

April 9, 2020

Valuation Updates and COVID-19 Issues

Dear ESOP Clients,

In light of the events related to COVID-19 and our changing economy, we wanted to provide you with some thoughts on ESOP valuations and address potential questions and concerns. For many of you, your most recent plan year ended was December 31, 2019, resulting in an effective date of the valuation at December 31, 2019. For those of you at another plan year end date, many of the key issues and concerns outlined below may pertain to you as well.

Will the current events and economic factors be considered for the December 31, 2019 valuation date?

The valuation date considers any known or knowable facts as of that date. As of December 31, 2019, COVID-19 was in its infancy and was not yet declared a worldwide pandemic. China didn't lockdown the city of Wuhan until January 23, 2020, and the first confirmed case in the U.S. occurred on January 21, 2020. In addition, the stock markets in the U.S. remained strong well into February, with the S&P 500 and NASDAQ at record highs on February 19, 2020. Since the events related to the COVID-19 pandemic were not known or knowable as of December 31, 2019, we will not be factoring this into our analysis and the resulting conclusion of value for the valuations effective December 31, 2019. We realize this may be a concern for the payouts and distributions that will take place utilizing the December 31, 2019 valuation date, but it is important for ESOP administration purposes for the valuation date to be adhered to, which ignores subsequent events not made aware of as the valuation date.

What should we do about payouts anticipated during 2020 that will be made based on the valuation as of December 31, 2019?

This question is more challenging to answer and depends on many factors. First, do you have meaningful repurchase obligations that will take place in 2020 that may put additional strain on the cash flows of the Company? Second, will COVID-19 materially impact your business, ability to maintain revenue streams, cost structure, and profitability? All of these factors affect the valuation and some industries will be impacted more than others.

Depending on your firm's position with respect to the question(s) above, some firms may choose to take no action as it results to the valuation as of December 31, 2019. For other firms, the strain on the business resulting from COVID-19 alongside significant payments to be made in 2020 related to the ESOP may be more meaningful, and these firms might consider an interim or mid-year valuation.

The ESOP Plan document should also address the timing of payouts for distributions and diversifications. There may be flexibility in the timing of these payouts, and even the possibility to temporarily suspend 2020 payouts to allow for an interim valuation.

What to consider in doing an interim or mid-year valuation?

First, we recommend you consult your ESOP Plan document. Many ESOP Plans specify that a valuation is done at the plan year end, and therefore, have annual valuations as of December 31. However, there may be a provision that allows for an interim valuation under certain circumstances. The provision will also likely indicate who should be called upon for an interim valuation, which in most cases is the "Plan Administrator."



If your ESOP Plan does not provide a provision for an interim valuation, it may be appropriate to amend the plan to include this provision. Communication with both your Plan Administrator and your Legal Counsel will be necessary to aid in this decision. However, courts have generally not allowed ESOPs to be subsequently amended to allow the use of an interim valuation date for participants who terminated employment or become eligible for diversification prior to such amendment.

Who makes the decision on doing an interim valuation?

Declaring whether or not an interim valuation will occur is a fiduciary decision. Generally, this would be a board directive, along with Plan Administrators and other plan fiduciaries (i.e. trustees), that would make the decision for an interim valuation. This decision must be made in the best interest of **all plan participants and beneficiaries**, including participants who have terminated employment. The decision for an interim valuation also cannot be made merely on the desire to manage an ESOP company's cash flow. Considering prior practices of the Company if it previously faced significant changes in economic conditions, and whether prior interim valuations have been done should also be taken into account.

If an interim valuation is deemed appropriate, selecting a date for the interim valuation to be made also comes with additional challenges. Obviously, there are many uncertainties with the COVID-19 pandemic and things are changing rapidly. It is unknown how long this will continue, and if economic conditions will continue to worsen or improve. It may make sense to delay the interim valuation until more economic clarity becomes available. The fiduciary duty of fairness to all plan participants in all actions taken or not taken should also be considered.

Other Items to Consider

Lastly, in light of the current events, we recommend thoroughly reviewing your ESOP Plan document and starting a conversation with your ESOP Plan Administrators, Trustees, and advisors to determine the best course of action. In conjunction with these conversations, it is important to communicate with your ESOP participants, and you should consider a communication strategy that effectively conveys the message you want to deliver.

We hope this helps to address some of the questions you have relating to your ESOP. We are in unprecedented times with many unknowns facing our economy and the COVID-19 pandemic. Please feel free to reach out to anyone on our team with your questions or comments. We are here for you as a resource and want to help you work through this difficult time together.

Please be safe and healthy.

All the best,

Kristin Howe, CVA – Consultant
Sarah Lucas, CPA, CVA – Senior Vice President
Dan Skowronski - Senior Vice President
Valerie DeMell - Executive Vice President