Westlaw Journal
# BANKRUPTCY

Litigation News and Analysis • Legislation • Regulation • Expert Commentary

VOLUME 9, ISSUE 8 / AUGUST 16, 2012

*Expert Analysis*

## Participants in a Bankrupt Company's Retirement Plan Can Expect to Wait For Their Money

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There are thousands, perhaps hundreds of thousands, of people throughout the country who face an obstacle when it comes to accessing their retirement plan if they worked for a company that has filed Chapter 7 bankruptcy. According to the Administrative Office of the U.S. Courts, 7,400 businesses filed for bankruptcy during the first quarter of this year.

When a business files for Chapter 7 bankruptcy, a panel trustee is appointed to oversee the bankruptcy and is required to assume fiduciary responsibility for administering any retirement plan by eventually terminating it and distributing the funds to participants. How long this will take and the amount of money participants receive depends in large part on how well the plan was administered prior to the filing. Previous errors or omissions can affect both factors.

Trustees also proceed carefully in order to meet their mandated fiduciary obligations to all participants while avoiding the potential for fines, penalties or participant claims if they violate these responsibilities.

Retirement plan funds for these companies always belong to the ex-employee participants. This was ensured by the Employee Retirement Income Security Act, passed in 1974. For the first three decades, however, no one was actually held accountable for terminating these plans and returning the participants' money. That changed in 2005 when the Bankruptcy Abuse Prevention and Consumer Protection Act was passed, requiring trustees to take on this responsibility.

Trustees are usually attorneys or CPAs who have special training to handle bankruptcy cases and are expected to understand bankruptcy law. This does not mean they are equally familiar with ERISA, Department of Labor and income tax mandates, which dictate retirement plan administration and termination procedures, or the proper way to communicate with participants. To handle these issues, they do have the option of retaining independent service providers, such as record-keepers, third-party administrators, accountants, ERISA consultants or attorneys, and IRA custodians. Since the trustees are ultimately accountable for the providers' performance and fees, though, they still need a fundamental understanding of the termination and distribution process.

The DOL is currently working on its "abandoned plan" program to include trustees. Once effective, the revised program is expected to lessen the trustee's plan responsibilities if the program's procedures are followed.

The trustee's starting point is to formally take action to terminate the plan. If the company had already done so, there is only the need to ratify this action. If it had not, it can be initiated by a trustee resolution.

Next, the plan documents and previous administrative actions must be reviewed to confirm that all required plan amendments were adopted, mandated compliance testing was undertaken and passed, benefits were properly vested and all required plan contributions were made. This review should uncover specific problems that must be addressed, while providing an indication of how long corrective action might take and what funds are available for distribution.

A recent survey from Towers Watson emphasizes the critical nature of this review, finding three out of four on-going retirement plans do not conduct regular compliance reviews on their own. The importance of this review should be sufficient to encourage trustees to begin plan termination proceedings early during the bankruptcy proceedings.

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Another reason to begin the process early is to address the varying needs and desires of plan participants. Some of them will have found jobs at other companies with retirement plans and may want to transfer their funds to their new employer's plans. Others may be unemployed, and some may have joined a company that does not offer a plan. There will be those who want to roll over their funds into their own IRAs and some who may choose a cash distribution, which will create tax consequences.

The DOL stipulates that plan participants must be notified of the pending termination and the procedures for obtaining their benefits. There are certain procedures that must be followed, such as providing them with a prescribed tax notice and specific distribution paperwork. While some record keepers or third-party administrators may handle these tasks, many do not. Therefore, trustees have to be involved, unless outside assistance is retained for this process.

A portion of the plan participants will be patient and allow the process to take its course. Others will be impatient. They may want their money as soon as possible and write letters, send emails or call trustees to push for the release of the funds. While they may not be happy to learn it could be many months, or perhaps a year or more, before the funds are available, they may be more patient if they know the trustee is actively taking all the necessary steps to bring the termination to a close. Some participants may even call the DOL for help, but the agency is generally satisfied if the process is moving forward.

Some participants are classified as "missing," because they have moved and cannot be located, and they provided no instructions as to what the trustee should do with the funds in their accounts. Others might have passed away but left no beneficiary information. There are also people falling into the "non-responsive" category. This occurs when the trustee has valid contact information but never receives any response when information is sent to them. The trustee is still responsible for administering these accounts during the termination process and for trying to reunite these participants with their money.

Another task trustees should initiate early is taking an inventory of all plan assets. This includes funds that are currently invested plus un-cashed checks that were sent to participants prior to the bankruptcy filing. Mandatory cash-out checks may have been sent to participants with balances of less than $1,000, because a plan is permitted to close these small accounts to eliminate the cost of administering them. Other outstanding funds could be from un-cashed checks sent to participants who requested their accounts be closed. Most plans also have funds representing checks that were sent to participants but returned for some reason.

The funds represented by all of these checks are still considered an asset of the plan. The total amount of money involved can be significant if these checks have been building up for many years prior to the bankruptcy filing.

