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By electronic delivery

Mr. Pablo Antolin
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Re: Comments – Core Principles of Private Pension Regulation

Dear Mr. Antolin:

We write in response to your request for comments on the Draft Recommendation of the Council on the Core Principles of Private Pension Regulation ("Draft Principles") released in July 2015. We appreciate the efforts of the Working Party on Private Pensions ("WPPP") and the Council of the Organisation for Economic Cooperation and Development (the "Council") to try to improve the world's pension systems.

The undersigned organizations and their members are very concerned that one of the Draft Principles runs counter to long-standing policies in the U.S. intended to encourage employee ownership.[1] Specifically, Section 4.16 of the Draft Principles discourages the pension investment in employer stock, including through employee stock ownership plans (ESOPs). Although we support diversification for most pension plans, the language of section 4.16 would also apply to ESOPs, pension plans expressly designed to incentivize companies to provide employees with the opportunity to own a part of the business. It has been national policy in the U.S. for over four decades to encourage employee ownership through ESOPs, and the wealth of evidence gathered over that time proves conclusively that ESOPs are beneficial for workers and the economy as a whole.

We urge the WPPP and the Council to add language to the Draft Principles explicitly creating an exception to the diversification requirement in section 4.16 of the Draft Principles for

[1] ESCA (Employee-owned S Corporations of America) is a trade association for Subchapter S corporation employee stock ownership plans. ESCA represents more than 190,000 employee-owners in virtually every state in the U.S., and its member companies engage in a broad spectrum of business activities and are a variety of sizes – from 25-person businesses to companies with 9,000 or more employee-owners. The ESOP Association is a trade association, with approximately 2700 members, whose primary members are corporations that sponsor an employee stock ownership plan, engaged in all business sectors.

ESOPs. Below, we provide background on ESOPs in the U.S. and summarize the available research.

ESOPs

There are approximately 7,000 ESOPs in the U.S. and another 2,000 plans that are not technically ESOPs but function like ESOPs. Taken together, these plans cover approximately 14 million participants and hold more than $1 trillion in assets. More than 90 percent of companies with ESOPs are closely held, although some of those companies are very large. However, most of the assets and employees in ESOPs are in public company plans.

ESOPs are intended to provide a mechanism to allow employees to own a portion of their employing company. A company may establish an ESOP by setting up a trust that is required to invest primarily in the employer's stock. The trust can be funded by direct contributions of company stock or periodic cash contributions used to buy shares. Unlike most defined contribution plans in the U.S., ESOPs are almost always funded entirely through employer contributions.

ESOPs are generally regulated as pension plans under U.S. law and are incentivized through the tax code. Like other types of U.S. qualified pension plans, contributions to ESOPs are deductible for the employer, and taxes for workers are deferred until such time as the plan makes a distribution. However, U.S. law recognizes the dual role the plans serve – *i.e.*, providing retirement security and encouraging employee ownership – by affording special treatment in certain circumstances. For example, ESOPs are exempt from the requirement that trustees and other fiduciaries diversify the assets of the plan, though they are required to give participants the right to diversify a portion of their company stock as they near retirement.

Policy Evidence

After 41 years of experience, the body of evidence overwhelmingly demonstrates that encouraging employee ownership through ESOPs is an efficient and effective means of improving retirement security *and* building a stronger economy. Consider the following:

- **ESOPs encourage savings**. ESOPs are an important tool for workers to prepare for retirement. The majority of private company ESOPs that are majority owned by an ESOP are S corporations. These S corporation ESOPs contribute $14 billion in new savings for their workers each year beyond the income the workers would otherwise have earned.[2] In 2010, the average ESOP account balance was $195,222.65.[3] That is significantly higher than the average account balance of a 401(k) defined contribution plan in 2010, which was $91,038.[4] One study found that ESOP companies contributed 75 percent more on average to their ESOPs than other companies contributed to their primary defined contribution plan.[5] In

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[2] Freeman and Knoll, *S Corp ESOP Legislation Benefits and Costs: Public Policy and Tax Analysis* (2008) ("Freeman and Knoll").
[3] ESOP Association and Employee Ownership Foundation, *2010 ESOP Company Survey* (2010).
[4] VanDerhei, *401(k) Participants in the Wake of the Financial Crisis: Change in Account Balances, 2007-2011* (2013).
[5] National Center for Employee Ownership, *Research on Employee Ownership, Corporate Performance, and Employee Compensation* (2015)("NCEO 2015").

fact, ESOPs actually increased contributions to retirement benefits for employees by 18.6 percent in 2008 while other U.S. companies increased their contributions to employee retirement accounts by less than 3 percent.[6]

- **ESOPs are more likely to offer a secondary retirement plan.** ESOP companies recognize that ESOPs are not a substitute for other retirement plans. Consequently, the majority of ESOP companies offer a retirement plan – either a defined contribution or a defined benefit plan – in addition to the ESOP.[7] ESOP companies are 9 percent more likely to have a secondary retirement plan than non-ESOP companies are to have just one plan.[8] In a survey of S corporation ESOPs, 94 percent of survey respondents said that they provide at least one other qualified plan to their employees in addition to the ESOP.[9] The 90% plus frequency of ESOP companies sponsoring an ESOP and one other savings plan[10] is also consistent with the findings of the Employee Ownership Foundation's "2015 ESOP Company Survey" of ESOP Association members.[11]

- **ESOPs contribute to diversification**. ESOPs are designed to help workers diversify their retirement savings as they near retirement. Although ESOPs are only one component of many workers' retirement savings, U.S. law recognizes the need to encourage diversification, so all mature ESOPs begin to diversify the assets in the plan over time. For example, employees with 10 years or more in the plan who are age 55 or older can diversify up to 25 percent of their company stock in the first five years after reaching this milestone and can diversify up to 50 percent in the sixth year.

