

# LIGHTS OUT FOR A 401(k) PLAN

Just as HR has to know the rules for setting up and overseeing a 401(k) plan, it should know the rules for shutting one down.

By Joanne Sammer

Every year hundreds, perhaps thousands, of the 400,000-plus 401(k) plans in operation are dissolved, for reasons that range from bankruptcy to merger. Although a 401(k) “must be established with the intention of being continued indefinitely,” according to the Internal Revenue Service (IRS), sometimes, as the agency acknowledges, business circumstances can cause a plan to be terminated.

The vast majority of plans that are closed are at small firms, experts say. “Most plan terminations—up to 90 percent—involve microplans with fewer than 100 participants,” says Doug Johnson, president of the Keane Organization, a consulting firm in Wayne, Pa., whose services include 401(k) plan terminations.

Often, Johnson says, plans are terminated because they “have low enrollment and have trou-

ble passing nondiscrimination testing, even though these plan sponsors may have tried unsuccessfully to increase participation by stepping up communication or introducing automatic enrollment.”

But any company, regardless of size, can find it has to shut down a 401(k) plan if it is going out of business, relocating to another country, or involved in a merger or acquisition. In fact, plan terminations in larger companies are usually a result of the combining of two companies, each with a 401(k) plan. In such circumstances, one of the 401(k)s becomes redundant.

Although companies have the option of combining existing 401(k) plans after the merger or acquisition is complete, some choose for various reasons to terminate the target company's plan and enroll that company's employees in the new parent company's plan.

No matter what the reason for shutting down a 401(k) plan, HR must address numerous—sometimes complicated—issues to make sure the plan is shuttered correctly.

## When HR Steps In

Closing a 401(k) requires great attention to detail, as illustrated by the sale of Boucher Communications, a Fort Washington, Pa., publisher of vision care journals. When Boucher was purchased by another company in 2005, director of operations Mary Steigerwalt had to manage the termination of Boucher's 401(k) plan before the purchase was completed.

“It can be a challenge to make sure everything is in compliance,” Steigerwalt says, recalling the process of closing the plan. “You need to have someone reviewing plan documents, making sure the plan has all of the necessary updates over the

# SWITCHING VENDORS

As with a termination of a 401(k), transferring a plan from one vendor to another requires great attention to administrative details, compliance requirements and participant needs. Along the way, HR professionals must resolve questions such as:

- Can the company's payroll operation or its payroll services provider accommodate the new vendor?
- Will the departing vendor cooperate during the changeover?
- How can the company minimize the blackout periods during which employees cannot make changes to the accounts or investments?
- Has the company communicated clearly and frequently enough to employees about the transfer?

“No detail is too small in these situations,” says Richard Koski, managing director at Buck Consultants in its Secaucus, N.J., office.

Despite the effort involved, many plan sponsors are showing themselves ready to change providers if their current one is unable to deliver on their needs. Atop the list of needs for most

employers are “full transparency of fees and expenses, and adequate investment options and performance,” Koski says.

For example, after many years with the same vendor, Gloria Heyer, firm administrator for the Denver law offices of Otten, Johnson, Robinson, Neff & Ragonetti, began looking for a new 401(k) provider after getting negative feedback from participants about late statements, inaccurate records and other matters.

The firm also wanted to expand its investment options, allow participants to have a brokerage account within their 401(k) plan accounts, and gain access to more-robust investment planning and modeling tools.

The transition to a new provider went smoothly, Heyer says. “We did a lot of planning and made sure we dotted every ‘i’ and crossed every ‘t.’” In addition, those who needed to be involved in the process—which usually includes representatives from payroll, HR, finance and the company's top leadership—were identified early and kept in the loop with weekly conference calls.

At Marubeni America Corp., the New York-based commodities and consumer-goods trading subsidiary of Japanese manufacturer Marubeni, the point of transferring to a new 401(k) provider was to generate interest in the plan through new services and investment tools.

