

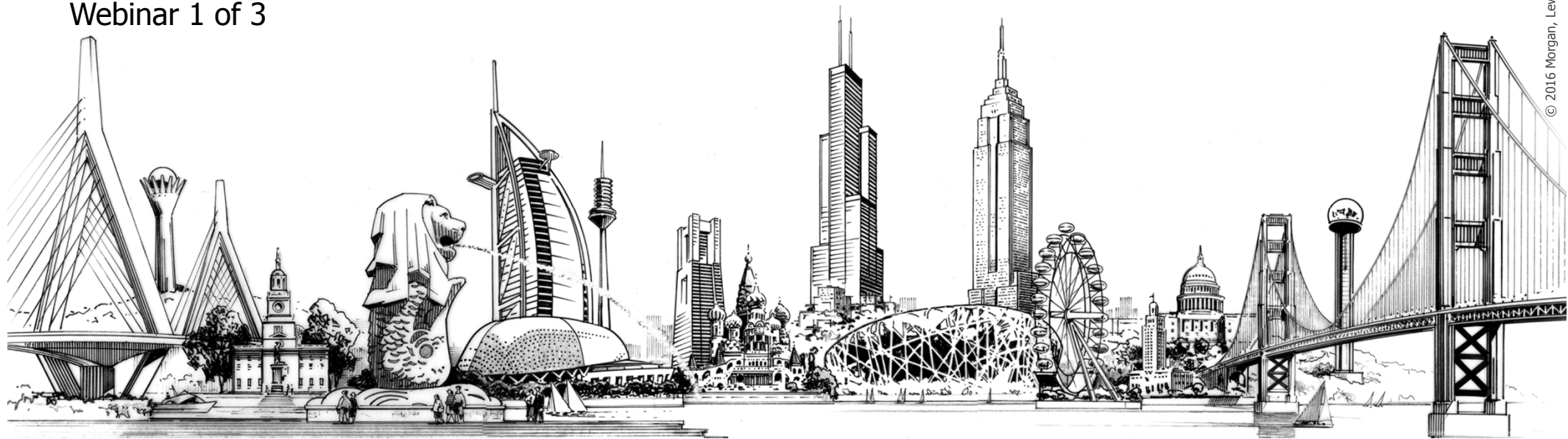
Morgan Lewis

# 2016 PLAN SPONSOR BASICS PLAN TERMINATION ISSUES

Presenters: Robert Abramowitz and Claire Bouffard

October 25, 2016

Webinar 1 of 3



# Overview

1. Why Terminate?
2. Analysis and Preparation
3. Selection of an Annuity Provider
4. From the NOIT to the PBGC Form 500
5. Second Thoughts – Withdrawing a Plan Termination
6. From Distributions to the Final Form 5500

**SECTION 01**

# **WHY TERMINATE?**

# Why Terminate?

- Pension risks are increasing
  - New proposed mortality table (increased life expectancy)
  - Interest rate volatility
  - Bipartisan Budget Act of 2015 further increased PBGC premiums
  - Changes in accounting rules accentuate volatility of pension plan exposure
- Costs of certain aspects of plan termination have decreased
  - Pension Protection Act of 2006 (PPA) changes result in the potential for calculation of smaller lump-sum payments than prior rules
  - Plans are generally better funded due to PPA-related funding requirements and improvements in the markets since 2008
  - Higher discount rate provided under MAP-21 (Interest Rate Stabilization) allows for full lump-sum payments
  - Strong balance sheets and access to inexpensive capital may allow more aggressive funding

**SECTION 02**

# **ANALYSIS AND PREPARATION**

# Feasibility of Termination

- Determine the funded status of the plan
  - Determination letter will require AFTAP certified by actuary
  - Determine whether additional contributions must be made
    - Plan must be fully funded on a termination basis (roughly 108%-112% of GAAP liability)
- Determine whether a “Commitment to Make a Plan Sufficient for Plan Benefits” is required
  - Agreement between the plan and the company that must be made in advance of the PBGC Form 500 filing so that the actuaries will be able to prepare Schedule EA-S
- Determine impact on financial statements
- Consider implications on existing plan investments

# Preliminary De-Risking

- Adding lump-sum distributions
  - Consider adding in advance of termination or providing lump-sum windows to allow deferred vested participants to take distributions in advance of termination
  - Limitations may apply to certain highly compensated employees
- Adding small-sum cashouts
- Freeze participation and accruals (if freeze is not already in place)
- Confirm that forfeiture provisions are adequate

