

Fact Sheet

U.S. Department of Labor
Employee Benefits Security Administration
January 16, 2025

Notice of Proposed Rulemaking Relating to Application of the Definition of Adequate Consideration

Today, the U.S. Department of Labor released a proposal under the Employee Retirement Income Security Act (ERISA) for fiduciaries on valuing employer stock purchased and sold by employee stock ownership plans (ESOPs). This proposal would carry out a SECURE 2.0 Act directive to provide principles-based guidance, facilitate the creation of ESOP, and protect ESOP benefits provided to workers. The Department is also proposing a prohibited transaction exemption that would provide a detailed road map for sellers and plan fiduciaries who are interested in creating a new ESOP that will purchase employer stock in accordance with ERISA's requirements.

ERISA

ERISA is a comprehensive statute designed to promote the interests of employees and their beneficiaries in most private-sector employee benefit plans, including retirement plans. It imposes duties and restrictions on persons who are “fiduciaries” with respect to employee benefit plans. Under ERISA section 404(a), fiduciaries must adhere to strict duties of prudence and loyalty.

The prohibited transaction provisions in ERISA section 406 restrict various types of transactions between a plan and persons who are “parties in interest” with respect to the plan and transactions that involve fiduciary conflicts of interest. ERISA section 408 sets out several statutory prohibited transaction exemptions and also authorizes the Department to grant conditional administrative exemptions from the prohibited transaction provisions.

Employee Stock Ownership Plans

An ESOP is a retirement plan designed to invest primarily in stock of the sponsoring employer or an affiliate. In a leveraged ESOP, the ESOP finances its stock acquisition through a loan obtained from, or guaranteed by, the sponsoring employer. The ESOP holds the stock on behalf of plan participants and allocates it to participant retirement accounts over time as the loan is repaid.

ESOPs can provide important retirement benefits for workers as well as an equity stake in the company. However, investment in employer stock through an ESOP can present significant risks for employees. If employees' retirement savings are largely invested in employer stock and the company goes out of business, employees risk losing not only their jobs, but also a significant portion of their retirement savings. Therefore, it is vitally important that ESOPs are managed in adherence with ERISA's requirements.

An ESOP's acquisition of stock issued by its sponsoring employer or an affiliate can violate ERISA's prohibited transaction provisions. However, a prohibited transaction exemption under ERISA section 408(e) provides relief if certain conditions are satisfied. One of the conditions is that the acquisition must be for fair market value. This is known as "adequate consideration," which is defined in ERISA section 3(18)(B). In the case of an asset without a generally recognized market, the term "adequate consideration" means the fair market value of the asset as determined in good faith by the trustee or named fiduciary pursuant to the plan's terms and in accordance with Department of Labor regulations.

1988 Proposed Regulation and Section 346 of the SECURE 2.0 Act of 2022

In 1988, the Department published a notice of proposed rulemaking to provide guidance on the application of the term "adequate consideration" in ERISA section 3(18)(B). This proposal recognized that Congress had assigned responsibility for ensuring plan compliance to ESOP fiduciaries, who have to adhere to the stringent obligations of prudence and loyalty set forth in ERISA section 404(a). The 1988 proposed rule was never finalized or withdrawn. However, interested parties and courts have frequently referred to its terms for guidance.

In 2022, SECURE 2.0 Act section 346(c)(4)(B) mandated that the Secretary of Labor issue formal guidance on the standards and procedures that are acceptable when establishing good faith fair market value for shares of a business to be acquired by an employee stock ownership plan. Prior to the SECURE 2.0 Act, an association petitioned the Department under the Administrative Procedures Act to provide guidance on ESOP valuations of employer stock.

Department's ESOP Enforcement Project

The Department's Employee Benefits Security Administration (EBSA) has maintained an ESOP National Enforcement Project since 2005. The project's purpose is to identify and correct ERISA violations in connection with ESOPs and ESOP transactions.

In the course of carrying out its enforcement investigations, EBSA has found repeated instances where a shareholder profited from an inflated valuation at the expense of the plan participants and beneficiaries. In several of its lawsuits involving such transactions the Department entered into settlements that included "process agreements" between the Department and an ESOP trustee. The agreements detail the process requirements for ESOP transactions to ensure the independence of trustees and appraisers, the careful review of relevant financial information, and the accuracy of employer stock valuations. This included requirements for:

- selecting and using a valuation advisor,
- oversight of a valuation advisor,
- the use of financial statements,
- document preservation, and
- other matters relevant to ESOP transactions, such as controlling interests and indemnification.

These process agreements provide valuable insight into how ERISA requirements should be applied with regard to ESOP transactions. However, unlike regulations, the agreements are tethered to the specific facts and parties involved in each case.

The New Proposed Regulation

The notice of proposed rulemaking (NPRM) released today would withdraw the 1988 proposed regulation, fulfill the SECURE 2.0 Act directive, and clarify elements of the term “adequate consideration.” The NPRM takes a principles-based approach in setting out a fiduciary framework for employer stock valuation and proper use and development of appraisals, without purporting to specify precise valuation methods and methodologies. It reflects principles expressed in numerous court decisions and important elements from the Department’s process agreements.

The adequate consideration test under the NPRM contains two distinct parts that must both be satisfied: “fair market value” and a “good faith” determination of that value.

- “Fair market value” under the NPRM generally means the price at which the employer stock would change hands in an arm’s length transaction between a willing buyer and a willing seller when the former is not under any compulsion to buy and the latter is not under any compulsion to sell, the parties are both willing and able to trade, and have reasonable knowledge of the facts relevant to the stock’s value.
- “Good faith” under the NPRM entails independent plan trustees or named fiduciaries determining value in accordance with a prudent process designed to ensure a sound conclusion as to the stock’s fair market value in conformity with ERISA’s fiduciary standards of prudence and loyalty.
 - Components of such a process include requirements that the fiduciary prudently:
 - select a qualified independent appraiser to prepare a written valuation report;
 - oversee production of a written valuation report based on complete, current, and accurate information; and
 - review the valuation report to ensure that it may reasonably be relied upon.
 - The NPRM includes minimum elements for each of these components.

The NPRM proposes an effective date that would apply to transactions taking place 60 days after publication of the final regulation.

The Proposed Administrative Prohibited Transaction Exemption

The Department is also proposing a prohibited transaction exemption safe harbor. The exemption is designed to provide a detailed map of how sellers and ESOP fiduciaries can comply with ERISA’s requirements when buying stock in connection with the creation of a new ESOP. While

parties can comply with ERISA without relying on the new safe harbor, the exemption provides a clear means of compliance that should promote the creation of new compliant ESOPs.

Under the proposed exemption, an independent trustee would be solely responsible for determining the appropriate purchase price for the employer stock. The independent trustee could rely on expert valuation advice it receives from an independent appraiser but only if the independent trustee determines that the advice is sound, prudent, and loyal to the ESOP and its participants and beneficiaries. In the circumstances set forth in the exemption, sellers would be permitted to rely on certifications from the trustee and appraiser to verify compliance.

Public Comment Period

The comment periods on the NPRM and the proposed class exemption run for 75 days after publication in the Federal Register, and the proposals each include instructions on submitting comments through www.regulations.gov. Commenters are free to express views not only on the provisions of the proposals, but also on any issues germane to the subject matter of the proposals.

Contact Information

For questions about the proposed rulemaking, contact EBSA's Office of Regulations and Interpretations at 202-693-8500.

For questions about the proposed class exemption, contact EBSA's Office of Exemption Determinations at 202-693-8540.