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Excuse Me, You're Standing Between Me and My Retirement Money

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Prior to when § 446 of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) added § 704(b)(11) to the Bankruptcy Code, panel trustees for business chapter 7 or 11 debtors had little involvement with companies' retirement plans or their plan participants. That has all changed.


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For employee-benefit plans governed by the Employee Retirement Income Security Act of 1974, as amended (ERISA) and maintained by the bankrupt company, the panel trustee is now mandated to perform the obligations of the plan administrator and has fiduciary responsibility to the plan and the plan participants. Stepping in as plan administrators and fiduciaries, they are subject to ERISA prudent-person standards. They must discharge their duties solely in the interests of these participants or their beneficiaries for the exclusive purpose of providing benefits to them and defraying the reasonable expenses of administering the plan.[1]

What makes this even more interesting is that panel trustees are most often bankruptcy attorneys or perhaps CPAs, skilled in bankruptcy law, but with limited experience in ERISA law that governs retirement plan activities, including how participants are dealt with throughout the plan termination process. Yet, panel trustees quickly learn that plan participants have little interest in all this. All plan participants know is that the panel trustee has control of their retirement money. As a result, they write, send emails and phone panel trustees asking for their funds. Some are polite inquiries. Others threaten lawsuits or worse.

[1] The statute also encompasses the trustee's obligations with respect to health and welfare plans, but those responsibilities, while similar, are beyond the scope of this article.

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Feature

There are other challenges as well. As asset distribution is being planned, panel trustees usually learn that some of the participants can no longer be located or fail to respond to any communications about the plan. Of course, there is the added pressure of the U.S. Department of Labor (DOL), which has the ability to impose fines if they are deemed not to have performed their duties properly.

Panel trustees clearly do want to reunite plan participants with their retirement funds as quickly as possible while still minimizing the risks of mistakes, participant lawsuits and/or DOL fines. To accomplish this, some trustees may choose to retain plan service providers to assist with the process. Whether they try to go it alone or rely on service providers, panel trustees will remain responsible for these providers' performance and their fees. Therefore, it is essential that panel trustees have a good understanding of the plan's termination and distribution process.


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The first step is to take formal action to terminate the retirement plan. This can be a simple panel trustee resolution to do so as of a specific date or to ratify prior action taken by the debtor. The next step is a thorough compliance review of plan documents and operations by persons experienced in doing so. The objective is to identify issues that would affect the amount of benefits to which participants may be entitled as well as the time required to terminate the plan and distribute those benefits. This review should also identify any failure to adopt required plan amendments, properly perform and pass compliance testing, determine whether benefits are properly vested, and confirm that all required plan contributions were made.

It is also critical that all plan assets are protected and kept intact. This includes all of the invested assets, as well as funds represented by uncashed or returned checks that were issued from the plan but not cashed by the participants. These funds are considered assets of the plan. Most retirement plans are subject to both ERISA and Internal Revenue Service (IRS) rules. As for the IRS, retirement plans that are "qualified" under the Internal Revenue Code of 1986, as amended (IRC), provide

benefits to plan participants that are tax-deferred until they are actually received by the participant.

As plan administrator, the panel trustee is responsible for assuring that the plan maintains its qualified status so that when the retirement plan is terminated, tax deferral of the benefits for the participants can be continued by rolling the benefit over to another qualifying plan or to an individual retirement account (IRA). Assets from a nonqualified plan cannot be rolled over and may be subject to a 6 percent IRS penalty if they are rolled over and not withdrawn before the participant files a tax return for the rollover year.

