

The Fall ESOP Forum

Best Practices in Employee Ownership

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EMPLOYEE OWNERSHIP**

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ESOP Audits and Investigations

Presented by:

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Overview and Disclaimers

- High level overview related to ESOP audits and investigations (not a step-by-step guide)
- Overview of DOL authority and how it is structured related to performing investigations
- Discussion of the process as well as the documents that may be requested
- Focus is on DOL audits and investigations
- Not a legal update, but information from cases can provide insight into the DOL perspective and focus areas
- If going through a DOL audit/investigation, recommended to consult with an experienced attorney
- I have worked both for and against the DOL in various ESOP investigations and litigations
- My perspective is from 15+ years on the valuation side and more recently on the ESOP trustee side (I am not an attorney)

Setting the Table

- DOL National Enforcement Project centered on ESOPs
- Increase in DOL audits/investigations/litigation
- Significant settlements and court decisions
- Recent changes at the DOL that may reduce ESOP investigations and litigation
- Helpful to understand ESOP audits and investigations even if you are not a party to one currently

DOL Authority

- Enforces ERISA's fiduciary rules and regulations mission
- Mission is to preserve/recover assets for the benefit of plan participants and beneficiaries
- The DOL has the authority to:
 - Perform on-site audits/investigations
 - Require submission of records
 - Inspect books and records
 - Question individuals
 - Subpoena records and testimony
 - Enforce subpoenas in court
 - Seek documents from plan sponsor, trustee, valuation firms, service providers, etc., even beyond the applicable statute of limitations and outside their statutory authority

DOL National Enforcement Strategy

- Since 2005, EBSA has maintained an ESOP National Enforcement Project
- Identifies and corrects violations of ERISA in connection with ESOPs
- Increase in DOL lawsuits and amicus brief filings
- Increase focus on review of valuation reports
- Regulation through litigation



DOL Examinations

- Generally, focuses on
 - Transactions
 - Qualifying Employer Securities
 - Prudence
 - Valuations (main focus)
 - Prohibited transactions

Investigation Trends

- More subpoenas and sooner
- More tolling agreements to various parties
- Settlement/process agreements
- Generally seeing a moderate/slight decrease in audits and investigations, depending on the region
- Some regional offices more aggressive than others
- Looking more at complex transactions
- Re-leverages – no litigation but DOL asking more questions

Sources of Cases

- Participant Complaints
- Form 5500 Reviews
- Referrals from other agencies (IRS)
- Media
- Random selection

Employee Benefits Security Administration (EBSA)

- EBSA is an agency of the DOL
- Responsible for administering, regulating and enforcing ERISA
- Headed by Preston Rutledge (sub-cabinet position)
- EBSA maintains 15 regional and district field offices throughout the US to conduct investigations to detect and correct violations of Title I of ERISA
- Career officials and political appointees

DOL - EBSA Overview

National Office

- Establishes policy and agency protocols
- Oversight of reporting and disclosure requirements
- Drafts regulations and interpretive guidance
- Conducts economic research to determine impact of policy and regulations on regulated community
- Process agreements

Regional Offices

- Conduct investigations of ERISA plans
- Provide compliance assistance through Benefits Advisors
- Conduct outreach to plan sponsors and other stakeholders



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EBSA Regional Offices



- Regional Offices
- District Offices

New EBSA Structure

- New organizational structure sent to EBSA staff on August 27, 2019
- 3 offices will now report to political appointee (Jeanee Wilson)
- New director position to oversee regional offices (yet to be filled)
- Take responsibilities away from Tim Hauser (Deputy Assistant Secretary)
- Effective October 1, 2019

Process Agreements

- GreatBanc
- First Bankers Trust
- Lubbock National Bank
- James Joyner
- Alpha Investment Consulting Group

DOL Use of Outside Experts

- DOL relies heavily on outside experts (typically valuation) when determining the merits of a case
- DOL does not have significant in house resources related to valuation
- Consulting expert in the beginning phase of an investigation
- Testifying expert (sometimes the same as consulting) as investigation continues through trial
- Inconsistent when experts are hired

Document Production

- Review document request list and confirm which party will provide each item
- Provide only what was requested
- Obtain all documents (including electronic documents) and make copies for auditor; retain originals
- Label and organize documents in the order requested
- Become familiar with the documents

Basic Documents

- Plan Document/ Trust Agreement
- Form 5500 filings (past 3 years)
- Summary Plan Descriptions
- Summary Annual Report for last year
- Fidelity Bond
- Fiduciary Insurance Policy
- Trustee Statements (past 3 years) (asset records)
- Service Provider Contracts
- Meeting Minutes
- Benefit Statements
- Asset records
- Payroll/contribution records

ESOP Documents

- Appraisals and Fairness Opinions
- Corporate Financial Information
- Corporate Tax Returns
- Stock Purchase Agreements
- Separate/side agreements that affect the control of the company (e.g., shareholder agreements)
- Documentation of consideration provided to a seller or any parties involved in a transaction (warrants, SARs, options, etc.)

