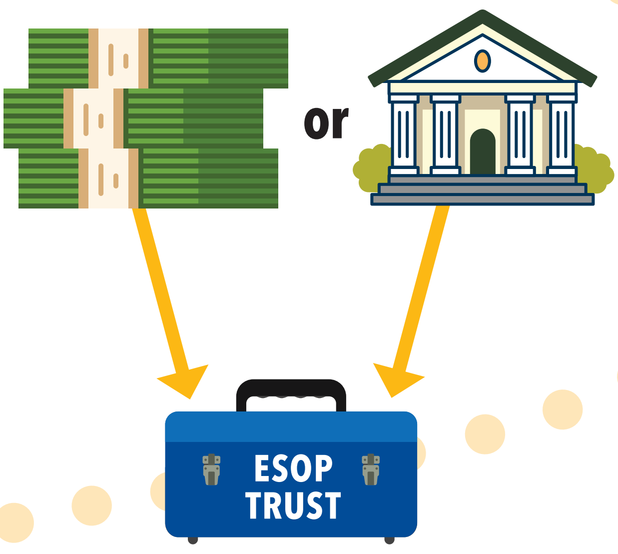
ESOP Nuts and Bolts

An ESOP enables employees to own part or all of the company they work for. Individual employees accumulate shares in their retirement accounts over time, and they cash in those shares when they retire or leave. Yet the stock they own never costs them a nickel. To see how this works, let's imagine that Pat, a company owner, decides to sell shares to an ESOP.

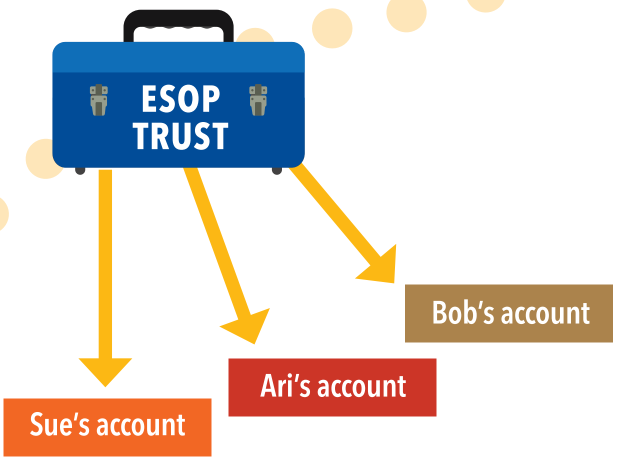
1 **The first step** is to set up an ESOP trust. The trust is a legal entity that will hold shares of stock on behalf of the employees. It is governed by many of the same rules as 401(k) plans, but it is funded entirely by the company.



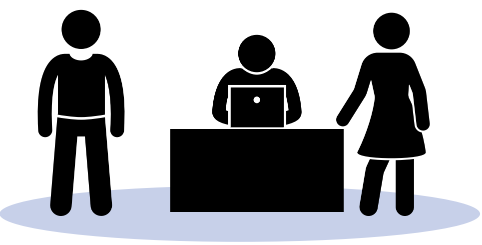
2 **Next,** the company contributes money to the trust, or else the trust borrows money from a bank, the seller, or both. If it borrows the money, as is common, the arrangement is called a leveraged ESOP.

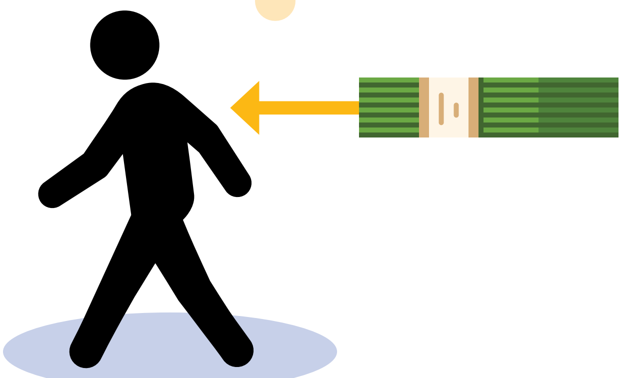
3 **Using that money,** the trust buys some or all of the company's shares from the owner or owners (Pat in this case). The price of the shares is determined by an independent appraiser.

4 **Then the trust begins allocating shares** to the retirement accounts of employees. In a leveraged ESOP—the kind with borrowed money—it allocates the shares as it pays back the loan. By law, shares must be distributed according to relative pay or by some formula that results in a more equal distribution.



See what happened? The employees' accounts now have stock, and they are the owners—without having made any cash outlay.





5 **When employees leave the company,** they are cashed out. The ESOP provides them with a significant retirement benefit. Beyond individual employees, the ESOP protects jobs by providing ownership continuity and keeping the company as a going concern.

And Pat not only found a buyer for her business while keeping it going, but she can keep working there and ease out in stages if that's the right thing for her and the company.