The Challenges Of Abandoned Retirement Plans In Ch. 7

By **David Goodrich and Nancy Simons** (November 27, 2024)

The administration of abandoned individual-account defined contribution plans when the sponsor is liquidating under Chapter 7 bankruptcy has traditionally been a complex and laborious process for Chapter 7 bankruptcy trustees.

David Goodrich

When a plan is abandoned, the custodian of a retirement plan, such as a 401(k) provider, is left with plan assets and plan beneficiaries. Stepping into the shoes of a bankruptcy entity, trustees have the power to terminate plans and assist beneficiaries with the transfer of plan assets.

Nancy Simons

With the enactment of the U.S. Department of Labor interim final rule for terminating retirement plans abandoned by employers, in effect since July 16, the hope is that its provisions will alleviate the administrative headaches and costs that trustees encounter when terminating plans in bankruptcy.

The rule includes (1) standards for determining when a plan is abandoned, (2) a simplified procedure for winding up an abandoned plan and distributing benefits, and (3) guidance on the trustee's ability to initiate and carry out the windup process for an abandoned plan.

Even with streamlined procedures, however, managing an abandoned plan can present challenges for trustees who are already burdened with the myriad of responsibilities involved in a Chapter 7 bankruptcy case.

Therefore, a fundamental understanding of the new DOL rule, its effect on trustees, and lingering questions the new DOL rule raises is essential for trustees attempting to navigate their responsibilities in unwinding abandoned plans in bankruptcy.

Overview of the DOL Interim Final Rule and Its Intent

The rule considers a terminated retirement account abandoned once the plan sponsor files for Chapter 7 bankruptcy. The trustee may serve as the qualified termination adviser, or QTA, upon appointment as trustee. The trustee may delegate his or her duties to a designee. The designee must, however, be a custodian QTA or an independent bankruptcy trustee practitioner that is not the appointed trustee.

Further, the IFR requires that a trustee (1) make reasonable and diligent efforts to determine if the plan is owed any contributions, (2) if contributions are greater than a de minimis amount, appoint a designee to terminate and windup the plan, (3) monitor the designee to ensure compliance with ERISA, and (4) report any activity to the DOL that may a breach of a fiduciary duty by any former plan fiduciary.

The DOL had good intentions in expanding the abandoned plan program to encompass plans with sponsors undergoing Chapter 7 bankruptcy. Typically, an entity that files Chapter 7 is no longer operating and has only a few remaining key officials that might be available to

assist trustees with their investigation of abandoned plans.

Frequently, entities that file a Chapter 7 bankruptcy ceased operations several years before the bankruptcy filing. In that situation, key employees or officers with knowledge of financial records and corporate affairs, including critical information relating to plans, are difficult to locate and often have foggy memories about plans.

Prior to the rule's enactment, trustees were not expressly authorized to serve in the QTA function. As a consequence, trustees were limited in their ability to manage the unwinding of a plan. Without familiarity with the process of terminating a plan or having access to the program, trustees and plan participants encountered significant delays and roadblocks along the way.

The interim final rule is intended to streamline the plan windup process for bankruptcy trustees. However, despite the good intentions behind the expansion of the abandoned plan program, several issues and challenges for trustees remain.

Identifying Abandoned Plans Presents Challenges

One significant question that has not been addressed by the rule is the extent of the trustee's responsibility to determine if a plan exists and where to seek out this information. Typically, the existence of a plan is not disclosed in the debtor's bankruptcy schedules or statement of financial affairs because there is no specific place for the disclosure of a plan.

Further, the mandatory Section 341(a) questions for entities in Chapter 7 do not include a question regarding abandoned plans. Unless a trustee specifically asks about the existence of a plan, the trustee will not likely be aware of an abandoned plan. And should the bankruptcy case close, a trustee no longer has the power to act for the bankruptcy entity or its creditors and, consequently, the plan cannot be administered by the trustee.

Trustees may need to conduct a thorough review across different bankruptcy schedules to identify a possible plan. For example, Schedule E/F typically lists creditors with unsecured claims, including priority unsecured claims, such as certain types of retirement accounts. However, the presence of retirement accounts here may be inconsistent, as some may not be considered priority claims.

Further, an entity's obligation to a retirement plan may be completely fulfilled and, therefore, a debt may not exist. If there is no debt owed to an abandoned plan, the abandoned plan will not be listed or mentioned in Schedule E/F.

As Schedule G is often used to list executory contracts and unexpired leases, this schedule might contain clues to an abandoned retirement plan if the retirement plan is an unexpired executory contract. Rarely, if ever, is an abandoned plan mentioned as an unexpired executory contract in Schedule G.

Where a plan trustee has performed all his or her obligations under an abandoned plan, the plan may not constitute an executory contract and, therefore, it may not need to be listed in Schedule G.