Many times, IRS plan-qualification issues discovered during the review can be corrected by submitting a request to the IRS under its Voluntary Correction Program. The IRS has a special set of rules for orphan plans, including plans of bankrupt debtors where the debtor no longer exists or is unable to maintain the plan. Normally, filing for relief under this program entails paying a compliance fee to the IRS and, depending on the nature of the deficiency, contributing additional funds to the plan. Under the special rule for orphan plans, both the compliance fee and the correction contributions may be waived if there are insufficient funds in the bankruptcy estate.[2]

Filing with the IRS to determine the qualified status of the plan is optional. A favorable determination assures that rollovers or other participant distributions will be granted the favorable tax treatment. It is like an insurance policy for the panel trustee and the participants with respect to the qualified status of the plan and the distributions. However, plan participants may be frustrated to learn that it could take up to a year to obtain a favorable letter. Moreover, certain historical data must be provided, including past versions of the plan document. If that information is not available, it may not be possible to obtain a favorable determination letter.

Determining ERISA compliance is also critical. ERISA plans are subject to enforcement by the DOL Employee Benefits Security Administration. An effective compliance review should identify any issues that could be violations under ERISA. For example, the failure to contribute employee deferrals to the plan is a violation is a violation of ERISA's fiduciary duties. It may also be a plan-qualification issue if the terms of the plan document were not followed. Panel trustees are not liable for failures that occurred before they assume the obligations of a plan administrator,[3] but they may be deemed liable if they become aware of a failure and do not take corrective action where such action is feasible. If sufficient resources are available, that may mean taking legal action against the former administrators or trustees. In other cases, it may mean notifying the DOL of the violation so it may take appropriate action.

[T]he bankruptcy court has the authority to award expenses for administering and terminating the plan regardless of whether the source of payment is the plan or the debtor's estate.

Another common compliance issue uncovered during a plan review is the failure to file complete annual reports (Form 5500) with the DOL. Plans with more than 100 participants are also required to have the plan audited annually and file an accountant's report with the Form 5500. An accountant retained by the panel trustee to rectify this situation is often still unable to issue an unqualified report because of problems that occurred in past years or the lack of complete data. While panel trustees are not responsible for annual reports prior to the year they assume the obligations of a plan administrator, those issues may prevent the accountant from issuing an unqualified opinion for the year. Thus, it may still be necessary to negotiate a resolution with the DOL to accept an incomplete filing.

Failure to file a report or reach a resolution may result in penalties being assessed against the panel trustee by the DOL that can be as much as $1,100 per day. The DOL has a voluntary delinquent filing procedure with reduced penalties of $10 per day up to $2,000 per filing and $4,000 per plan, or $750 per filing and $1,500 per plan for plans with less than 100 participants. Unfortunately, this program does not have a penalty waiver provision for orphaned plans. Moreover, the penalty cannot be paid from the plan. Therefore, the program is only useful if there is another source from which the reduced penalty may be paid.

The DOL is working on a project to lessen the ERISA burden on panel trustees terminating retirement plans. The extent of the relief to the normal ERISA rules is unknown at this time. Until these new rules have reached the stage where they may be relied on, a cautious panel trustee will comply with all applicable ERISA rules and regulations.

The compliance review may also reveal vesting failures that occurred because the debtor laid off a significant number of employees before filing for bankruptcy but failed to fully vest those who were also plan participants. If a plan is partially terminated, affected participants must be 100 percent vested in all plan benefits. A partial termination occurs if 20 percent or more of plan participants terminate their employment because of employer-initiated action or a series of actions, such as a layoff.[4]

Prior to terminating a plan, the panel trustee must attempt to notify all plan participants of the pending termination and the procedures for obtaining their benefits. The DOL has prescribed certain procedures that must be followed for plan fiduciaries to be deemed to have satisfied their responsibilities in this regard.[5] Generally, this involves providing them with a prescribed tax notice and specific distribution paperwork. While some plan recordkeepers or TPAs (third-party administrators, which does the compliance and administration for retirement plans) may handle the entire distribution process, most do not, so the panel trustee will have to be involved to some extent unless outside assistance is retained for this process.

It may be easy to reach out to those vocal participants who have been writing and calling, as well as other participants who are waiting for the situation to be resolved. In all likelihood, there will be another group who cannot be contacted and will be classified as "missing." Some may have moved and left no forwarding address, while others may have passed away and there is no current beneficiary contact information. More participants actually have not disappeared, but they still fail to respond to any information the panel trustee sends to them.

