Workshop 13 - "When the Pension Promise Fails - Unilateral or Forced Reduction of Accrued Pension Entitlement"

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AN OVERVIEW - U.S. BENEFIT CONSIDERATIONS IN BANKRUPTCY

This summary briefly describes the major retirement plan considerations that may arise in connection with the bankruptcy or insolvency of the employer who is the plan sponsor.

I. Defined Benefit Pension Plan

A. PBGC rules permit termination of a defined benefit pension plan by a plan sponsor only (1) if the plan has sufficient assets to pay all benefit liabilities upon termination (referred to as a "standard termination"), or (2) under certain "distress termination" events.

B. The insolvency or bankruptcy of the employer would not automatically require the termination of the on-going plan, assuming that the plan sponsor or other participating employers will continue to maintain it.

C. Termination of the defined benefit plan in a standard termination would not pose a significant issue to the plan sponsor. Presumably, any surplus assets that are not used for benefit purposes would be returned to the debtor's estate and used to pay claims.

D. A distress termination would be available only if the plan sponsor and all members of its controlled group meet specified distress criteria. These include liquidation or reorganization in bankruptcy or insolvency proceedings, or a demonstration that the entity would be unable to pay its debts when due and continue in business, or the costs of providing coverage have become "unreasonably burdensome" as a result of a decline in the workforce. As a practical matter, if the plan sponsor and other members of its controlled group continue in business, a distress termination would not be possible.

E. Liability for minimum funding contributions to an ongoing pension plan are joint and several for all control group members. Accordingly, it is likely that the solvent members of the controlled group will need to negotiate with the bankruptcy trustee or receiver to address whether the debtor's pension plan will continue or be "topped up" to permit a standard termination.

F. PBGC requirements

1. A notice of reportable event to the Pension Benefit Guaranty Corporation ("PBGC") may be required for one or more of the following events:

a. Change in Contributing Sponsor or Controlled Group. Notice is waived if the entity represents a de minimus 10% segment of the plan's old controlled group; if no variable rate PBGC premium is

required; or if, as of the applicable testing date, the Plan has less than $1 million in unfunded vested benefits.

b. Liquidation of Member of the Plan's Controlled Group. This notice is waived under circumstances similar to a. above.

c. Bankruptcy or Similar Settlement. Notice of Reportable Event for this event is *not* waived under most circumstances.

2. Multiemployer Liability - If there is participation pursuant to a collective bargaining agreement in a multiemployer plan, Section 4062(e) of the Employee Retirement Income Security Act of 1974, as amended (ERISA), states that if: (i) an employer "ceases operations at a facility in any location; and (ii) as a result of such cessation of operations, more than 20 percent of the total number of his employees who are participants are separated from employment"; then (c) withdrawal liability may be assessed in the same manner as when a "substantial employer" withdraws from a multiple-employer plan.

a. Section 4063(b) would impose on the withdrawing employer, together with the members of its controlled group, a proportionate share of the underfunding liability that would apply if the plan were terminated under the PBGC's "distress termination" procedures. The proportionate share is based upon the five year contribution history of the withdrawing employer divided by the total contributions made by all contributing employers over the last five years.

b. In lieu of payment of the withdrawing employer liability, the employer may furnish a bond to the PBGC in an amount not exceeding 150% of liability payable in the event that the plan is terminated within the next five years.

c. Because liability under this provision is joint and several among controlled group members, the insolvency or bankruptcy of an affiliate that triggers ERISA §4062(e) could result in liability to the plan sponsor and its continuing subsidiaries and affiliates.

II. Defined Contribution Plans

A. Plan Termination and Distributions

1. The insolvency or bankruptcy of a participating employer in the defined contribution plan would not automatically require the termination of the on-going plan, assuming that the plan sponsor or other participating employers will continue to maintain it.

2. The plan administrator would need to consider whether any claims against the bankruptcy or receivership estate are warranted.

a. For instance, a bankruptcy or receivership claim would be warranted if elective deferrals have been withheld but not remitted to the Plan.

(i) A claim to recover elective deferrals withheld but not remitted to the plan are not priority claims.

(ii) Elective deferrals that are withheld but not remitted to the plan are plan assets under ERISA, and the plan sponsor will be deemed to have engaged in a prohibited transaction under ERISA §406(a) and (b).

3. In a bankruptcy liquidation there may be no one left to terminate the plan and make distributions. Accordingly, the bankruptcy court may turn to the bankruptcy trustee or appoint an independent fiduciary to assume the task.

4. Treatment of forfeitures. Reversions generally are not permissible in a defined contribution plan. The Plan Administrator will need to determine if the forfeitures are "plan assets." If they are, no reversions may occur. Then, the allocation to participant account needs to be addressed.

