

Plan Terminations

ASPPA Benefits Council

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Partial Terminations	Complete Terminations	Potpourri	Qualification Issues	PBGC Covered Plans
<u>Types</u>	<u>204(h) Notice</u>	<u>Safe Harbor Plans</u>	<u>Amendments</u>	<u>Distress Termination</u>
<u>Rev. Rul. 2007-43</u>	<u>Distribution of Assets</u>	<u>Lost Participants</u>	<u>Determination Letter</u>	<u>Involuntary Termination</u>
<u>Other Views</u>	<u>Special 401(k) Rules</u>	<u>Minimum Funding</u>	<u>Anti-Cutback Rule</u>	<u>Employer Liability</u>
<u>Plan Amendments</u>	<u>Complete Discontinuance</u>	<u>Non PBGC DB Plans</u>	<u>Permanency</u>	<u>Options</u>

Types

■ DC Plan

- Participation is reduced by significant percentage
- Employees right to vest are adversely affected by plan amendment

■ DB Plan

- Decrease/cessation in future benefit accruals resulting in increase/creation of reversion

■ Ultimately a factual determination

Rev. Rul. 2007-43

- Greater than 20% turnover rate presumed to be a partial termination
- Turnover Rate:
 - # of employees experiencing Employer Initiated Severance
 - # employees participating in plan at the beginning of Applicable Period + new participants

Rev. Rul. 2007-43

■ Applicable Period

- Generally a 12 month period or
- Longer period if there is a series of related terminations

Rev. Rul. 2007-43

- Employer Initiated Severance
 - Count vested and nonvested employees
 - Dave's Rule: count them all unless:
 - Death
 - Disability
 - Retirement at or after plan's NRA
 - Transfers within control group
 - Voluntary
 - Voluntary burden is on employer to demonstrate severance was not employer initiated

Rev. Rul. 2007-43

- Consequence of partial termination
 - Full vesting of *affected* participants
- *Affected* participants
 - Rev. Rul. says: 100% all participants who incurred a severance (without distinguishing between employer initiated and voluntary)
 - Statute says: 100% *affected* participants

Rev. Rul. 2007-43

- Overcoming the presumption
 - Applicable turnover rate is routine
 - Replacement of employees
 - Replacement employees performed essentially the same job functions
 - Possibility of reversion

Other Views

- Title 1 of ERISA Claims
- Who do you count (vested vs nonvested) in the turnover ratio
 - Count Both: 2nd Circuit and IRS
 - Count only Nonvested: 7th and 5th Circuits
- Factors indicating that there is no partial termination
 - Employer realize a tax benefit
 - Terminations were result of corp transaction
 - Employer motives (bad faith in terminating employees)

Plan Amendments

■ Curtailment

- Not a *per se* partial termination
- Typically involves amendments
 - Restrict eligibility conditions for future employees
 - Benefit or contribution formula
 - Restrictions on vesting
- Additional factors
 - Potential for reversion is increased
 - Prohibited discrimination results
 - Potential for discrimination increases if non-vested accrued benefits remain non-vested

Plan Amendments

- **Generally, no partial termination where a money purchase plan (MPP) is merged or converted into a profit sharing plan (PSP) and**
 - **Same vesting schedule is retained**
 - **All MPP participants will be covered by the PSP, although separate accounting applies and**
 - **The MPP monies remain subject to the joint and survivor annuity rules**

Plan Amendments

- DB amended into DC plan
 - Complete termination
 - Plan Subject to PBGC must satisfy the standard or distress termination rules
 - Full vesting required
 - Must protect the “defined benefit feature”

204(h) Notice

■ Applicable Plans

- DB
- DC subject to Code § 412

■ Triggers:

- Significant reduction in the rate of future benefit accruals
- Significant reduction in an early retirement benefit or retirement type subsidy

204(h) Notice

■ Applicable Individuals

- All participants and any beneficiary that is an alternate payee under a QDRO
- “Designee” - those individuals named by an applicable individual in writing

■ Significant reduction

- DB plan - a reduction in the rate of future benefit accruals if it is reasonably expected to reduce the future annual benefit commencing at normal retirement age.
- DC plan - a reduction in future benefit accruals if it is reasonably expected to reduce the amount of future annual allocations to the participant’s account

204(h) Notice

- Significant reduction
 - DB plan - a reduction in the rate of future benefit accruals if it is reasonably expected to reduce the future annual benefit commencing at normal retirement age.
 - DC plan - a reduction in future benefit accruals if it is reasonably expected to reduce the amount of future annual allocations to the participant's account
- Determination of a “significant” reduction is based on the reasonable expectations, taking into account all facts and circumstances

