

# Distributions, Diversification, and Segregation Challenges

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# ESOP Distribution Rules

- Timing (applies to stock acquired after 1986)
  - Termination due to death, disability, or retirement
    - No later than plan year following
  - Other termination
    - No later than 6<sup>th</sup> plan year following
  - Leveraged ESOP exception
    - Only applies to shares acquired with such loan
    - Application in S Corps questionable
  - General ERISA timing (retirement, RMD) may require earlier timing

# ESOP Distribution Rules

- Method (applies to stock acquired after 1986)
  - Lump sum
  - Installments
    - Over a period not exceeding five years (6 installments)
    - Extension for large balances
      - One additional year (but not more than 5 additional years) for each \$195,000 or fraction thereof by which such balance exceeds \$985,000 (indexed)

# ESOP Distribution Rules

- Form
  - Cash
  - Stock - participant has right to demand distribution in employer securities
    - Exceptions:
      - Charter or bylaws restrict the ownership of substantially all outstanding employer securities to employees or to a qualified plan trust
      - S Corporation
      - May still distribute stock with the requirement that it be immediately sold to the company or ESOP
        - S corporation concerns – Rev Proc 2003-23 and Rev Proc 2004-14
    - Put option

# Distribution Challenges

- What are your challenges?
- Some common challenges
  - Changing timing, method and/or form
  - Repurchase liability driving benefit levels
  - Former employees not electing distribution
  - Former employees receiving distribution installments who are rehired

# Diversification

- Eligibility – 55 and 10 years of participation
- Qualified election period – six plan year period following eligibility
- Eligible amount
  - 25% in first five years
  - 50% in final year
  - Cumulative calculation

# Diversification

- Election – first 90 days of plan year
- Satisfied – second 90 days of plan year
- Satisfaction options
  - Distribution
  - Transfer to another qualified defined contribution plan of the employer that offers at least 3 distinct investment options
  - Offer at least 3 distinct investment options within the plan

# Diversification Challenges

- What are your challenges?
- Some common challenges
  - Election/satisfaction timing requirements
  - Year of participation definition
  - Qualified participant definition



## Diversification Challenges (Cont'd)

- Some common challenges
  - Determination of eligible amount
    - Impact of other events, including excess diversification, installment or in-service distributions, rebalancing
  - Change in satisfaction method
  - Former employees eligible for both diversification and installment payment of distributions

# Segregation

- What is it?
  - Investment change for former employees – swapping company stock for other investments
  - Moving cash into accounts of terminated/non-active participants' accounts in exchange for shares of company stock of equivalent value
  - Helps manage the “Haves and Have-Nots” issue by moving shares to active participants' accounts allowing current employees to benefit from increase in share value

# Segregation Challenges

- What are your challenges?
- Some common challenges
  - Replacement investment
  - Nondiscrimination rules for creative designs
  - Varied funding
  - Check plan language – whole shares v. fractional shares, all shares v. vested shares
  - Former employee rehired after account segregated

# Distributions, Diversification, and Segregation Challenges

## Questions

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