# Additional Steps Prior to Termination

- Collective bargaining
  - May require union negotiation
  - Will require additional notices
- Missing participants and bad data
  - Must use certified mail, check employer records, check with beneficiaries on file, and conduct a commercial locator search
- Find consultant for assistance with annuity selection
- Determine date for termination
- Notify trustee, actuary, recordkeeper, and other service providers
- Consider whether any alternative arrangements (such as defined contribution plan) will be adopted
- Adopt resolutions terminating the plan (can be adopted any time prior to plan termination date)
- Determine whether SEC reporting is required



# Document Retention

- Plan sponsor must submit records to PBGC within 30 days of its written request
- Detailed documentation of each step in the termination process from the pre-termination steps should be retained for at least six years following filing of Form 501 or “indefinitely” if the company intends to remain in business
- Examples of documentation that should be retained include:
  - Participant documentation, including any missing participant searches
  - Actuary calculations and worksheets with underlying plan data
  - All plan documents and amendments
  - Executed distribution election paperwork returned
  - Annuity contracts, bank or trust statements, and other proof of payment of benefits

# Sample Termination Timeline

WHAT	WHEN
Notice of Intent to Terminate (NOIT) and 204(h) Notice	60-90 days before termination date (204(h) – 45 days)
Adoption of Termination Amendment and Resolutions	Before termination date
Termination Date	As selected
Notice to Interested Parties	10-24 days before determination letter filing
Determination Letter Filing	Prior to Form 500 filing
Commitment to Make a Plan Sufficient for Plan Benefits	Prior to Form 500 filing (if required)
Notice of Plan Benefits	Prior to Form 500 filing
PBGC Form 500	Within 180 days after termination date
Notice of Annuity Information	45 days before the annuity purchase (if not provided with NOIT)
Distribute Election Packages	30-90 days before distribution date
Distribute Assets	Due by later of 180 days after the PBGC's 60-day review period of the Form 500 or 120 days after receipt of favorable determination letter
Recover Excess Assets	After all benefits distributed – file Form 5330 by the last day of the month following reversion, if applicable
PBGC Form 501	Within 30 days after benefits are distributed
PBGC Audit	Varies (selected for audit in quarter following quarter in which termination was completed)
Final Form 5500	Last day of the seventh month after the final distribution

**SECTION 03**

# **SELECTION OF AN ANNUITY PROVIDER**

# Fiduciary Background

- Decision to terminate a plan and annuitize is a settlor decision
- Selection of a particular annuity provider in connection with the plan termination is a fiduciary decision
  - Duty of loyalty (exclusive benefit rule)
  - Duty of prudence (“prudent expert” standard)
    - Courts have interpreted the duty of prudence to be a “prudent expert” standard. A fiduciary doesn’t need to be an expert, but may need to consult one to make sure it meets the standard.
      - Interpretive Bulletin 95-1 indicated that fiduciaries need to consult with a qualified, independent expert to select an annuity provider unless they have the necessary expertise.
      - Interpretive Bulletin 95-1 states that fiduciaries are required by the duty of prudence to conduct an “objective, thorough, and analytical search” to select annuity providers.
  - Duty to diversify plan investments
  - Duty to follow plan terms

# Selection of Annuity Provider

- Interpretive Bulletin 95-1 states that fiduciaries “must take steps calculated to obtain the safest annuity available, unless under the circumstances it would be in the interests of participants and beneficiaries to do otherwise”
- Factors to be considered in the search include (List from IB 95-1):
  - The quality and diversification of the annuity provider’s investment portfolio;
  - The size of the insurer relative to the proposed contract;
  - The level of the insurer’s capital and surplus;
  - The lines of business of the annuity provider and other indications of an insurer’s exposure to liability;
  - The structure of the annuity contract and guarantees supporting the annuities, such as the use of separate accounts; and
  - The availability of additional protection through state guaranty associations and the extent of their guarantees.
- It is possible that more than one provider can offer the safest annuity available.

# Terms of the Annuity Contract

- Annuity contract must be able to preserve certain terms of the plan
  - All distribution options available to the participants must be available under the annuity contract, including timing of distributions
  - Contracts should be reviewed to ensure that plan terms such as forms of distribution and interest rates are accurately reflected
  - Five-year averaging rules may apply to the interest crediting rate and the interest rate used to convert the account balance to an annuity on or after normal retirement date for hybrid plans
- Consider whether benefits should be funded through insurer's general account or through separate accounts