204(h) Notice

■ Timing of Notice

- Generally, at least 45 days before the contributions are to cease.
- Plans with fewer than 100 participants, at least 15 days before the contributions are to cease.
- In the case of a business transaction, regardless of the number of participants, at least 15 days
- liabilities transferred in a merger, transfer or consolidation (but only if there is a significant reduction to an early retirement benefit or retirement subsidy), notice must be provided no later than 30 days after the effective date of the amendment

■ Delivery of Notice

- must result in actual receipt of the notice

204(h) Notice

■ Content Requirements

- Must state that contributions will no longer be made as of the specified date
- Must be written to ensure the average participant will understand the amendment to the plan
- A description of the benefits before and after the amendment
- It must provide the information necessary for each Applicable Individual to determine the change in benefits including illustrative examples.
- There can be no misleading or false information in the notice

204(h) Notice

- Failing to provide notice (Egregious Failure)
 - Failure occurs when the failure was within the control of the plan sponsor and is
 - an intentional failure or
 - a failure to provide most of the individuals with most of the information they are entitled to receive
- Disregard the amendment (participant entitled to pre-amendment benefits)

204(h) Notice

- Non-Egregious Failure
 - The amendment is effective
 - No impact on individuals right to recover benefits under ERISA

204(h) Notice

- Excise tax regardless of nature of failure
 - \$100 per individual who was not provided the notice per day
 - Period during which the excise tax is computed begins on the date of the failure and ends when the notice is given
- Relief
 - Reasonable diligence waiver
 - 30 day grace period

Distribution of Assets

- The terminated plan must distribute assets as soon as administratively feasible or the plan is once again subject to the qualification, funding and reporting requirements
- As soon as administratively feasible is determined based on the facts and circumstances, but is presumed not to have occurred if distribution has not been completed within one year.
- If there is a determination letter request pending, the time period for distribution is “suspended” pending the issuance of the determination letter

Special 401(k) Rules

- No Code § 401(k) contributions can be distributed if the employer maintains an “alternative” defined contribution plan
- Alternative DC plan is any defined contribution plan other than an ESOP, SEP, SIMPLE IRA, Code § 403(b) plan, Code § 457(b) plan and Code § 457(f) plan maintained during the period beginning on the date of a plan termination and ending 12 months after the date of final distribution of plan assets

Complete Discontinuance

- Full vesting required
- Facts and Circumstance Test
 - Discontinuance to avoid full vesting
 - Contributions recurring and substantial
 - Reasonable probability that contributions will not be made
 - 3/5 presumption
- Vesting required not later than last day of the taxable year of employer following last taxable year in which substantial contribution was made

Safe Harbor Plans

- Suspension or reduction of nonelective contributions
- Requirements
 - Substantial business hardship
 - Supplemental notice
 - Effective no earlier than 30 days after the notice is provided
 - Opportunity to adjust elective deferrals
 - Amend plan to provide for ADP/ACP current year testing
 - Make nonelective contribution for the partial plan year

Safe Harbor Plans

- Notice content
 - Consequences of suspension/reduction
 - Procedures to adjust the elective deferral
 - Effective date
- Substantial business hardship (Code §412(c))
 - Operating at an economic loss
 - Substantial unemployment/underemployment in the trade or business
 - Sales and profits in the industry are depressed/declining
 - Likelihood of continuing the plan w/o relief

Safe Harbor Plans

■ Other Issues

- Top heavy
- Prorating compensation limit Code §401(a)(17)

Lost Participants

- Fiduciary duty to attempt to locate plan participant
- Discharging the fiduciary duty
 - Certified mail
 - Social Security Administration or IRS letter forwarding services
 - Checking records of other plans maintained by the employer for more current contact information
 - Contacting designated beneficiaries
 - Internet search
 - Expense can be charged to participant

Lost Participants

- PBGC's missing participant program
 - Using the program is optional
 - PBGC must be provided with missing participant information
 - If participants are found, payments may be in a lump sum or any other form permitted by PBGC
- Rollover to IRA
- Transfer to taxable account less withholding
- Escheat

Minimum Funding

- Code § 412 provides strict minimum funding standards for pension plans (defined benefit, money purchase pension plans and target benefit plans). Code § 4971 imposes an excise tax on the plan sponsor for failing to satisfy these requirements
- PPA has added §430, which has replaced § 412 for minimum funding standards for defined benefit plans
- A funding deficiency is not eliminated just because a plan is terminating
- The funding deficiency cannot be corrected by having participants “waive” their benefit

Minimum Funding

■ Minimum Funding Waiver

- The employer can request a funding waiver but the waiver does not excuse the employer from making the contributions
- In a controlled group, each member of the group is jointly and severally liable for the payment of the contribution
- The IRS will check to see if
 - any participants accrued a benefit or contribution for the plan year prior to the date of termination
 - the funding requirements have been met up to the date of termination
 - the funding requirements were timely made
 - any receivables were paid prior to the date of termination
 - any excise tax under Form 5330 was paid
 - any existing funding deficiency has been addressed

