

Terminating a Defined Benefit Plan Checklist

A Lexis Practice Advisor® Checklist by
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This checklist outlines the requirements for terminating a single-employer defined benefit plan covered by Title IV of the Employee Retirement Income Security Act of 1974 (ERISA). If the plan assets are sufficient to pay the benefit liabilities, the plan sponsor can voluntarily begin the process of terminating the plan in a “standard termination.” If there are insufficient plan assets, the only options for plan termination are a “distress termination” initiated by the plan sponsor or an “involuntary termination” initiated by the Pension Benefit Guaranty Corporation (PBGC). This checklist provides an overview of the procedural steps involved in the various types of plan terminations.

For additional information regarding terminations of PBGC-insured plans, please see (1) [Defined Benefit Plan Standard Terminations](#), (2) [Defined Benefit Plan Distress Terminations](#), and (3) [Defined Benefit Plan Involuntary Terminations](#). Also see [IRS: Terminating a Retirement Plan](#). For information on the type of plans that are subject to the PBGC insurance program, see Lexis Tax Advisor -- Federal Topical § 1C:15A.05.

Introduction

Plan sponsors may consider terminating a defined benefit plan for many reasons, including cost, replacement of the defined benefit plan with another type of retirement plan, substantial changes in ownership of the company, etc. Once the plan sponsor ultimately decides to proceed with the termination, you will need to consider specific rules and time lines that must be followed. As you might expect, the termination process requires accurate historical data, significant communications with plan participants, and reporting and disclosure to agencies such as the Internal Revenue Service (IRS) and the PBGC.

Standard Terminations

First and foremost, a standard termination requires that the plan have sufficient assets to satisfy all benefit liabilities as of the distribution date, whether or not such benefits are vested. All accrued benefits indeed become vested upon plan termination. I.R.C. § 411(d)(3). As the termination process may be expensive (engaging the plan actuary, plan accountant, and selecting insurers), the plan should be adequately funded to meet these additional expenses in addition to making benefit payments. Otherwise, the plan sponsor should satisfy these expenses from non-plan assets. If plan assets are insufficient, two options are available to facilitate the standard termination of an underfunded plan:

- Providing supplemental employer contributions to make the plan whole –or–
- The “majority owner” (defined as a participant having a 50% or greater interest in the plan sponsor) can forego benefits (with spousal consent)

29 C.F.R. § 4041.21(b).

Direct the plan sponsor to fund the plan before the proposed termination date. Once the decision is made to pursue a standard termination, the plan sponsor must take the following steps:

