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Reversal of Fortune -- The "New and Improved" Abandoned Plan Rule - Part II[1]

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In Part I of this article, we discussed the expanded “abandoned plan” rule recently promulgated by the U.S. Department of Labor on May 26, 2011. The DOL announced that it was expanding the “abandoned plan” rule to include liquidating bankruptcy trustees in the streamlined process for winding up the affairs of abandoned individual account retirement plans (which include 401(k) plans). Part II discusses the new regulatory scheme to assist bankruptcy trustees in the winding up of 401(k) plans, and also provides some guidelines for receivers and other fiduciaries that have not been included in the expanded “abandoned plan” rule.

The Regulatory Solution for Liquidating Bankruptcy Trustees

In its May 2011 “Preliminary Plan for Retrospective Analysis of Existing Rules” the DOL stated:

> [B]ankruptcy trustees, who often are unfamiliar with applicable fiduciary requirements and plan-termination procedures, presently have little in the way of a blueprint or guide for efficiently terminating and winding up such plans. Expanding the program to cover these plans will allow the responsible bankruptcy trustees to use the streamlined termination process to better discharge its obligations under the law. The use of streamlined procedures will reduce the amount of time and effort it ordinarily would take to terminate and wind up such plans. The expansion also will eliminate government filings ordinarily required of terminating plans. Participation in the program will reduce the overall cost of terminating and winding up such plans, which will result in larger benefit distributions to participants and beneficiaries in such plans.

The allure of the “abandoned plan” rule for bankruptcy trustees comes from the depressing experience of using the standard retirement plan termination process. The traditional procedures for terminating and winding up ERISA-regulated 401(k) plans can be time-consuming, complicated, and tedious. Under the standard retirement plan termination procedures, the 401(k) plan must be updated to conform to the current Tax Code requirements, missing or incomplete Annual Form 5500 Reports must be corrected (and if necessary, late filing penalties paid), operational defects must be corrected through EPCRS, etc., etc.

The DOL’s “Termination of Abandoned Individual Account Plans” regulation (which encompasses 401(k) plans, money purchase pension plans, profit-sharing plans and ESOPs), shortcuts these standard termination procedures in favor of its own streamlined process. See 29 C.F.R. § 2578.1 (“Abandoned Plan Regulation”). The Abandoned Plan Regulation provides standards for determining when a plan is abandoned, simplifies the procedures for winding up a plan, limits the exposure of the “qualified termination administrator” (“QTA”) to ERISA fiduciary breach claims, and sets forth a simplified process for distributing the plan’s assets to participants. What follows is a short summary of how the abandoned plan process will work in a bankruptcy liquidation.

Identifying the Qualified Termination Administrator

The first step in this process is to identify the “qualified termination administrator.” A QTA is responsible for determining whether an individual account plan is abandoned and for carrying out the activities associated with terminating and winding up the plan’s affairs. Pursuant to 29 C.F.R. § 2578.1(g), the QTA must meet two requirements. First, the QTA must be “eligible to serve as a trustee or issuer of an individual retirement plan, within the meaning of section 7701(a)(37) of the Internal Revenue Code.” 29 C.F.R. § 2578.1(g)(1). Second, the QTA must be holding assets of the abandoned plan. 29 C.F.R. § 2578.1(g)(2). A liquidating bankruptcy trustee easily meets both of these requirements.

Eligible Plans

To qualify as an “abandoned plan” and to be eligible for termination under the procedures set forth in the Abandoned Plan Regulation, a QTA must make two findings. First, the QTA must find that either no contributions to, or distributions from, the plan have been made for at least twelve (12) consecutive months immediately preceding the date on which the determination is being made; or other facts and circumstances, such as the filing by or against the plan sponsor for liquidation under Title 11 of the United States Bankruptcy Code, or any other actions that suggest to the QTA, or of which the QTA is aware, that the plan is or may become abandoned by the plan sponsor. 29 C.F.R. § 2578.1(1)(i)(A) and (B). Second, if, after reasonable efforts to locate or communicate with the plan sponsor, the QTA determines that the sponsor no longer exists, cannot be located, or is unable to maintain the plan, then the plan can be found abandoned. 29 C.F.R. § 2578.1(b)(ii)(A)-(C).

Once found “abandoned,” a plan is officially “deemed terminated” ninety (90) days following the date a letter is received from the Employee Benefit Security Administration’s Office of Enforcement acknowledging receipt of the notice of plan abandonment. 29 C.F.R. § 2578.1(c).[2]

Streamlined Process For Winding Up the Affairs of Individual Account Plans

The steps to wind up an abandoned 401(k) plan are simple and straightforward. The QTA must update the plan’s records; calculate the benefits payable to each participant or beneficiary; report delinquent contributions; engage service providers; pay (from plan assets) all reasonable expenses associated with carrying out the QTA's tasks; provide written notice to all plan participants or beneficiaries; distribute the benefits; file a Special Terminal Report for Abandoned Plans (see 29 C.F.R. § 2520.103-13); and circulate a final notice. 29 C.F.R. § 2578.1(d).

Limited ERISA Liability

A QTA is deemed by this regulation to have satisfied the fiduciary requirements of ERISA section 404(a) with respect to winding up the plan, except for selecting and monitoring service providers used in terminating the plan. 29 C.F.R. § 2578.1(e). This streamlined process for abandoned 401(k) plans does not require abandoned plans to be requalified under the Tax Code nor does it require the QTA to file any Form 5500's. The QTA is also not required to conduct an inquiry to determine whether breaches of fiduciary responsibility may have occurred with respect to a plan prior to becoming the plan's QTA. 29 C.F.R. § 2578.1(e)(2). The QTA is not obliged to collect delinquent contributions on behalf of the plan as long as the QTA informs the DOL in writing about any known delinquencies.

