

# WHITE PAPER: ORPHAN PLAN ISSUES FOR DEFINED CONTRIBUTION AND DEFINED BENEFIT PLANS

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### I. Introduction

So-called "orphan plans" are defined contribution or defined benefit plans that have been abandoned by their sponsors and all other plan fiduciaries authorized to act on their behalf. As a result, there is no longer an employer or other plan fiduciary to administer the affected plan or make distributions to plan participants, beneficiaries and alternate payees ("plan participants"). Most typically, the plan sponsors of orphan plans have gone through bankruptcy or have lost their corporate charter. Plans whose fiduciaries are simply unwilling to act should not be considered "orphan plans". Rather, existing fiduciaries should be compelled to act in accordance with their fiduciary duties under ERISA, and their failure to act should be brought to the attention of the U.S. Department of Labor ("DOL") for enforcement action. In the case of a plan sponsored by a sole proprietor, an orphan plan might be defined as a plan where there has not been contact or transactions for a certain number of months or years (e.g., two years).

Why are retirement plans abandoned by their sponsors? There are several possible explanations for the abandonment of these plans, including: (1) bankruptcy or dissolution of the plan sponsor entity; (2) financial circumstances of the plan or plan sponsor; (3) refusal by individual plan fiduciaries to "step up to the plate" to terminate the plan and distribute assets; (4) lack of knowledge about the existence of the plan; (5) lack of knowledge about the operation of the plan (e.g., identifying the third party administrator, prior trustee, investment advisor, investment manager, custodian, financial institution where assets are held); (6) unwillingness or inability to assume responsibility for plan administration, investments and distributions for fear of fiduciary/plan administrator status and out-of-pocket expense; (7) significant operational or form

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defects that need to be corrected to maintain the plan's tax-qualified status; (8) lack of funds necessary to terminate the plan, pay on-going plan expenses and pay account balances/accrued benefits; (9) prior prohibited transactions, fiduciary breaches or criminal activity involving the plan that need to be resolved or brought to the attention of the appropriate federal agency(ies); (10) removal of plan fiduciary by the DOL; (11) mergers/acquisitions; (12) death of sole proprietor; and (13) termination, dissolution or bankruptcy of the third party administrator responsible for a small plan's compliance and maintenance.

According to the Report of the Working Group on Orphan Plans at the DOL's Employee Benefits Security Administration ("EBSA") dated November 8, 2002 ("Report")<sup>1</sup>, orphan plans represent only about two percent of all defined contribution plans and less than one percent of total defined benefit plan assets. According to Sanford Koepfel's testimony in the Report, orphan plans contain, on average, between \$100,000 and \$500,000 and have between 10 and 20 remaining participants. Average account size is under \$10,000 according to Mr. Koepfel. The DOL reported that 464 civil cases were brought between October 1, 1999 and June 30, 2002 involving orphan plans and that the DOL recovered more than \$51 million that was paid to plan participants. During this same period, the DOL appointed 43 independent fiduciaries in 37 cases. The cost of terminating an orphan plan is estimated at between \$10,000 and \$30,000.<sup>2</sup> No statistics were provided for defined benefit plans. Testimony in the Report indicated that the number of orphan plans was predicted to increase in the years ahead.

Orphan plans create significant legal and practical problems for plan participants, third party administrators and other service providers, federal agencies (IRS, DOL and PBGC) and the courts (including the federal bankruptcy courts).

## II. Objectives of Orphan Plan Task Force of IRS Northeast Liaison Group

The short-term objective of the Orphan Plan Task Force and of this White Paper is to focus attention on, and bring a cross section of benefits practitioners into the ongoing debate and discussion regarding, the disposition of orphan plans. The longer-term objective is to develop a unified, coordinated and workable approach to dealing with orphan plans that would involve the IRS, DOL, PBGC, bankruptcy courts and practitioner community. Any workable comprehensive approach would also seem to require legislative and/or regulatory changes. The Orphan Plan Task Force recommends the development of a joint DOL-IRS-PBGC program (the "Program") to develop procedures relating to orphan plans, as discussed below.

## III. Issues

### A. Authority to maintain plan's tax-qualified status, terminate plan and make distributions

As an initial matter, the Program will need to decide which plans are orphan plans based on policies and procedures established by the Program. The case will then be handled under the Program. To the extent that the DOL, IRS or PBGC is already handling an orphan plan situation,

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<sup>1</sup> Report of the Working Group on Orphan Plans dated November 8, 2002 available on DOL website at [www.dol.gov/ebsa](http://www.dol.gov/ebsa).

<sup>2</sup> Id.

