Crowe

Q&A

10 common questions employees ask about ESOPs

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1. What is an ESOP?

An ESOP, formally known as an employee stock ownership plan, is a tax-qualified retirement plan that invests primarily in the employer's stock. The company sets aside stock (and sometimes cash) in the ESOP to help the employee prepare for retirement.

2. What does an ESOP mean to me?

It means the employee will be a beneficial owner of the company at no cost and will have equity in the company and retirement benefits. The employee will not, however, participate in the management and day-to-day decision-making, hiring and firing decisions, and will not have access to confidential information. The ESOP does not guarantee employment at the company.

3. What is the purpose of an ESOP?

Owners have many options when selling a company. An ESOP is an effective tool for ownership succession-planning and enables employees to share in a company's success.

4. How is an ESOP different from a company's 401(k) plan?

There are two key differences between ESOP and 401(k) plans. First, an ESOP invests primarily in an employer's stock, while a 401(k) plan generally offers various mutual funds in which employees may invest funds. Second, 401(k) plans permit employees to contribute their own money into the plan, while ESOP contributions come solely from the company – making them completely free to employees.

5. How is the price of the stock in the ESOP determined? How often is it valued?

The price of the stock in an ESOP is typically determined on an annual basis by a qualified valuation company working in conjunction with the plan's trustee. These entities specialize in determining the value of ESOP-owned businesses. The value is based on many factors, including the company's current and projected performance, the performance of similar publicly traded companies, the outlook for the industry, the geography within which the company operates, and the overall economic outlook.

6. How often will my ESOP account balance change?

An ESOP account balance will change only once per year. Employees will receive an annual statement that provides the financial activity for the year, including the updated stock value.

7. How may the value of an account in the ESOP be increased?

Since the value of an ESOP account is based in large part on the value of the company's stock, anything an employee is able to do to help the company succeed and grow will also help an ESOP account balance grow. An employee's part in this depends on his or her role in the company, but taking any actions to improve efficiency, cut expenses, or to increase sales could increase the value of an ESOP account. Employee owners can have an effect on building a better company and increasing its value.

8. What is an ESOP acquisition loan?

ESOPs are permitted by law to borrow money to purchase shares (better known as an ESOP acquisition loan). The stock purchased with the loan is held in a suspense account – an account used on a temporary basis for any transaction or balance that cannot be identified – and is allocated to participants only as the loan is repaid.

9. Where is the employee's portion of the ESOP kept?

The assets of the ESOP – primarily company stock and cash – are held in the ESOP trust, a special entity established for the ESOP. An employee's portion of the ESOP assets are recorded in an ESOP account established under his or her name.

10. What is the role of an ESOP trustee?

The trustee controls the ESOP trust. He or she represents the plan participants and makes sure that the plan is operated in the best interests of the plan participants. The trustee also sets the annual price of the stock with the help of the independent valuation firm.

This Q&A was authored by Monika Zimmer and Pete Shuler, benefit plan services principals with Crowe. Crowe is a third-party administrator that handles all facets of plan administration for ESOPs.

Learn more

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