- Prepare a board resolution approving the prospective plan termination. The board resolution should state:
 - The effective date of the proposed plan termination (this is an important date, as it marks the end of funding obligations and benefit accruals and will drive the termination time line) –and–
 - Provide any grants of authority necessary to effectuate the termination, including the filing on IRS Form 5310 that is necessary to obtain a determination from the IRS regarding the qualified status of the plan on termination
 - Prepare and adopt a plan amendment to:
 - Terminate the plan as of the effective date set forth in the board resolution
 - Amend the plan for all current law that applies to the plan and taking effect as of the date of termination
 - Cease plan contributions
 - Provide for full vesting of any affected participants that are not already vested
 - Add a lump sum window period (if applicable) –and–
 - Permit the plan to distribute benefits as soon as administratively feasible in accordance with plan terms following the termination date
 - Prepare and distribute an ERISA Section 204(h) Notice to “affected parties” at least 45 days before the proposed termination date. 26 C.F.R. § 54.4980F-1, Q&A-9(a). Affected parties include participants, beneficiaries of deceased participants, alternate payees under qualified domestic relations orders, and any labor unions representing participants. For more information about the Section 204(h) Notice, see [ERISA 204\(h\) Notice Requirements](#). For a sample suspension notice, see [ERISA § 204\(h\) Notice of Benefit Accrual Reduction or Cessation](#).
 - Prepare requests for, and solicit, annuity quotes from annuity providers (if applicable).
 - Prepare and distribute the Notice of Intent to Terminate (NOIT) to affected parties at least 60 days and not more than 90 days before the proposed termination date. 29 C.F.R. § 4041.23. See [Defined Benefit Plan Standard Terminations – The Termination Process Step-by-Step](#) and [Notice of Intent to Terminate \(Defined Benefit Plan Termination\)](#).
 - Prepare and file required IRS forms. Use IRS Form 5310 Application for Determination for Terminating Plan to request a determination of the plan’s qualified status on termination. This provides assurance, among others, to participants receiving lump sums that they qualify as “eligible rollover distributions” under I.R.C. § 402(c)(4). See Applying for an IRS Determination Letter under [Defined Benefit Plan Standard Terminations – The Termination Process Step-by-Step](#), [Determination Letter Application Procedures](#) and [IRS: Terminating a Retirement Plan, for more information](#).
 - **IRS Form 6088**. Distributable Benefits from Employee Pension Benefit Plans must be submitted with Form 5310.
 - **IRS Form 5310**. Application for Determination Upon Termination should be submitted before or concurrently with PBGC Form 500, Standard Termination Notice Single-Employer Plan Termination.
 - **IRS Form 8717**. User Fee for Employee Plan Determination Letter Request must be submitted with Form 5310.
 - Prepare and distribute Notice of Plan Benefits (NOPB) to affected parties no later than the day on which the plan files PBGC Form 500 (see next step below). 29 C.F.R. § 4041.24(a). See [Defined Benefit Plan Standard Terminations – The Termination Process Step-by-Step](#) and [Notice of Plan Benefits \(Defined Benefit Plan Termination\)](#).
 - Prepare and file [PBGC Form 500, Standard Termination Notice Single-Employer Plan Termination](#), (including the Schedule EA-S) with the PBGC on or before the 180th day after the proposed termination date. 29 C.F.R. § 4041.25(a). The PBGC has 60 days after receiving a complete Form 500 to review the information and documents submitted for the termination to determine whether it will issue a notice of noncompliance in accordance with ERISA § 4041(b)(2)(C) (29 U.S.C. § 1341(b)(2)(C)).
 - If any benefits may be distributed in annuity form, prepare and distribute a Notice of Annuity Information (NOAI) to affected parties. This is provided, generally, with the NOIT. If the NOAI does not identify all annuity providers, distribute a supplemental notice identifying annuity providers no later than 45 days before the distribution date. 29 C.F.R. § 4041.27(a), (b)(2). See Notice of Annuity Information under [Defined Benefit Plan Standard Terminations – The Termination Process Step-by-Step](#).
 - Prepare and distribute the benefit election forms to affected parties. This identifies the form that the insurance annuity will take (i.e., a single life annuity for unmarried
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participants and a qualified joint and survivor annuity for married participants, unless they are permitted to elect a different form of payment. For a sample QJSA Notice and a QJSA waiver that meets I.R.C. § 417 notice and waiver requirements, see [QJSA Notice \(Defined Benefit Plan\)](#) and [QJSA Waiver\(Spousal Consent\) \(Defined Benefit Plan\)](#).

- o This includes all (now) vested participants who have a remaining accrued benefit in the plan. Participants in-pay status and those about to begin payment will receive an annuity contract providing for active annuity payout.
- o Other participants will receive a certificate for a deferred annuity.
- Distribute plan assets to satisfy all plan benefits by the distribution deadline. The distribution deadline is the later of:
 - o 180 days after expiration of PBGC's 60-day review period (29 C.F.R. § 4041.28(a)(1)(i)) –or–
 - o 120 days after receiving a favorable IRS determination letter (provided that Form 5310 was submitted before or concurrently with PBGC Form 500) (29 C.F.R. § 4041.28(a)(1)(ii))
 - If the plan has missing participants, follow the rules for distributing benefits of missing participants described in PBGC Form MP-100. See [Locating Missing Participants in Qualified Retirement Plans – Missing Participants in Terminating Defined Benefit Plans](#) and [Missing Participant PBGC Program Procedures Checklist](#). Amounts satisfying the accrued benefit of missing participants may be sent (1) to the annuity provider(s) (with a list of these amounts and annuity providers being provided to the PBGC) or (2) you can transmit the amounts to the PBGC. See [PBGC, Determining amount to transfer to PBGC](#).
- Distribute the participant tax notice required under I.R.C. § 402(f) where you are paying a lump sum to the participant. For a sample notice, see [Eligible Rollover Distribution Notice \(Non-Roth Contributions\)](#).
 - o Participants who qualify for a cash out under I.R.C. § 417(e) (where the plan permits) can receive immediate payment without regard to spousal consent from a married participant. If the plan has been amended for a lump sum optional form of payment for amounts exceeding \$5,000, obtain spousal consent from married participants. To learn more about offering a lump sum option, see [Lump Sum Window Programs](#).