The notification process is relatively easy for participants whose contact information is available. For missing and non-responsive individuals, the DOL specifies the steps the trustee must take to locate them. This includes using certified mail, checking other plan records, and trying to contact listed beneficiaries through IRS or Social Security Administration letter forwarding services. Utilizing an Internet search, commercial locator service and credit reporting services are also advised.

If these steps are unsuccessful, trustees are allowed to protect the account assets of these individuals and satisfy their own fiduciary obligations by rolling their account balances into IRAs in their names. This is known as an automatic rollover. It reduces the time, costs, compliance issues and fiduciary liabilities associated with missing and non-responsive participants.

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Automatic rollovers are offered by qualified IRA custodial firms. Funds from un-cashed or stale-dated checks can also be transferred into IRAs in those participants' names. These custodial firms will often assume the obligation to continue trying to communicate with these individuals. Trustees may benefit from retaining a custodian that can undertake the entire process beginning with the search for missing participants, contacting those in the non-responsive category, and eventually opening the IRA accounts when permitted.

Meanwhile, the trustee must also monitor and manage the compliance review process, because the results impact the amount each participant receives and when those funds are available.

The amended Internal Revenue Code of 1986 says that income taxes on funds in a qualified retirement plan are deferred until they are received by the participant. Thus, the trustee must make a reasonable effort to assure the plan maintains its tax deferred status. If for any reason the IRS deems the plan to be non-qualified, those funds cannot be rolled over and could be subject to an IRS penalty.

IRS qualification problems can often be corrected by submitting a formal request to the agency. The IRS has a special set of rules for orphan plans, including retirement plans of bankrupt companies that are unable to maintain the plan. Normally, filing for relief requires paying a compliance fee to the IRS and perhaps making additional contributions to the plan. The IRS has the option of waiving the fees and contributions under its rules for orphan plans if there are insufficient funds in the bankruptcy estate.

Filing with the IRS to confirm qualified status has its drawbacks. A favorable ruling assures that rollovers or other participant distributions will be granted the favorable tax treatment. This could take up to a year, though, which will hold up distribution to participants. In some cases, historical data must be provided, including past versions of the plan document. If that information is not available, a favorable letter may be impossible to get.

The compliance review also confirms a plan's adherence to ERISA mandates as set out by the DOL. The review will determine if all elements of the plan document have been followed and if all employee deferrals were made. A failure to do either is an ERISA violation.

Another common compliance violation uncovered during a review is a failure to file complete annual reports (Form 5500) with the DOL. Plans with more than 100 participants must also be audited every year and file an accountant's report with the Form 5500. If such filings or audits were not performed, trustees may retain accountants to perform these functions.

While the goal is to receive an unqualified opinion from the auditor, under certain circumstances, accountants have no option but to issue a "qualified report," due to problems that occurred in past years or the lack of complete data. Trustees are not responsible for annual report and audit problems occurring prior to when they became plan administrator, but they may be required to negotiate a resolution with the DOL to accept an incomplete filing. If a report cannot be filed or a resolution reached, the DOL can assess severe penalties that the trustee is not allowed to pay from the plan assets.

The compliance review may also reveal vesting failures that occurred because the company laid off a large number of employees before filing for bankruptcy. If 20 percent or more of plan participants terminate their employment because of an employer initiated action or a series of actions, such as a layoff, the plan is considered to be partially terminated. If this is the case, the affected participants must be 100 percent vested in the plan.

Fortunately for trustees and participants, there are service providers with a great deal of experience in all of the above issues. Some specialize in a few areas while others can perform all of the participant relations and compliance review-related tasks. If the plan has sufficient assets, they can be used to pay most plan administration and termination expenses, including fees the providers will charge. If not, the only other source for payments is from the bankruptcy estate.

Trustees may choose to seek advance approval from the bankruptcy court before retaining service providers, because the DOL has the authority to review any fees paid to them and can seek to recover the funds for participants if it believes any were not reasonable. The DOL is not bound by the bankruptcy court's review, but having the court review the fees significantly improves the odds that they will not be challenged for reasonableness.

The DOL and the participants will feel more comfortable with this process if they understand that any providers selected by the trustee have been carefully screened to confirm their expertise. The preferred qualifications include:

- Experience conducting plan reviews, recommending action, preparing plan amendments and submitting requests for IRS and DOL consideration.

- Ability to prepare 5500 annual reports and work with an auditor if required.
- Willingness to undertake participant communications on behalf of the panel trustee, including preparation of distribution packages.
- Ability to accept and create rollover IRAs for the plan's missing and non-responsive participants and those for whom the company has un-cashed or returned checks.
- Experience searching for missing participants or non-responsive individuals.

Certainly, some of the problems faced by these plan participants can be alleviated if plan administrators follow appropriate administrative procedures throughout the life of the plan. Participants should also do their part by keeping plan sponsors informed of their contact information and by reaching out to the trustee after a bankruptcy filing.

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