Non PBGC DB Plans

- Plan assets sufficient
- Making assets sufficient (Pre-PPA)
 - Owner only plan (haircut)
 - Plans covering more than owners
 - Allocate assets under ERISA 4044 priority categories
 - Haircuts to HCEs full benefits to NHCEs
- Benefit limitations (Post PPA)
 - Code §436 benefit limitations

Amendments

- Must comply with all qualification requirements that are effective as of the date of termination
- Qualification requirements that are effective after date of termination but before plan assets have been distributed need not be adopted if the assets are distributed as soon as administratively feasible following termination

Determination Letter

- Not required

- Staggered remedial amendment period
- Subsequent law changes applicable at plan termination date (guidance)
- Verification of compliance with prior law
- Institutional trustee and some vendors require a determination letter before they will make distributions

Anti-Cutback Rule

■ Protected Benefits

- Can't force an immediate distribution in a particular form
- If the normal form is an annuity, participant must affirmatively elect (with spousal consent if applicable) an optional form of benefit

■ Prohibition on distribution prior to participant's attainment of NRA or age 62

Anti-Cutback Rule

- Distribution following termination
 - Cash out small account balances
 - Amend the plan to require immediate single sum distribution without participant consent
 - No annuity distribution available
 - No other DC plan maintained in control group
 - Distribute an annuity providing for the optional forms under the plan (Plans subject to Code §417)

Permanency

- Rebuttable presumption is created if a plan terminates within a few years of establishment
- Business necessity
 - Facts and circumstances
 - Unforeseeable when plan was adopted
 - Bankruptcy
 - Substantial change in ownership
 - Merger
 - Substitution of new plan
 - Employee dissatisfaction with plan and preference for a current pay increase
 - Financial ability to continue the plan
 - Change in law
 - Passage of time
- Retroactive disqualification

Distress Termination

- If plan assets are less than benefit liabilities
- If plan sponsor meets at least one of these criteria:
 - Entity is in bankruptcy/insolvency proceeding
 - Reorganization in bankruptcy/insolvency
 - Unless distress termination occurs, entity will be unable to pay debts and continue in business
 - Unreasonably burdensome pension costs (demonstrated to satisfaction of PBGC) solely as a result of decline in its workforce

Distress Termination

- Establish proposed termination date
- Notice to affected parties of intent to terminate
 - Participants, beneficiaries, alternate payees, union
 - At least 60 days prior to but no more than 90
 - Content requirements
- Notice of intent to terminate (Form 600)
 - 60 to 90 days prior to the proposed termination date
- Distress Termination Notice (Form 601)
 - No later than 120 days after proposed termination date

Distress Termination

- Restrictions once Form 600 is filed
 - No loans
 - No distribution of assets or action to implement termination
 - Payments may only be made in the form of annuities
 - Must limit payments to guaranteed benefit or benefits which would be available if allocated under ERISA §4044
- Amount due PBGC is difference between plan assets and plan liabilities plus interest

Involuntary Terminations

- **Mandatory proceedings**
 - Plan does not have assets available to pay benefits due under the plan
 - Distress Termination where the assets are insufficient to pay guaranteed benefits
- **Discretionary proceedings**
 - Failed to meet minimum funding/Notice of Deficiency for excise tax for failure to meet minimum funding
 - Plan is unable to pay benefits when due
 - Plan has made a distribution to a substantial owner
 - Increased risk of long run loss to PBGC
- **Court order or agreement as to appointment of trustee**

Employer Liability

- Any person who is a contributing sponsor or member of its control group is liable to PBGC for the deficiency
- Lien on contributing employer and control group, but not to exceed 30% of collective net worth
- PBGC and contributing employer and control group members can negotiate alternative arrangements for satisfaction of liability
- Liability is joint and several

Employer Liability

- Mere changes in the form of entity, merger or liquidation into a parent do not change the liability, the successor entity assumes the liability
- Seller liability in asset sale (purchaser assumes plan)
 - May have no liability if assets are sufficient to pay guaranteed benefits
 - PBGC does have means to impose liability
 - Treat seller as a substantial employer
 - Treat transaction as intent to evade if plan terminates within 5 years
 - Deal terms should take into account PBGC liability

Options

- Can use average market value
 - 110% of 2008 market value
- Use full yield curve
- Freeze benefits
- Use unused carryover balances
- Minimum Funding Waivers
- Plan termination
- Legislative relief
- Waiver of benefits
- Systematically pay out benefits
- Aggressive solutions