- **ESOPs are better investments**. S corporation ESOPs outperformed the S&P 500 in terms of total return per participant by 62 percent from 2002 to 2012.[12] The plans' net assets increased over 300 percent, and distributions to participants from those plans totaled nearly $30 billion in the same time period.[13] Moreover, ESOPs are not risky investments as evidenced by the extremely low default rate for ESOPs that borrow money. A recent study found that only 1.3 percent of ESOP companies defaulted in a way that imposed losses on their creditors for loans between 2009 and 2013.[14] Overall, ESOP performance is significantly better than the typical defined contribution plan in the U.S. (*i.e.,* 401(k) plans), and that is due, in large part, to two factors. First, employee ownership cultivates loyalty among employees, and that, in turn, enhances firm prosperity. Second, privately-held ESOPs are more than often closely held businesses managed for long-term growth. The Employee Ownership Foundation's survey of ESOP companies consistently evidences that private

[6] Swagel and Carroll, *Resilience and Retirement Security: Performance of S-ESOP Firms in the Recession* (2010)
[7] NCEO 2015.
[8] *Id.*
[9] National Center for Employee Ownership, *Retirement Security and Wealth Accumulation in S ESOP Companies* (2005). Also 93% was the response provided by ESOP companies. Benchmarking ESOP Companies, id.
[10] Corey Rosen , *Do ESOPs Need Reform? A Look at What the Data Show,* Tax Notes, June 22, 2015
[11] The ESOP Association and the Employee Ownership Foundation, 2015 Economic Performance Survey (2015)
[12] Ernst & Young, *Contributions of S ESOPs to Participants' Retirement Security* (2015).
[13] *Id.*
[14] Rosen and Rogers, *Default Rates on Leveraged ESOPs, 2009-2013* (2014).

ESOP companies have increased revenues, increased profits, and increased share value. 2015 data is consistent with all results of this annual survey since 1991.[15]

- **ESOPS drive economic growth.** S corporation ESOPs are a major driver of the U.S. economy. Their total output, along with the industries they support, was $246 billion in 2010, nearly 2 percent of U.S. GDP.[16] S corporation ESOPs directly employ 470,000 workers and support an additional 940,000 jobs.[17] ESOP Corporate members of The ESOP Association employ approximately 500,000 employees. ESOP jobs grew by 60 percent in the decade from 2001 to 2010 while job growth in the U.S. private sector as a whole remained relatively flat.[18]

- **ESOPS buffer against economic adversity and job loss**. During the Great Recession in the U.S. (2007-2009), S corporation ESOPs performed better than other companies in job creation, revenue growth, and providing for workers' retirement security.[19] In 2008, employment in the U.S. fell by 2.8 percent, and per worker earnings grew by on 3 percent. In contrast, employment in S corporation ESOP companies *rose* by 2 percent and wages per worker in those companies grew by 6 percent. A recent analysis by the Center for Opinion Research General Social Survey found during the Great Recession employees of companies with employee stock plans were four times less likely to be terminated than employees of conventionally owned companies. The 2014 GSS Survey found in 2014, 9.3 percent of all working adults in the private sector not in employee ownership plans reported having been laid off in the last year, compared to just 1.3 percent of those respondents who say they own stock in their company through some kind of company-sponsored employee ownership plan.[20]

Recommendation

Given the strong evidence in favor of encouraging employee ownership through ESOPs, we recommend adding language to section 4.16 of the Draft Principles explicitly creating an exception to the diversification requirement for employer stock in plans expressly designed to hold employer stock, such as ESOPs. Specifically, we recommend adding the following to the end thereof:

> These limitations should not apply in the case of pension funds specifically designed to invest in employer stock.

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The overwhelming body of evidence suggests that encouraging employee ownership through ESOPs is a proven and effective means of improving the retirement security of workers

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[15] The ESOP Association and the Employee Ownership Foundation, 2015 ESOP Company Survey (2015)
[16] Brill, *Macroeconomic Impact of S ESOPs on the U.S. Economy* (2013) ("Brill 2013").
[17] *Id.*
[18] Brill, *An Analysis of the Benefits S ESOPs Provide the U.S. Economy and Workforce* (2012) ("Brill 2012").
[19] Brill 2013.
[20] Rosen, *The Impact of Employee Ownership and ESOPs on layoffs and the Costs of Unemployment to the Federal Government* (2015).

and the economy as a whole. Therefore, we urge the WPPP to recognize the benefits of ESOPs and respect U.S. national policy encouraging employee stock ownership by adopting our recommended changes to the Draft Principles. We would be happy to provide additional information or to discuss the matter further.

Sincerely,

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President & Executive Director
ESCA (Employee-owned S Corporations of America)

J. Michael Keeling, CAE
President
The ESOP Association

cc: Ambrogio Rinaldi, Chair, Working Party on Private Pensions
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