Barriers to Accessing Records and Information

Another challenge not addressed by the rule is the trustee's access to records. Not every business has an organized and sophisticated recordkeeping system where plan information

and details can be found.

Many entities enter bankruptcy with little or no formal financial records. This is especially true where records were kept on a third-party server such as QuickBooks and the subscription is not paid, which terminates the entity's access to its financial records. An entity with limited recordkeeping may likely fail to provide anything that would signal the existence of an abandoned plan to a trustee.

Furthermore, if a plan sponsor is identified with a known financial institution, it may be challenging for trustees to gain access to the necessary personally identifiable information, or PII, for employees enrolled in the plan, which would limit the ability to manage its administration.

Financial institutions often refuse to disclose protected information to trustees as a matter of policy or as a result of a statutory or regulatory mandate. Even when a trustee is the holder of the privilege to access PII, access is often denied because of a party's unfamiliarity with the bankruptcy process and the role of a trustee.

This barrier creates two key challenges for trustees. First, trustees may be unable to verify beneficiary details or address specific administrative needs without PII. This limitation affects the trustee's ability to properly manage or distribute plan assets according to fiduciary standards.

Second, trustees may be forced to depend on the financial institution's willingness to assist in managing the plan, which could be further complicated by the institution's policies or reluctance to disclose sensitive information without a court order.

In the absence of reliable records and limited access to PII, trustees must often navigate incomplete information while ensuring they remain compliant with both bankruptcy requirements and privacy regulations. Addressing these issues may require guidance on how trustees should request information or potential legal measures that can authorize limited PII access to facilitate plan administration while upholding privacy laws.

Time and Cost Burdens

The time and cost required for trustees to manage abandoned plans should not be underestimated. Trustees already are stretched thin with limited fee compensation and any added responsibilities can create a significant burden.

The typical trustee may be responsible for between five and 100 cases per month. Adding in additional responsibilities across a high number of cases can make the administration of abandoned plans unmanageable, especially for no-asset cases. Trustees often maintain staff and must pay operational costs for their practices.

In addition to the $60 per case fee trustees receive — which may go unpaid if a bankruptcy entity receives a filing fee waiver — trustees receive a commission in cases where distributions are made to creditors.

The limited compensation structure for a trustee often requires a trustee supplement his or her income with other work, i.e., professional services as a lawyer or an accountant, and the trustee's "other job" decreases the time available for the trustee to perform services.

In cases where a trustee has been appointed and the only compensation to be paid is $60, a

trustee who is burdened with an abandoned plan is performing services to beneficiaries of the abandoned plan for no compensation.

Further, locating a QTA where contributions exceed the de minimis standard may be problematic. In a no-asset case, a trustee will be required to retain a QTA with no resources to pay the QTA. Although trustees may occasionally receive pro bono services, the IFR imposes a financial burden on the trustee and QTA in situations where $60 is the only compensation paid to the trustee.

Trustees must shoulder the time-intensive requirements of managing abandoned plans, often without additional fees, placing financial strain on their operations.

Heightened Liability Risks

The expansion of duties related to abandoned plans also exposes bankruptcy trustees to heightened liability risks. As trustees take on the responsibility of locating, managing and potentially disbursing retirement plan assets, they assume new fiduciary obligations that carry significant legal implications.

As the real party-in-interest in a Chapter 7 bankruptcy case, trustees are occasionally sued in their fiduciary capacity triggering a need for a defense. In cases with little to no assets, the retention of a lawyer requires the trustee to negotiate a pro bono representation arrangement with his or her lawyer.

Should an issue arise with an abandoned plan, the trustee will likely be saddled with litigation or an administrative process that will be expensive and time-consuming, and, should the trustee's immunity from personal liability be waived, personal liability for acts taken in connection with an abandoned plan can put them at risk for litigation.

Conclusion

The Department of Labor's interim final rule marks an important step toward addressing the long-standing challenges associated with abandoned individual-account defined contribution plans in Chapter 7 bankruptcies.

By allowing bankruptcy trustees to serve as QTAs, the rule introduces a streamlined process that aims to reduce administrative obstacles and provide clarity for trustees. However, as this article has outlined, practical challenges remain that may hinder the effective implementation of these provisions.

For the abandoned plan program to reach its full potential, further refinements are needed. Clearer guidance on locating plan information, mechanisms to facilitate access to necessary records, protections against heightened liability, and, critically, adjustments to trustee compensation are vital for sustainable administration.

Only with these improvements can the program support bankruptcy trustees in navigating abandoned plans efficiently while upholding their commitment to beneficiaries and creditors. The success of this initiative ultimately rests on balancing the intent to protect employee retirement assets with the practical needs and limitations of trustees in bankruptcy cases.

David M. Goodrich is a partner at Golden Goodrich LLP.

Nancy Simons is a regional director at Stretto.

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