Other Documents

- Loan and pledge documents
- Amortization schedules
- Allocation reports
- Diversification elections
- Distribution reports
- 1042 elections



General Issues/Areas of Review

- General Plan Operations
- In accordance with Plan Document
- Reporting and Disclosure
- Bonding
- Remittance of Employee Contributions
- Review of Plan Assets
 - Prudence, Prohibited Transactions, Self Dealing

Valuation Issues

- Projections (#1 issue)
- Discount Rate
- Guideline/comparable public companies
- Long-term growth rate
- Executive compensation
- Equity incentive plans (SARs, stock options, phantom stock)
- Warrants
- Control
- Improper normalization adjustments
- Unreliable company financial information
- Mathematical errors

Non-Valuation Issues

- Loan Issues
 - Interest Rate
 - Primary Benefit
 - Default provisions
- Release and Allocation errors
- Diversification election errors
- Dividends / S-Corp Distributions
- Distributions to eligible participants
- Corporate malfeasance
- 1042 prohibited allocations
- Bonding

Initial Contact

- Starts with phone call from Investigator / Auditor
- Followed by confirmation letter
 - Date & time of visit
 - Plan(s) to be reviewed
 - Records / documents needed
 - Varies depending on issue
- Subpoena
- Keep records of all contacts with agent

Once Contacted

- Identify point person
- Contact counsel
- Identify time frame being reviewed
- Address confidentiality
- Set meeting date or response date
- DOL will want to interview Plan fiduciary (may want counsel present)

On-Site Visit

- Unless separate interview is scheduled, be prepared to answer questions
 - Ask for clarification
 - Make a list of questions to be answered later and get confirmation of answers
- Check in with agent periodically
- Do not offer access to staff not requested

Onsite Investigative Work

- Interviews with key personnel and plan fiduciaries
- Basic operations / services
 - Contributions
 - Benefit payments
 - Expenses
 - Investments
- Identification of
 - Service providers
 - Record-keeper(s)
- Record Review

Interview / Deposition

- Informal Interview
 - Conversation with investigators who take notes
 - Investigator will write up a “Report of Interview”
 - No right of interviewee to review or correct
 - May be follow-up questions
- Formal Deposition
 - Recorded by a court reporter
 - Counsel may object, but effect of objections is limited
 - Deponent has right to review transcript and correct spelling errors or errors in transcription

Timing

- Be patient
 - Agent may ask for more information orally or by follow-up letter
 - Always respond in writing
 - Agent may expand years to be reviewed
 - Can be a lengthy period of time between initial contact and a closing letter
 - DOL may seek tolling agreement



Concluding the Investigation

- Issues Identified
- Corrective Actions
- Closing Letter

Correction

- Usually, DOL will send “Notice Letter”
 - Identifies problems
 - Offers chance to discuss correction
- DOL encourages Voluntary Compliance
- Proper Correction >> “Closing Letter”
 - Identifies problems & corrective actions
- No Correction >> referral to the Solicitor’s Office

Needing Correction

Depending on circumstances, DOL may seek

- Correction of prohibited transactions
- Restoration of losses
- Penalties
- Removal of fiduciaries
- Removal of service providers
- Appointment of independent fiduciary
- Implementation of new internal controls
- Supplemental distributions to Ps & Bs
- Final accounting

Litigation

If Voluntary Compliance Fails

- Solicitor's office involved (DOL Attorneys)
- Refer for Litigation
- Demand Letter Issued
- File Complaint

6 year statute of limitations - DOL may issue tolling agreements to one or more parties

IRS Referrals

- IRS Coordination Agreement and Statute requires:
 - referral of prohibited transactions to IRS
 - IRC § 4975 excise tax (tax qualified pension plans)
 - referral of potential issues affecting tax qualified status

Criminal Referrals

- Under some circumstances, criminal referrals may be made
 - Theft / embezzlement
 - Kickbacks / bribes
 - False statements to investigators
 - Willful failures to file / false filings
 - Health care fraud

Questions ?

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