III. Fiduciary Considerations

A. Overview - While the decision to terminate a plan is a non-fiduciary settlor function under ERISA, the steps taken to implement the decision to terminate an ERISA plan, typically taken by the bankruptcy trustee, including the decision to pay plan expense from plan assets, is a fiduciary function under ERISA. With respect to these plan decisions, the trustee could be a fiduciary under ERISA obligated to act prudently and for the exclusive benefit of plan participants.

B. Section 704(a)(11) of the Bankruptcy Code requires the trustee to perform the obligations of the retirement plan administrator. The bankruptcy trustee has a duty to maximize the bankruptcy estate for the benefit of creditors and to expeditiously reduce the estate for equitable distribution to creditors.

C. Accordingly, the trustee may have an inherent conflict between the duties to creditors under the Bankruptcy Code against the duties to plan participants as a fiduciary under ERISA. For example, with respect to a plan deficiency, the plan is potentially a creditor. In this scenario, the bankruptcy trustee is faced with the conflict of deciding whether to bring a claim, on behalf of the plan and as an ERISA fiduciary, against the bankruptcy estate, and at the same time, as bankruptcy trustee, obligated to consider whether the plan's claim against the estate is valid and warrants payment.

IV. Common Considerations

A. A decision may be needed as to whether a participant reduction resulting from the bankruptcy is a partial termination event requiring full vesting of affected participants.

B. Form 5310 *Application for Determination for Terminating Plan*: A decision is needed as to whether to file an application for determination with respect to the

terminating plan. There is a tension between the desire to expeditiously distribute the plan assets and the inevitable delay in waiting for an IRS determination (not legally required but providing reliance that the plan continued to meet applicable qualification requirements through termination).

C. Form 5500 *Annual Report/Return of Employee Benefit Plan*: There is an obligation to file a final Form 5500 with the DOL. An audit report may be required as well. These costs may be significant, especially in the context of a smaller plan.

D. Plan Expenses

1. Who is responsible to pay plan expenses such as:

a. independent fiduciary's fees;

b. vendor fees for the preparation and filing of Forms 5310 and 5500;

c. auditor fees for the preparation of audit report (if needed);

d. costs associated with distributions and rollovers;

e. preparing benefit statements and notifying participants of their benefits under the plan; and

f. legal fees.

2. Payment of these expenses could be another conflict issue as to whether payment should be by the bankruptcy estate or from plan assets. A further decision, if a defined contribution plan, is whether the expense allocated on a pro rata or per capita basis against the participant accounts.

V. **Orphan Plans**

A. Overview - Bankruptcies, mergers, acquisitions, and other similar transactions affecting the status of an employer, too often result in employers, particularly small employers, abandoning their individual account pension plans. When this happens, custodians such as banks, insurers, mutual fund companies, etc. are left holding the assets of these abandoned plans but do not have the authority to terminate such plans and make benefit distributions. In these situations, participants and beneficiaries have great difficulty accessing the benefits they have earned. In response, the DOL's Employee Benefits Security Administration (EBSA) has developed rules to facilitate a voluntary, safe and efficient process for winding up the affairs of abandoned individual account plans so that benefit distributions are made to participants and beneficiaries.

B. Plan Abandonment. A plan generally will be considered abandoned if no contributions to or distributions from the plan have been made for a period of at least 12 consecutive months and, following reasonable efforts to locate the plan sponsor, it is determined that the sponsor no longer exists, cannot be located, or is unable to maintain the plan.

C. Determinations of Abandonment. Only a qualified termination administrator (QTA) may determine whether a plan is abandoned under the regulations. To be a QTA, an entity must hold the plan's assets and be eligible as a trustee or issuer of an individual retirement plan under the Code (*e.g.*, bank, trust company, mutual fund family, or insurance company).

D. Termination and Winding-Up Process. The regulations establish specific procedures that QTAs must follow, including: notifying EBSA prior to, and after, terminating and winding up a plan; calculating benefits; notifying Ps & Bs of the termination, their rights and options; distributions; filing a summary terminal report. A QTA is not required to amend a plan to accommodate the termination.

E. Fiduciary Liability.

1. QTAs that follow the regulations will be considered generally to have satisfied the prudence requirements of ERISA with respect to winding-up activities. A QTA does not have an obligation to conduct an inquiry or review to determine whether or what breaches of fiduciary responsibility may have occurred with respect to a plan prior to becoming the QTA for such plan.

2. A QTA is not required to collect delinquent contributions on behalf of the plan, provided that the QTA informs EBSA of known delinquencies.

F. Annual Reporting Relief. The regulations provide annual reporting relief, under which QTAs are not responsible for filing a Form 5500 on behalf of an abandoned plan, either in the terminating year or any previous plan years; but the QTA must complete and file a summary terminal report at the end of the winding-up process.

G. Class Exemption. Accompanying the regulations is a class exemption that provides certain conditional relief from ERISA's prohibited transaction restrictions. The exemption would cover transactions where the QTA selects and pays itself: (i) for services rendered prior to becoming a QTA; and (ii) to provide services in connection with terminating and winding up an abandoned plan, including distribution costs.

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