LEGAL UPDATES

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ESOP Fiduciary Duties When Investing in Non-Stock Assets

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On February 6, 2025, a Pennsylvania federal judge gave preliminary approval to a $2.1 million settlement resolving a class action involving the Pride Mobility ESOP. This case is one of six brought so far—and the second to settle—claiming that the ESOP's investment in assets other than employer stock was too conservative.

Each of the complaints contains virtually identical allegations: the ESOP fiduciaries allowed cash to accumulate, typically after the transaction debt was retired, and, instead of adopting and following an investment policy, the cash was invested in a money market or government debt fund. According to the complaints, this resulted in participants losing out on the higher investment returns that would have been achieved if the fiduciaries had accepted some risk in pursuit of higher investment returns.

One of the foundational fiduciary principles of ERISA is to diversify "the investments of the plan so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so." While an ESOP is generally exempt from the diversification requirement, this is only to the extent of employer stock held by the plan. The issue raised by these cases is whether the plan fiduciaries went too far to minimize the risk of large losses by investing too conservatively.

ESOPs have cash needs. These include the need to fund diversification for participants who have attained age 55 with at least 10 years of participation, and the repurchase obligation if the ESOP makes distributions to terminated participants in cash. Cash can accumulate quickly in an ESOP after the internal loan debt is fully repaid, especially if the level of contributions and dividends/S distributions is not reduced after the internal loan is retired.

What this means to you

Qualified plans other than ESOPs typically have an investment policy that guides plan investments. Adopting—and following—an investment policy for an ESOP's assets other than employer stock is a prudent exercise of a fiduciary's duties. An ESOP company and the ESOP's fiduciaries should monitor the level of cash in the ESOP to make sure that it is sufficient to meet the ESOP's liquidity needs. If the level of cash exceeds the ESOP's liquidity needs, then the ESOP fiduciaries should develop and document a strategy to invest the assets in accordance with ERISA's fiduciary duties.

Contact us

If you have any questions about ESOPs or fiduciary duties in connection with ESOPs, please contact Alan Kandel or Jordan Bergkamp.