Form 5500 Annual Reporting Relief

The QTA is not responsible for filing a Form 5500 annual report 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 with the DOL at the end of the winding-up process.

Class Exemption

Accompanying the regulations is a class exemption that provides conditional relief from ERISA's prohibited transaction restrictions. PTE 2006-06. Absent this class exemption, the ERISA statute would otherwise prohibit the QTA, as an ERISA plan fiduciary, from receiving payment for his or her services from the plan's assets. See 29 U.S.C. § 1106. This section of the ERISA statute generally prohibits a plan fiduciary from dealing with the assets of an ERISA plan so as to benefit himself either directly or indirectly. The ERISA statute, however, also authorizes the DOL to grant administrative exemptions from these self-dealing prohibitions. ERISA § 408(a), 29 U.S.C. § 1108(a). The abandoned plan rule prohibited transaction class exemption permits the QTA to pay itself for services rendered to the plan prior to becoming the QTA; to provide services in connection with terminating and winding up the abandoned plan; and for distributions from abandoned plans to IRAs or other accounts established by the QTA resulting from a participant's failure to tell the QTA where to send his or her plan money. The QTA may also pay reasonable expenses from the plan's assets for winding up the plan.

Participant Notification

The QTA must notify participants that the plan is being terminated because it has been abandoned by the plan's sponsor. This notice must also tell the participant his or her account balance and the date on which it was calculated. The participant notification must include the following statement, "The actual amount of your distribution may be more or less than the amount stated in this letter depending on the investment gains or losses and the administrative cost of terminating your plan and distributing your benefits." 29 C.F.R. § 2578.1(d)(2)(vi)(3)(ii). Participants must also be informed of their distribution options. The distribution notice must include a statement explaining that if a participant fails to make a distribution election within 30 days from receipt of the notice, then the QTA will distribute the account balance to an IRA or to an interest-bearing federally insured bank account or to the unclaimed property fund of the state of the last known address of the participant.

Procedure for Terminating an Abandoned 401(k) Plan

The regulations require that the former plan sponsor be sent a "Notice of Intent to Terminate the Plan," to his or her last known mailing address. This letter must be sent via certified mail. Thirty days after the day this letter is sent, a second notice of plan abandonment needs to be mailed. This notice goes to the DOL and will indicate the fiduciary's intent to serve as a QTA. A model notice has been posted on the DOL's website. A "notice of plan termination" then needs to be sent to the plan's participants after the 90-day notice period provided to the DOL has expired. Participants will have 30 days to inform the QTA how they wish to receive their Plan distributions. A model participant Notice of Plan Termination is also provided by the government. When all of the Plan's assets have been distributed, a "Final Notice" must be sent to the DOL notifying it that the termination process has been completed. A model "Final Notice" is also provided by the government.

No Need to Update the Plan

The Internal Revenue Service stated in the "Abandoned Plan" Regulation that it will not challenge the qualified status of any Plan terminated under this regulation or take any adverse action against, or seek to assess or impose any penalty on, the QTA, the Plan, or any participant or beneficiary of the Plan as a result of the termination, including the distribution of the Plan's assets, provided the QTA satisfies three conditions. First, the QTA reasonably determines whether the survivor annuity requirements of the Tax Code apply to any benefit payable under the Plan. The qualified joint and survivor annuity provisions of the Tax Code do not apply to ESOPs. Second, each participant must be provided with a non-forfeitable right to his or her accrued benefits as of the date of the termination subject to income, expenses, gains and losses between the date of the Termination Notice and the date of distribution. Third, participants and beneficiaries must receive a notice of their rights to roll over amounts from the 401(k) Plan to an IRA. An IRS model notice concerning rollovers is also available.

Conclusion

For 401(k) plan participants whose plan sponsor is in bankruptcy liquidations, following the standard retirement plan termination procedures must feel like having to endure one last kick in the teeth. After experiencing bounced payroll checks and worse, these former employees are then faced with the double whammy of a prolonged 401(k) plan termination and having their individual plan accounts charged with significant expenses incurred in the termination process.

The "abandoned plan" rule should be a significant help to both plan participants as well as liquidating bankruptcy trustees. It will simplify defined contribution retirement plan terminations, it will lower plan expenses, and it will insulate the bankruptcy trustee from ERISA claims during the plan termination process. More importantly, these new rules will speed up the termination of the retirement plan as well as the distribution of the retirement plan's assets to the plan's participants. Sometimes what is lost is found.

While the DOL has expressly included Chapter 11 liquidating trustees under the "Abandoned Plan Rule," the treatment of receivers and other bankruptcy fiduciaries is unclear. While they can argue that by analogy the new abandoned rule should also apply to them, past experience suggests the DOL will narrowly apply the new rule. If the new rule does not cover a receiver's efforts in terminating a 401(k) plan, then he or she must take care to follow the existing 401(k) plan termination procedures described in Part I of this article.

[1] The DOL updated its regulatory agenda on January 25, 2012, stating that it expects to issue the revised "Abandoned Plan Rule" regulation in May 2012.

See DOL RIN 1210-AB47.

[2] A copy of the "abandoned plan" regulation can be downloaded from the following website: http://ecfr.gpoaccess.gov/cgi/t/text/text-idx?c=ecfr&tpl=/ecfrbrowse/Title29/29cfr2578_main_02.tpl. The regulation includes an Appendix containing all relevant model letters and notices.

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