An Early Diversification Program
A Worthy Addition to the Ideal ESOP Plan

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The "Ideal ESOP Plan" described in the accompanying article is boxed in by existing government rules and regulations. As such, it might be missing an appropriate provision for the following situations (in all cases assume the ESOP participant is 42 years old with 15 years of service):

1-I want to buy a house and have no savings. I need money for a downpayment.

2-I have an elderly mother with upcoming heavy uninsured medical expenses. I need cash.

3-I have 3 children who will be in college beginning in 4 years. Financial aid and scholarships won't be enough. I need cash.

4-I like the ESOP but it scares me to have all my retirement eggs in one basket. I don't want to wait until I'm 55 years old to begin diversifying my savings investments.

None of these participants would be satisfied by the Ideal ESOP Plan. [Would they be satisfied by <u>your</u> ESOP Plan?] For cases 1-3, with the Ideal ESOP Plan, the participant would have to quit, and then wait 6 years, to receive the needed cash – not a desirable outcome for either the company (good employees should not quit) or the participant. The participant in case 4 simply has no way to be satisfied by any ESOP Plan designed to stay within the government-prescribed box, so this participant stays at the company and is vaguely dissatisfied – not a desirable outcome.

But let's think outside the box. Let's think about a way to solve the problems for each participant in cases 1-4 and keep them as happy, productive employees. With this additional feature, we can make the "Ideal ESOP Plan" truly ideal!

One way would be to offer the required Age 55 Diversification at an age earlier than age 55, but required diversification applies only to stock in ESOP accounts, and many participants have accumulated large "other investments" (or "cash") portions of their ESOP accounts.

Here is the early diversification program we designed and installed at ComSonics, Inc., the 100% ESOP-owned company in Harrisonburg VA at which I was previously employed as CFO. We called it Early Partial Liquidation; however, for this article, I'll use the more generic Early Diversification Program nomenclature. The program's purposes were to provide a mechanism for allowing current employees to receive cash and/or diversify their ESOP accounts AND remain an employee. Further, since they would have more control over their ESOP investment, they would feel more like owners, thereby contributing to our desire to maintain our ownership culture among all employees.

Here is how ComSonics' EDP worked:

1-ESOP participants were eligible for EDP in the year after they had completed 7 years of service (thus, only 100% vested participants are eligible).

2-Once eligible, they had the right to elect to diversify up to 20% of their ESOP account (stock + cash), and they had the EDP option every year … until they elected it.

3-Once participants elected EDP, they had to wait 7 more years before they would be eligible again.

4-Participants electing EDP could elect to receive their EDP cash as:

a-cash

b-direct rollover into an IRA

c-rollover into their 401(k)

5-Because this was a discretionary program offered by the company (i.e., not required by any government regulation) and we had no desire to have the EDP bankrupt the company, if the company did not have sufficient liquidity to pay the EDP, the ESOP Administrative Committee could decide not to honor EDP elections for that year, or to honor only a certain % of all requests. Participants affected by this decision would be first in line next year for EDP payments if they still wanted to elect EDP.

What has been ComSonics' experience? A few participants elect EDP every 7 years while about half have never elected EDP. The others make their decision based upon stock price and/or their personal needs for a particular year. While I was there, about 50% of those that elected EDP took the money as cash, and about 50% rolled it over into an IRA or their 401(k).

Case 4 participants who were concerned about all their retirement eggs being in one basket were satisfied as they could implement their own personal diversification programs.

Cases 1-3, which represented actual employees – they all exercised EDP, and they all stayed employed at the company.

Every EDP request has been met when requested. The company plans for estimated EDP elections each year and never has had to turn down a request.

In all cases, the ESOP participants felt more like owners. If they so desired, they could receive some of their ESOP benefit and remain employees of the company. OAW