- Prepare and distribute an NOAI to participants receiving their plan benefits in the form of an annuity no later than 30 days after all plan benefits are distributed. 29 C.F.R. § 4041.27. For information about finding an annuity provider(s), see Dep't of Labor Interpretive Bulletin 95-1, 29 C.F.R. § 2509.95-1.
- Prepare and file [PBGC Form 501](#), Post-Distribution Certification for Standard Termination, with the PBGC no later than 30 days after distributing all plan benefits. 29 C.F.R. § 4041.29(a). No penalty is imposed for late filing, however, until 90 days after the last benefit distribution. 29 C.F.R. § 4041.29(b).
- Make the final payment of the PBGC's premiums, which must be submitted to the PBGC by the earlier of (1) the regular due date, or (2) the date the sponsor files PBGC Form 501.
- Prepare and file the final Form 5500 for the plan year of termination. This must be submitted by the last day of the seventh month after the month in which the plan distributed all of its assets (which likely is a short plan year). [IRS Form 5500 Instructions](#), p. 4. The final Form 5500 must show no plan assets, liabilities, or participants.

Distress Terminations

A distress termination is available for plans that do not have sufficient assets to pay all benefit liabilities under the plan for which a plan sponsor successfully demonstrates to the PBGC that it (with its controlled group) is in financial distress. A distress termination is initiated by the plan sponsor (as opposed to an involuntary termination that is initiated by the PBGC, see below). In a distress termination, the plan sponsor and each member of its controlled group must meet one of four distress tests specified by ERISA. 29 C.F.R. § 4041.41(c). See [Defined Benefit Plan Distress Terminations](#) for more information regarding these tests and 29 C.F.R. § 4041.41–4041.51. Also see [PBGC, Distress Termination Filing Instructions](#). In a distress termination, the plan sponsor must take the following steps:

- Consider scheduling a pre-filing consultation call with PBGC's Corporate Finance and Restructuring Department to discuss the filing process and ensure the filing of a distress termination is appropriate for the plan sponsor. See [PBGC, Distress Terminations](#).
- Prepare a board resolution approving the plan termination (the PBGC must agree to this date). The board resolution should:
 - o Identify the plan termination effective date (this is an important date, as it marks the end of funding