2 *See* IRS Revenue Procedure 2008 50.

3 Some have argued that the panel trustee does not become the plan administrator but is only required to perform the obligations of the administrator. The authors believe that is a distinction without a difference, and the DOL is of a similar view.

4 *See* IRS Revenue Ruling 2004 43.

5 *See* DOL Field Assistance Bulletin 2004 02.

For terminating plans, the DOL recommends a series of steps that panel trustees must take when searching for missing participants before embarking on an automatic rollover IRA program. If these efforts are unsuccessful, panel trustees are allowed to roll over the assets of these retirement accounts to qualified IRA custodians to be held for each participant's benefit. Choosing IRA custodians for rollovers is a fiduciary decision. There are also specific DOL safe-harbor rules, and if they are followed, the DOL deems that the fiduciaries have satisfied their responsibilities.[6]

It has become common for panel trustees to retain retirement plan service providers that can bring specific expertise to all phases of the plan termination and distribution process. Typical service providers include a record-keeper, TPA, an accountant, an ERISA consultant or attorney, a financial adviser and an IRA custodian. Because plan trustees are responsible for these providers' performance and fees, panel trustees must know how to identify viable candidates for these assignments. This does not mean that the cheapest service provider must always be retained. The panel trustee should be more interested in determining that a provider is delivering the best value to the plan and the participants. In most cases, competitive proposals should be obtained for each major service provider, including the current provider if retention is an option.

It is possible to find firms that can perform more than one of the necessary tasks, or perhaps all of them for a single fee and provide the plan trustee with a single point of contact. Depending on the size, scope and potential issues related to the plan, panel trustees might wish to work with providers who are also willing to assume a co-fiduciary role with the trustee.

If the plan has sufficient assets, plan assets can be used to pay most plan-administration and termination expenses, including service-provider fees. If not, the only other source for payments is the debtor's estate. While there is a split of authority, the better reasoning is that the bankruptcy court has the authority to award expenses for administering and terminating the plan regardless of whether the source of payment is the plan or the debtor's estate.[7] Where possible, a panel trustee should seek advance approval from the bankruptcy court to hire and compensate plan service providers. The DOL also has authority to review whether the fees paid were reasonable, and to seek recovery from the panel trustee to the extent it deems any compensation to be unreasonable. Obtaining bankruptcy court approval of the fees up-front can only strengthen the panel trustee's case in such a situation. Meanwhile, panel trustees should prepare a list of criteria to follow when reviewing potential service providers being considered. This includes (1) the extent of their experience, conducting plan document and operation reviews recommending appropriate action, preparing plan amendments, and submitting appropriate requests for IRS and ERISA consideration; (2) their ability to prepare Form 5500 annual reports and work with an auditor, if required; (3) their willingness to assume responsibility for participant communications on behalf of the panel trustee, including preparation of distribution packages; and (4) their ability to implement IRA rollovers on behalf of missing or nonresponsive participants, including size and number of accounts that can be accepted and the level of service to be provided to the panel trustee and to participants who are identified following the completion of the rollover.

A thorough search should identify competent professionals who can perform one or more individual services as well as professionals that actually handle every aspect of the termination. Some are geared to handle the termination of smaller plans, while others have the ability to help with much larger cases. There is no need for panel trustees to wait until a company's bankruptcy has been resolved to begin retirement plan termination proceedings. These activities can run concurrently, which should make the panel trustee's job much easier and plan participants much happier. ■

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6 ERISA § 404, 29 U.S.C. § 1104. DOL Regulation, § 2550.404(a) 2(c).

7 *Compare In re The Robert Plan Corp.*, 439 B.R. 29 (Bankr. E.D.N.Y. 2010), and *In re NCSO Inc.*, 427 B.R. 165, 174 (Bankr. D. Mass. 2010) (court has authority), with *AB & C Group Inc.*, 411 B.R. 284, 290 (Bankr. N.D. W.Va. 2009), and *In re Mid States Express Inc.*, 411 B.R. 688 (Bankr. N.D. Ill. 2010) (no authority).