The National Center for Employee Ownership

These are excerpts from various parts of the presentation

For information on obtaining your own customized presentation, visit http://www.nceo.org/r/board-training

Effective Boards of Directors: Best Practices in Governing an ESOP

Corey Rosen
National Center for Employee Ownership
crosen@nceo.org

Rules for All Boards

- Duty of care: Act in a way that voids harm to the company. Board members must be informed about the business and its financials, have a basic understanding of what the business does, regularly attend meetings, and document what they have done.
- Duty of loyalty: Boards represent the interests of the shareholders as shareholders, make sure that there is fairness in any transactions involving company stock, and must disclose conflicts.
- Should be adequately insured.

Are Boards Different in ESOPs?

- There are no specific requirements under securities laws or ERISA for ESOP company boards.
- There is an emerging consensus that ESOP boards should be more active than private company boards usually are and that they include outside directors. This makes the ESOP more credible to employees and creates fewer conflict of interest scenarios.
- ESOP board members need to know about ESOP law and practice because there are potential fiduciary issues and because running an ESOP company can be different from a non-ESOP company.
- ESOP board members need to know how ESOPs work and read the valuation report carefully.
- ESOP board members appoint and monitor the trustee.

ESOP Basics

- Part of the Employee Retirement Income Security Act.
- ESOPs are governed by the same laws that also govern pension plans, 401(k) plans, and profit sharing plans.
- Like all retirement plans, ESOPs must be managed for to maximize the long-term financial benefit for plan participants.
- Stock is held in a trust where it is subject to allocation, vesting, and distribution rules.
- ESOP cannot pay more than an appraised fair market value to buy shares from a non-ESOP owner and not less than FMV to buy shares from a departed employee.

Key Issues for ESOP Company Boards

- Who Should Be on Your Board?
- What Should the Functions of a Board Be?
- How Should the Board Interact with the Trustees?
- Are There Special Policies and Practices ESOP Company Boards Should Follow?

Fiduciary Issues

- Appoints and monitors trustees. In a few companies, employees elect the fiduciaries.
- Courts have ruled that boards have an ERISA fiduciary duty to make sure trustees are qualified to do the job and carry out their responsibilities according to the requirements of the law and the plan.
- Boards can direct trustees, but that makes them fiduciaries.
- Plan “settlor” functions—the design and funding of the plan—are board, not fiduciary decisions

Who Should Be The Fiduciary?

- Inside trustees allow for greater internal control and lower cost, but fiduciaries have substantial responsibilities and to do the job well takes considerable time.
- Independent outside trustees provide expertise and added protection in the case of audits or lawsuits, but there are significant costs and some loss of control.
- Directed trustees provide the same expertise, but much more limited fiduciary protection.