“The plan had been underutilized despite healthy matching contributions,” says Howard Tiegel, senior vice president of human resources. “The transfer process was really a way to get people to focus on the 401(k) plan and the importance of retirement investing.” To do that, the company coupled communication about the transfer and blackout periods required under the Sarbanes-Oxley Act of 2002 with an internal marketing effort on behalf of the 401(k) plan.

“In the end, it also became a platform for promoting the other benefits and services available through the HR department,” Tiegel says. “It has made our value proposition more relevant to employees.”

—Joanne Sammer

## ► Online Resources

For additional resources on 401(k) plans, including guidance on terminating plans, see the online version of this article at [www.shrm.org/hrmagazine/07January](http://www.shrm.org/hrmagazine/07January). There you will find links to:

- IRS statements on starting, operating and terminating 401(k) plans.

- A history of 401(k) plans from the Employee Benefit Research Institute.

- A Department of Labor statement on locating missing participants in terminated defined contribution plans.

- IRS guidance on IRAs, including rules for rollovers into IRAs.

past few years, making sure contributions were made on a timely basis, and so on.”

Steigerwalt, now a consultant in Philadelphia, says her biggest challenge was notifying the company’s former employees who still had money in the plan. “Some of the plan participants had not been employed by the company for years, and we had lost touch with them.” Because the company was relatively small, she says, “I thought I knew where our former employees were, but when it came to doing the final contact, I realized how many people were missing.”

While it took time to track people down, Steigerwalt says, it took even longer to get them to fill out the necessary paperwork and tell the company how they wanted to receive their distribution from the plan.

As a result of her experience, Steigerwalt urges HR professionals to begin dealing with termination issues as soon as they know that a plan termination is inevitable. The further away from the transition to a new parent company following a merger or acquisition, she says, “the harder it becomes to get people to take action, particularly if they have moved to a different job.”

Even though recordkeepers do their best to keep track of past participants through change-of-address notices, it is still possible for people to slip through the cracks, particularly if they move several times and fail to keep the recordkeeper notified of their current address. Steigerwalt used various tools, including online search engines, to track down the 10 or 12 missing participants. Finding them took a couple of weeks, she says, and getting all participants to decide how they wanted to receive their distributions took much longer.

## The Need To Start Early

When a company is facing a merger or acquisition, chances are the 401(k) plan will not get a lot of attention during the due diligence process. With so much other financial and operational due diligence going on before a deal goes through, checking out a target company’s 401(k) plan generally is not a priority.

And that can be a mistake. There are certain determinations and decisions that the companies involved should make about their 401(k) plans before the deal is done.

A key decision when both companies have 401(k) plans is whether to combine the two plans into one after the merger is complete, or terminate the target company’s 401(k) plan before the deal is complete and offer participants the option of moving their assets to the new parent company’s plan.

If the two plans are merged after the deal is done, there is a risk for the new parent company: Any problems or structural defects in the target company’s 401(k) plan would then become problems or defects of the parent company’s plan, and the merged 401(k) could be disqualified if those problems are not addressed.

“There can be danger in merging plans,” says Richard Kos-

ki, managing director in Secaucus, N.J., of Buck Consultants, a global HR consulting firm. “Most companies do not do enough pre-deal due diligence around 401(k) plans. If compliance problems are discovered within the plan after the deal closes, the situation could get ugly.”

To avoid the risk of disqualification, a merger partner or acquirer can specifically request, or in effect require, that the target company terminate its 401(k) plan before the deal closes.

Terminating the plan before the deal is done can also prevent problems down the road stemming from any number of issues, such as failure to file appropriate forms with the IRS or failure to deposit contributions in a timely fashion.

“If one party thinks there might be defects in plan structure, it can terminate the plan before completing the deal and take that issue off the table,” says Luan Fox, a principal with PricewaterhouseCoopers in New York.

If problems with a 401(k) plan are detected before the deal closes but there’s not enough time to terminate the plan before the deal is completed, the companies involved can agree to set aside a reserve fund to pay for expenses related to fixing the target company’s 401(k) plan and bringing it back into compliance. During this process, the employees from the target company can be enrolled in the new parent company’s plan. Then, after the problems in the acquired company’s plan are dealt with appropriately, the two plans can be merged safely.