**SECTION 04**

# **FROM THE NOIT TO THE PBGC FORM 500**

# Notices Prior to Termination Date

- Notice of Intent to Terminate (NOIT)
  - Must be provided to participants (active, retired, or deferred vested), alternate payees, beneficiaries of deceased participants, and employee organization representing participants
  - Must be provided 60-90 days prior to the termination date
  - Consider requesting missing information, such as spouse's date of birth, in mailing
- Notice of Annuity Information (NOAI) – If annuity provider is unknown at this time, a supplemental notice with the name of the annuity provider must be provided at least 45 days prior to the annuity purchase
- 204(h) Notice – only required for plans in which participants continued to accrue benefits
  - Must be provided 45 days prior to date accruals stop (e.g., termination date)
  - Only required for participants affected by freeze



# Plan Amendments

- Plan must be amended prior to termination to:
  - Comply with all applicable law
  - Provide 100% vesting to all participants with accrued benefits as of the termination date
  - Establish a termination date
- If the plan is filed for a determination letter with the IRS, the plan needs to be amended and restated prior to termination and may need to be amended again after termination if requested by the IRS. Any amendment requested by the IRS must be adopted within 91 days of the date of the determination letter.

# IRS Determination Letter Filing

- Final determination letter filing is not required, but is very common and usually recommended
- Determination letter request must be submitted before the first anniversary of the termination date or date of adoption of termination resolutions, whichever is later. However, if the company wishes to wait to make distributions until after the plan has received a favorable determination letter, the determination letter must be submitted before the Form 500 is filed with the PBGC.
- Plan restatement is required, as well as sample benefit calculations
- If the plan is also qualified in Puerto Rico, a determination letter must be filed by the due date to file the company's Puerto Rico tax return

# PBGC Form 500

- Notice of Plan Benefits (NOPB) must be delivered to each participant, beneficiary of a deceased participant, and alternate payee on or before the date of filing of this form
  - If a participant dies or submits a QDRO during the pendency of the termination, the beneficiary or alternate payee must be given an NOPB promptly after the proposed termination date and on or before the distribution date
- Must be filed within 180 days following the termination date
- PBGC has 60 days to review for compliance, but this period may be extended if agreed to by the PBGC and plan administrator in writing
- Assets must then be distributed by the later of 180 days following the end of the PBGC's 60-day review or 120 days after the favorable determination letter is issued. An extension may be requested.
- PBGC has indicated that it will audit all plans with more than 300 participants and will randomly select plans for audit with 300 or fewer participants

**SECTION 05**

# **SECOND THOUGHTS – WITHDRAWING A PLAN TERMINATION**

# Withdrawing a Plan Termination

- If the company decides not to proceed with the plan termination prior to the distribution of assets, the steps of the termination must be undone
  - If termination amendments have been adopted, the plan must be amended
  - If termination resolutions have been adopted, resolutions must be adopted canceling the resolutions
  - If the NOIT was provided to affected individuals, the affected individuals must be notified that the termination has been canceled
  - If the Form 500 has been filed, the PBGC must be notified
  - If the plan applied for a determination letter, the plan should request that the application be withdrawn

**SECTION 06**

**FROM DISTRIBUTIONS  
TO THE FINAL FORM  
5500**

# Maintaining Compliance

- After the termination date, but prior to the date the last distribution is processed, the plan must continue to operate in accordance with its terms
  - QDROs must continue to be reviewed and processed
  - Participants must receive all required notices
    - Annual funding notices
    - Summary plan descriptions, summaries of material modifications
    - Individual benefit statements
  - Claims and Appeals Processing
  - Required Minimum Distributions
  - Form 5500 and other filings
  - PBGC premiums must be paid
  - Distributions processed on request

# Distribution of Assets

- Benefit election forms must be distributed to participants not less than 30 days before the distribution date.
- Annuity contracts and lump sums must be distributed by the later of 180 days following the end of the PBGC's 60-day (or extended) review or 120 days after the favorable determination letter is issued. An extension may be requested.
- Certificates of insurance and any supplemental notice of annuity contract must be given to participants within 30 days after they become available, but no later than 90 days following the distribution deadline.
- If participants are missing, amounts can be paid to the PBGC, in accordance with the PBGC's missing participant program
- After all benefits are distributed, excise tax may be avoided if any excess assets are transferred to a successor plan



# Additional Post-Termination Filings and Reports

- PBGC Form 501 (with PBGC Schedule MP for missing participants)
  - Due no later than 30 days after all benefits are distributed; may not be extended, but the PBGC will not assess a penalty if information is filed within 90 days of distribution deadline.
- IRS Form 5330 (in the event of any reversion of assets)
  - Due by the last day of the month following the month of the reversion
- IRS Form 1099-R
  - For individuals who received lump sums, due January 31 of the year following distribution
  - For all others, due February 28 of the year following the year of distribution
- IRS Final Form 5500
  - Due last day of the seventh month following the final distribution (extension may be available)
- Final PBGC Premium Filing
  - October 15 for calendar year plans (adjusted to next business day if due date falls on the weekend)

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**QUESTIONS?**

# Thank You

Thank you for joining our webinar today.

