

**CASE OF THE WEEK***w/o 01.22.2012****Chapter 7 vs. Chapter 11 Bankruptcy and the Effects on Retirement Plans***

Our ERISA consultants on the Columbia Management Learning Center Resource Desk regularly receive calls from financial advisors on a broad array of technical topics related to IRAs and qualified retirement plans. For example, we routinely guide Columbia Management's financial advisor partners through the effects of an employer's bankruptcy on the company's retirement plans.

A recent call with a UBS advisor in New York is representative of a common inquiry regarding bankruptcy and retirement plans. The advisor asked: **"Are the effects on an employer's retirement plan different based on whether the firm files for a Chapter 7 vs. Chapter 11 bankruptcy?"**

Highlights of Recommendations

- Yes, if a firm is filing for bankruptcy, the effects on the business's retirement plans will differ based on the type of bankruptcy.
- Generally, there are two types of bankruptcy filings, based on which chapter of the Bankruptcy Code applies: Chapter 7 (liquidation) or Chapter 11 (reorganization).
- In a Chapter 7 liquidation bankruptcy filing, the bankrupt business typically liquidates its assets to pay its creditors and ceases to exist. In cases like this, the bankrupt business usually terminates its retirement plans.
- In a Chapter 11 reorganization bankruptcy filing, the bankrupt business receives protection from the court while it works to restructure its financial affairs so that the business can continue to exist. In cases like these, the effect of the reorganization on a business's retirement plans could vary from no affect at all to plan termination.
- Regardless of the type of bankruptcy, participants' qualified plan assets are fully protected from the general creditors of the business under the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 and the Employee Retirement Income Security Act of 1974.
- If the bankrupt business maintains a defined benefit plan, it must notify the Pension Benefit Guaranty Corporation (PBGC—the governmental agency that insures private sector defined benefit plans) of the bankruptcy filing—either Chapter 7 or Chapter 11. The PBGC, however, does not automatically take over the defined benefit plan. The PBGC's goal is to work with the business to help it preserve its plan if at all possible.
- The PBGC will only assume the responsibility for paying benefits to participants of a private employer's defined benefit plan following either a distress-initiated plan termination (where the employer determines it is financially unable to support the plan further), or a PBGC-initiated plan termination (where the PBGC determines the employer cannot fulfill its financial responsibilities to the plan).

Conclusion

A business owner's bankruptcy may or may not affect the business's retirement plans. Financial advisors who understand the types of bankruptcy and how each may affect a business's retirement plans set themselves apart from the average advisor and, thereby, win more clients and retirement plan business. As always, the Columbia Management Learning Center is available to help.