## Several Steps Along the Way

The time required and the overall ease of the termination process can depend on the nature of the 401(k) plan and the sophistication of the providers. Everything from a loan provision to company stock as an investment option can add complexity to the termination process and extend the time it takes to terminate the plan from several weeks to several months. “This is not a cookie-cutter type of thing,” Koski says. “The facts determine how companies should proceed.”

Because the termination process is so driven by federal laws and regulations, HR should seek legal counsel, whether internal or external, to help guide its decision-making and actions. There are also consulting firms that can provide support throughout the termination process. >

But there are some broad recommendations that experts make for all plan terminations:

**Make it formal.** Once a company has decided to terminate its 401(k) plan, it should get formal approval to do so from the company's board of directors or whatever other body—perhaps a benefits or investment committee made up of company executives—is authorized to act with regard to the 401(k) plan. Approval usually has to be in a written resolution from that governing body. Although it is not required to do so, the plan sponsor can also file a notice seeking IRS approval of the plan's termination.

**Get in compliance.** The employer must make sure the plan is fully in compliance with all applicable laws and regulations—everything from passing nondiscrimination testing to the annual filing of Form 5500, the IRS form that reports on the characteristics and operation of the plan. “If the plan is out of compliance for any reason, the company must fix those com-



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pliance problems before it can move forward with terminating the plan,” Johnson says.

**Notify plan services providers.** The company must also inform its 401(k) plan service provider and any other vendors about its intention to terminate the plan. Bear in mind that the provider may charge plan-termination fees. “The company could face an accelerated charge for terminating a plan before the contract is up,” Koski says. If the vendor has been unable to recoup all of its start-up costs for the relationship over the life of the contract, it may try to recoup them through termination fees. These fees could be negotiable and may be spelled out in the vendor contract. Additional costs that might be incurred are those for outside counsel and expert help for the termination process.

**Communicate with employees.** The plan termination decision should be explained to employees; they should be informed on how the termination will occur and on their responsibilities during the termination process.

Employees need to be informed that they will be unable to gain access to their plan accounts or assets for a period of time before the final plan termination occurs and until their plan assets are distributed or rolled over as they directed. The date when this will occur should be communicated to all participants. During that period, the assets in each account will be liquidated and rolled over or distributed according to the wishes of each participant.

From an employee relations standpoint, telling workers their 401(k) plan is being terminated may not be as problematic as it might seem. If the company is merging or being acquired, terminating the plan rather than merging it with the new parent company's plan gives employees more options for investing their retirement money.

For example, employees can reinvest their assets from a terminated 401(k) plan in a variety of ways—either by rolling them into an individual retirement account (IRA) that may offer preferable investment options, taking their assets as cash (after paying any applicable taxes and early withdrawal penalties) or rolling them into the new parent company's 401(k) plan.

“Many employees will welcome gaining access to their assets, especially if they don't know much about the new parent company or its 401(k) plan,” says Fox of PricewaterhouseCoopers. “They have more freedom to decide whether to roll their assets into the new plan or into an IRA.”

**Find everyone.** Of course, one of the most important administrative functions in a plan termination is tracking down all of the people who have assets in the plan, canvassing them on how they want to handle their asset distribution and then distributing the money accordingly. This task is relatively straightforward when all of the participants are still employed with the company sponsoring the plan because all contact information is likely to be up-to-date and HR professionals have ready access to those individuals for in-person follow-up.

Asset distribution becomes more complicated when former employees are involved and have not kept the plan recordkeeper informed of their current contact information, as consultant Steigerwalt could attest. In such instances, the plan sponsor is obliged to track down those individuals through the use of internal and external resources as necessary. The IRS and the U.S. Social Security Administration provide letter-forwarding services that can help plan sponsors track down these individuals.

**Make it final.** Once the plan is in compliance and all of its assets have been distributed appropriately, the plan sponsor can file its final Form 5500 with the IRS. Then, and only then, HR can consider its job done. ■

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