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How To Successfully Navigate A DOL ESOP Investigation

By Aaron Geibel

“Dear Sir or Madam...our office has scheduled a review of the above captioned plan to determine compliance with the provisions of ERISA.” A formal notice from the Department of Labor (DOL) can bring a sense of unease to any employee stock ownership plan (ESOP) practitioner. However, by developing an understanding of why investigations occur and familiarizing oneself with the DOL’s audit practices, navigating one will be less ominous.

What Is A DOL Investigation?

The DOL enforces the federal laws of retirement plans under the Employment Retirement Income Security Act of 1974 (ERISA). ERISA provisions grant the DOL authority to conduct investigations of ESOPs and, unlike those conducted by the Internal Revenue Service (IRS), it has discretion to investigate and reinvestigate any plan it so chooses. Because ESOPs fall under the governance of ERISA, fiduciary duty is required to those who administer, manage, or control plan assets and any ESOP fiduciary is required to act solely in the best interests of the plan’s participants.

Beginning in 2005, the DOL’s ESOP review project initially focused on the valuation of privately-held employer securities purchased by the ESOP. Even more so today, ESOP trustees are under continued scrutiny from the DOL regarding this subject matter. The trustee must continually demonstrate due diligence in analyzing the transaction and determine that the valuation procedures considered when authorizing the share purchase result in the trust’s payment of no more than fair market value (i.e. “adequate consideration”). Ultimately, the DOL monitors whether participants are being overcharged for the stock acquired by the plan. Failure of any ESOP trustee to uphold this duty may result in them being held liable for making the ESOP trust whole, as evidenced by an increase of monetary settlements in recent court rulings.

Why Was Our ESOP Selected?

Because the DOL does not detail their selection process, understanding why your ESOP is under investigation remains unclear. They commence for various reasons, including through referrals from other government agencies or media sources, via plan participant complaints, through computer generated targeting (e.g. collecting information on Form 5500), or by random audit. Many of the investigations do not occur until after a fiduciary breach occurs and the severity of any infraction will determine any company/civil penalties or criminal proceedings. Additionally, DOL enforcement agencies typically provide little advance notice, so knowing how to respond before an investigation begins is critical.

What Can We Expect?

The formal investigation process begins after receipt of a notification letter from a DOL regional office. This letter requests an abundance of plan documentation, including:

- Plan and trust document
- ESOP board minutes and correspondence
- ESOP allocation report
- ESOP trust statements
- Copies of Form 5500
- ESOP loan documents
- Payroll data
- Service provider agreements

This information must be provided to the investigator within a certain deadline, although extensions may be granted. It is good practice for a company to establish a point of contact (i.e. ERISA legal counsel) to help aid in the information exchange process. This helps to avoid disruptions, maintains organization, and ensures all requested materials are reviewed and properly

addressed. Once all requested documentation is received, the DOL conducts on-site visits comprised of in-person interviews, including key personnel, plan fiduciaries, and those involved with the day-to-day operations of the ESOP. During this stage, it is crucial that legal counsel represent those being interviewed since they can detail what to expect and inform those interviewed of their rights during the process.

What Happens Next?

At the end of the audit period, the DOL must decide whether to take any further action. This phase of the investigation may take several months and, during that time period, the DOL may discontinue communication with the contact person. Ideally, an investigation ends with receipt of a “no action” letter, meaning the DOL has found no improprieties during its audit. To the extent that the DOL investigation uncovers violations of ERISA, they will issue a Voluntary Compliance Letter. The letter generally details the facts gathered by the DOL during the investigation, outlines the violations that they have uncovered, and invites discussions related to the remedy of such violations. The DOL may also insist on entering into a written settlement agreement, of which, civil penalties may be imposed. Should settlement not be amenable to both parties, the DOL may also provide the IRS with their findings, which may impose further penalties or excise taxes.

In summary, one should not underestimate the seriousness of a DOL investigation or the resulting outcome. In the interest of transparency, the department does provide online access to their enforcement manual, detailing their internal audit guidelines and checklists. With a thorough review of these documents and an understanding of the general steps of an ESOP DOL investigation, any plan sponsor can successfully navigate one.

Questions? Contact the Findley consultant you normally work with or Aaron Geibel at Aaron.Geibel@Findley.com or [614.453.4653](tel:614.453.4653).