- obligations and benefit accruals and will drive the termination time line), which will be the bankruptcy filing date if the plan sponsor has filed for relief under the Bankruptcy Code. 29 C.F.R. § 1322(g) –and–
- Provide any grants of authority necessary to effectuate the termination
- Prepare and adopt a plan amendment to:
 - Terminate the plan as of the plan terminative effective date set forth in the board resolution
 - Cease plan contributions –and–
 - Provide for full vesting of any affected participants that are not already vested
 - Identify which one of the four distress tests can be satisfied by each contributing sponsor and controlled group member.
 - Prepare and distribute an ERISA Section 204(h) Notice to affected parties at least 45 days before the proposed termination date. See [ERISA § 204\(h\) Notice of Benefit Accrual Reduction or Cessation](#).
 - Prepare and file [PBGC Form 600](#), Distress Termination Notice of Intent to Terminate, including information about which distress test the plan satisfies, in satisfaction of ERISA § 4041(c)(1)(B) (29 U.S.C. § 1341(c)(1)(B)). Form 600 must be provided no later than 60 days before the proposed plan termination date and no earlier than 90 days before. 29 C.F.R. § 4041.43(a)(1).
 - Prepare and distribute the NOIT to affected parties no later than the date the Form 600 is filed with the PBGC. ERISA § 4041(c)(1)(A) (29 U.S.C. § 1341(c)(1)(A)); 29 C.F.R. § 4041.43(a). See 29 C.F.R. § 4041.43(b) for contents of the NOIT. The plan must also disclose whatever information was submitted to the PBGC within 15 days of a participant's or beneficiary's request, or whenever the plan updates the information given to the PBGC that was the subject of a previous request. ERISA § 4041(c)(2)(D)(i) (29 U.S.C. § 1341(c)(2)(D)(i)).
 - PBGC will issue a notice of compliance or a notice of noncompliance by the proposed termination date. 29 C.F.R. § 4041.44(a).
 - Beginning on the proposed termination date, continuing plan administration including benefit distributions (other than noncash out lump sums) reduce the benefits of those participants currently being paid to the estimated benefit amounts which will be payable by PBGC upon termination under ERISA following 29 C.F.R. Part 4022, Subpart D. See PBGC, Guaranteed Benefits.
- Prepare and file [PBGC Form 601](#), Distress Termination Notice Single-Employer Plan Termination, (including the Schedule EA-D) on or before the 120th day after the proposed plan termination date. 29 C.F.R. § 4041.45. Additionally, a 60-day advance notice is required to be given to the affected parties. 29 C.F.R. § 4041.43(a)(1)(3).
 - If the plan has sufficient assets to provide at least all guaranteed benefits, as determined by the plan's enrolled actuary, the plan does not need to provide participant and benefit information, unless the PBGC requests, but must meet certain requirements for notifying participants, distributing benefits and filing PBGC Form 602, Distress Termination Post-Distribution Certification. 29 C.F.R. § 4041.45(b)(2).
 - If the plan terminates in a distress termination without sufficient assets to pay all benefit liabilities, as determined by the plan's enrolled actuary:
 - The plan sponsor must provide all participant and benefit information to the PBGC by the later of (1) 120 days after the proposed termination date, or (2) 30 days after receipt of the PBGC's determination that the requirements for a distress termination have been satisfied.
 - The plan sponsor must provide participants and beneficiaries at least all PBGC-guaranteed benefits (and if unable to, the PBGC will consider an involuntary termination), the sponsor and each controlled group member thereafter being jointly and severally liable to the PBGC for the total amount of the unfunded benefit liabilities. ERISA § 4062(b) (29 U.S.C. § 1362(b)); 29 C.F.R. 4041.45(b)(1). –and–
 - The plan sponsor and its controlled group are jointly responsible for paying a termination premium to the PBGC. ERISA § 4006(a)(7) (29 U.S.C. § 1306(a)(7)).
 - Prepare and file [PBGC Form 602](#), Distress Termination Post-Distribution Certification, with the PBGC no later than 30 days after distributing all plan benefits.

Involuntary Terminations

An involuntary termination is initiated by the PBGC after a determination is made that a plan has insufficient assets to pay benefits under the plan. A determination of the plan's inability to pay benefits is made at the PBGC's discretion based on one of three statutory findings (e.g., failure to

meet minimum funding requirements, the plan will be unable to pay benefits when due, a reasonable expectation that an unreasonable increase in “long run loss” may occur, or there has been a distribution to a substantial owner, causing the plan to become underfunded). The PBGC will then issue a notice of determination to the plan administrator, and the plan administrator and the PBGC will enter into an agreement to terminate the plan on a mutually agreed upon proposed termination date. Where the plan sponsor disagrees with the PBGC’s proposed termination date, the PBGC may seek a court order to terminate the plan. For more information on the involuntary termination process, see [Defined Benefit Plan Involuntary Terminations](#).

The plan sponsor and all members of its controlled group still will be responsible for payment to the PBGC of a termination premium. ERISA § 4006(a)(7) (29 U.S.C. § 1306(a)(7)). For controlled group information, see [Controlled Group and Affiliated Service Group Rules for Employee Benefit Plans](#).

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Virginia is a member of the Employee Benefits + Compensation Group. Her practice focuses on the representation of employers with respect to retirement and welfare benefits, executive compensation, and benefits issues in corporate transactions. Ms. McGarrity advises clients on the implications of tax, securities, labor, and other laws, including ERISA and the Sarbanes-Oxley Act. Ms. McGarrity partners with clients to develop benefit plan design and compliance strategies that meet both their business objectives and the legal requirements applicable to their employee benefit plans. She counsels clients with regard to the full spectrum of employee benefit matters, including qualified defined benefit and defined contribution plans, defined benefit plan funding, nonqualified programs and executive compensation arrangements, plan compliance and correction, health and welfare programs, participation in multiemployer plans, withdrawal liability, and mergers and acquisitions. Ms. McGarrity has spent significant time understanding and speaking on health care reform issues.

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