Upcoming webinars in our “2016 Plan Sponsor Basics” series:

- **401(k) Issues** | Wednesday, November 9 | 1:00–2:00 pm ET (*Rescheduled from October 11*)
- **Plan Audit Issues** | Wednesday, November 16 | 12:00–1:00 pm ET

Register at <https://morganlewisevents.webex.com/>

We hope you have found this to be useful and informative. Again, if you have any feedback or suggestions, please let us know. Thank you for participating and we look forward to seeing you at future events.

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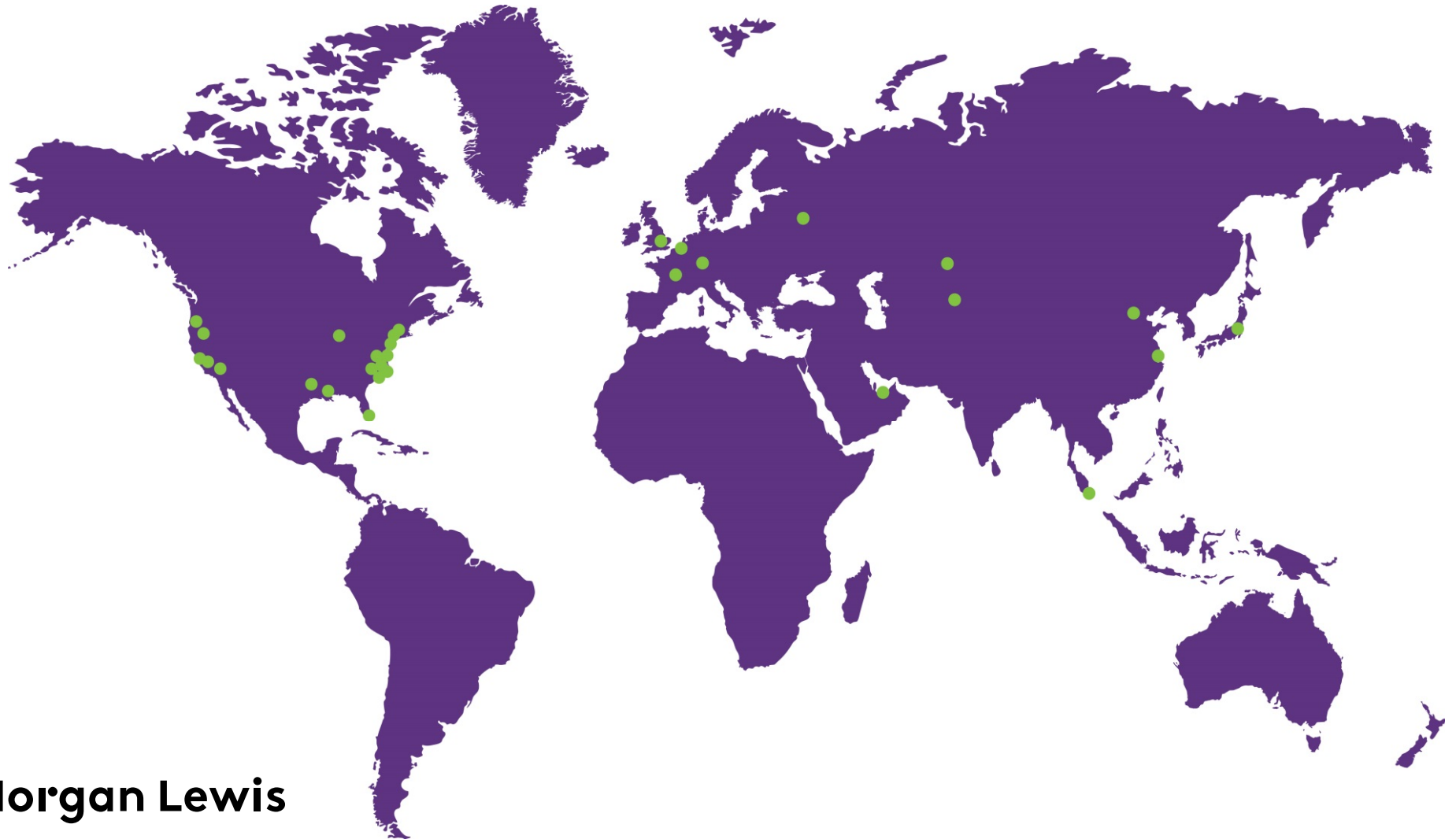
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