 response team providing insight to businesses as they address challenges related to the coronavirus outbreak. The page contains programming and content to assist clients and other interested parties across multiple areas of operations, including labor and unemployment, retailing, and supply chain management, among others.