Written Testimony of J. Michael Keeling, President of The ESOP Association, to the Subcommittee on Financial Institutions and Consumer Credit, of the Committee on Financial Services, on "Financial Services Regulatory Relief: Private Sector Perspectives"

May 19, 2005
2128 Rayburn House
Office Building

Written Testimony of J. Michael Keeling

Chairman Bachus, ranking member Sanders, members of the Subcommittee on Financial Institutions and Consumer Credit of the House Committee on Financial Services, and guests of the Subcommittee, my name is J. Michael Keeling, and I am the President of The ESOP Association, or descriptively, the Chief Staff Officer. The ESOP Association is a trade association, governed by the Internal Revenue Code Section 501(c)(6). Our primary members are U.S. corporations that sponsor employee stock ownership plans, or ESOPs, which are tax qualified deferred compensation arrangements where employees are the beneficial owners of the corporation sponsoring the ESOP. Secondary members of the Association are individuals who provide a variety of services to ESOP companies, search as legal, administrative, valuation, lending, among other things.

Approximately 97% of our 1,400 ESOP companies' members are private, small to mid-sized businesses. Our member demographics are thus similar to businesses as a whole.

I have served as the chief staff officer of the Association since April 1991, and first began work with the group as general counsel in early 1982, shortly after leaving a position as chief staff officer to former Congressman J. J. "Jake" Pickle for nearly 10 years.

You may wonder what someone who works for the companies that are employee-owned through ESOPs has to say to you, as you examine ways to ease, and improve, the regulation of our nation's financial institution? Before I finish, I would hope that you would conclude that discussions of creating employee ownership should be before your full committee, and your subcommittee more so than the tax and labor committees of Congress.

Let me explain. An ESOP is similar to any other defined contribution plan such as a 401(k) plan except for two statutory, distinguishing characteristics. Unlike other defined contributions plans, an ESOP must be primarily invested in employer stock, and may borrow money to obtain its primary asset, stock of the plan sponsor. Attachment A summarizes the research that ESOPs are good for America, the ESOP companies, and employee-owners in the vast majority of instances.

Note the words "borrow money", which clearly means you should have an interest in the approximately 11,000 ESOP companies.

But let's dig a little deeper.

First, a big picture statement as to why your subcommittee should be involved with ESOPs as you work with your primary concern, our nation's financial institutions. 90% of ownership is created in a free enterprise society by financing. The idea that one can work hard on a salaried job, save a few pennies, and then start and own a business that succeeds, but never be financed, is a "Pollyanna" pipe dream. Entrepreneurs get financed, and as they pay off their debt, or line of credit, what they own becomes more valuable.

ESOPs borrow money to enable average pay persons, the employees, to be owners. The ESOP method of financing cuts the employees in on the ownership of what makes people truly financial secure in a capitalistic system—productive assets.

The sources of ESOP financing are generally from the institutions you oversee.

So ESOPs are intertwined with financial institutions in economic theory, and in practicality.

Now let's climb down from the skies a bit.

In the 108^{th} Congress, the Subcommittee's ranking member, Mr. Sanders, introduced H.R. 2969, and before the close of the Congress he was joined by 17 of his colleagues, including members of the committee Manzullo, Maloney, Carson, and Lee, plus members such as Rohrabacher and Goode. The entire package Mr. Sanders put forward was to create a method to fill a gap in financing the saving of American manufacturing jobs.

His proposal was to establish a lending program in the U.S. Treasury to provide loan guarantees, feasibility grants, and even in some instances direct loans to permit employees to buy their plants under certain condition and operate them as ESOP companies, or employee-owned co-operatives, which are called EWOCS.

In today's climate of tight budgets, and the general leeriness of many towards Federally sponsored loan programs, it will take more work by the employee ownership community to make the case to you and your colleagues that the entire H.R. 2969 package should move forward. We will continue to try to make that case, as it does not matter whether one is Republican, Democrat, or Independent, all are troubled to see American jobs lost, when there may be reasonable and sensible ways to preserve those jobs through employee ownership.

But, as ESOP experts reviewed H.R. 2969, one provision of Mr. Sanders et al bill jumped off the page as a modest, but meaningful first step in accomplishing several worthy goals.

The provision is Section 6 of H.R. 2969. Section 6 provides that the appropriate Federal financial supervisory agency assessing a financial institution's record of meeting the credit needs of its entire community should also include as a factor the institution's capital investments, loans, loan participation, technical assistance, financial advice, grants, and other ventures undertaken by the institution to support or enable manufacturing employees to establish employee stock ownership plans or eligible worker owned cooperatives that are at least 51% employee-owned plans or cooperatives.

Mr. Chairman, please note the precise language of Section 6. It is very modest. It does not automatically mean the Federal supervisory agency will mindlessly give a bank community reinvestment credit for making a loan to establish or expand an ESOP or an EWOC. It only makes it a factor. The loan also has to be for employees of a manufacturing facility that end up with at least 51% ownership.

In the real world, what kind of ESOP transaction are we talking about? We are talking about, under current ESOP laws and practices, about 150 to 200 new ESOP companies a year. Because of the 51% requirement, I would state that Section 6 would currently cover 80 to 100 ESOP transactions a year. These are companies that represent prior to the ESOP transaction a division, or a subsidiary of a much bigger company, that has decided, for whatever reason, to close the division down, or to sell it. Attachment B is a news article form the *Baltimore Sun* describing the typical situation I am talking about as a Belgium company sought to close a manufacturing facility in inner city Baltimore, but with the State of Maryland's help, the employees saved their jobs with a 100% ESOP buyout.

When this subcommittee had hearings on the entire H.R. 2969 on June 10, 2003, it heard stories of companies that were shut down, or about to be shut down, even though the union and management of the plant, and sometimes non-union employees and management, could make a strong case that as owners they could make the plant thrive in our global, extremely competitive market place.

But they often could not get the financing, as it is a fact that many regional, local, and even big national banks, do not understand employee ownership, much less understood how to finance employee ownership. So the jobs went down the tube.

Now, we come to a win-win situation: Financial institutions have the burden, and it can be easily justified, to comply with the Community Reinvestment Act of 1977. Congressman Sanders, in H.R. 2969, with Section 6, has proposed, "Here banks, help Americans, expand ownership, and it will be easier for you to comply with the Community Reinvestment Act of 1977."

So here is a little step, easing a bit a regulatory requirement on financial institutions, and at the same time providing an incentive for more financial institutions to learn about making ESOP and EWOC loans to save jobs, and to expand ownership.

So Mr. Chairman, and subcommittee members, this is why I am here today.

Indulge me to put one more thought on the table. I quote a speech,

In America's idea of freedom, citizens find the dignity and security of economic independence, instead of laboring on the edge of subsistence. This is the broader definition of liberty that motivated the Homestead Act.

To give every American a stake in the promise and future…we will…build an ownership society. We will widen the ownership of homes and businesses, retirement savings, and health insurance—preparing our people for the challenges of life in a free society.

By making every citizen an agenda of his or her own destiny, we will give our fellow Americans greater freedom from want and fear and make our society more prosperous and just and equal. President George W. Bush, Inauguration Speech, January 20, 2005.

Mr. Chairman, and members of the subcommittee, there should be legitimate debate over the specifics of how to build a more prosperous, just, and equal society through ownership. But I submit that Section 6 of H.R. 2969 can be one small, but meaningful, specific step that will move us towards that ownership society, while at the same time, potentially easing a regulatory burden faced by those you oversee.

I appreciate your time and invitation to be here today.

Attachments