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October 8, 2025

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Via Electronic Mail

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RE: Select Committee on Pension Policy Study of SHB 2034 and SSB 5085

Dear Aaron:

Please allow this letter to follow-up to your electronic mail messages dated June 27, 2025 and July 18, 2025, regarding the Select Committee on Pension Policy ("SCPP") Study of LEOFF Plan 1 in relation to SHB 2034 (a proposal to terminate and restate LEOFF Plan 1) and SSB 5085 (a proposal to merge LEOFF Plan 1 with PERS Plan 1 and TRS Plan 1) and to respond to your various questions. As part of our response, we understand that our analysis will be provided to the SCPP as part of its study. Please allow this letter also to confirm that we previously have reviewed SHB 2034 and SSB 5085 on behalf of the Washington State Department of Retirement Systems ("DRS") during the 2025 legislative session. Separately, we previously have considered with you and the OSA potential merger issues related to LEOFF Plan 1, for example, with the SCPP study in 2016. Of course, if you need copies of any of our prior correspondence regarding the issues of LEOFF Plan 1 and its potential merger with other DRS plans or its potential termination, please do not hesitate to let us know.

I. EXECUTIVE SUMMARY

As will be discussed in greater detail in this Memorandum, under the Internal Revenue Code ("Code") and applicable Treasury Regulations ("Treas. Reg."), the term "merger" means the actual merger of assets and liabilities of more than one qualified plan into a single plan where the assets and liabilities are "usable" across the spectrum of merged plans. In order for a merger to be considered "legal" or "valid" for purposes of federal tax law, <u>each participant in the merging plans must receive benefits on a termination basis from the plan immediately after the merger which are equal to or greater than the benefits the participant would have received on a termination basis immediately before the merger</u>. Code §§ 401(a)(12) and 414(l). In this regard, a plan member who has reached normal retirement age or reached other vested status under the merging plans must be vested in his/her accrued benefit as of that date. <u>Finally, in order for a merger to be valid it must comply with the exclusive benefit rule under Code § 401(a)(2)</u>. Accordingly, as part of the merger, it must be impossible for any part of the corpus or income of the merged plans to be used for or diverted to purposes other than for the exclusive benefit of the employees or their beneficiaries before there has been a complete satisfaction of all liabilities with respect to employees and their beneficiaries under the Plans.

In order to confirm that the merger would be approved by the Internal Revenue Service ("IRS"), we would normally strongly recommend that DRS and/or the Plans seek a new determination letter on the new merged plan in order to ensure its qualified status under the Code. Unfortunately, the plans' ability to obtain a new determination letter will be limited by the IRS' new procedures for determination letters for individually designed plans (*see* Revenue Procedure 2016-37). There may be a way to structure the merger – *i.e.* SSB 5085's proposal to create a new plan by the three existing plans coming together – which would allow a determination letter request to be submitted. Regardless, we also recommend that the Plans and/or DRS seek a Private Letter Ruling from the IRS to confirm that either a merger or termination involving LEOFF Plan 1 does not result in any tax consequences for any affected members.

We want to note that the IRS does not require an overfunded plan to be changed, whether by enhancing benefits to existing members or by merging or terminating the plan. Rather, these are considerations for the plan sponsor (in this case, the Washington State Legislature).

II. <u>OVERVIEW OF THE THREE PLANS</u>

- LEOFF Plan 1 is a cost-sharing multiple-employer defined benefit plan which was established by the Washington State Legislature during the 1969 session. It covers all full-time, fully compensated, local law enforcement and firefighters who established membership on or before September 30, 1977. The Plan is closed to new members. Based on membership data from the 2024 Actuarial Valuation Report, there were 6 active members as of June 30, 2024, and 5,945 retired or inactive members. LEOFF Plan 1 members are eligible for retirement at the age of 50 with five years of service. RCW 41.26.090. Also, members are vested after the completion of 5 years of eligible service. RCW 41.26.170. Based upon information in the Annual Comprehensive Financial Report (page 218), for the fiscal year ended June 30, 2024, LEOFF Plan 1 included 4 county and/or municipality employers.

- TRS Plan 1 is a cost-sharing multiple-employer defined benefit plan which was established in 1938. It covers all certificated public school employees who worked in an instructional, administrative, or supervisory capacity who established membership on or before September 30, 1977. The Plan is closed to new members. Based on membership data from the 2024 Actuarial Valuation Report, there were 62 active members as of June 30, 2024, and 27,516 retired or inactive members. TRS Plan 1 members are eligible for retirement at any age after 30 years of service, at age 60 with five years of services or at age 55 with 25 years of service. RCW 41.32.483. Also, members are vested after the completion of 5 years of eligible service. RCW 41.32.470. Based upon information in the Annual Comprehensive Financial Report (page 217), for the fiscal year ended June 30, 2024, TRS Plan 1 included 60 employers.

- PERS Plan 1 is a cost-sharing multiple-employer defined benefit plan which was established in 1947. It covers all state employees, elected officials, employees of local governments, legislative committee employees, community/technical college employees, classified employees of school districts, district/municipal court judges, and some employees of the Supreme Court, Court of Appeals and superior courts who established membership on or before September 30, 1977. The Plan is closed to new members. Based on membership data from the 2024 Actuarial Valuation Report, there were 395 active members as of June 30, 2024, and 37,618 retired or inactive members. PERS Plan 1 members are eligible for retirement at any age after 30 years of service, at age 60 with five years of services or at age 55 with 25 years of service. RCW 41.40.180. Also, members are vested after the completion of 5 years of eligible service. *Id.* Based upon information in the Annual Comprehensive Financial Report (page 214), for the fiscal year ended June 30, 2024, PERS Plan 1 included 242 employers.

III. OVERVIEW OF FEDERAL LAW - MERGER

In this section, we consider the federal tax law requirements for a plan merger – the rules that would apply to any merger of assets and liabilities of two or more governmental defined benefit plans.

A. Source of Guidance

Governmental pension plans are subject to certain specific provisions of the Code and related Treasury Regulations. In general, governmental pension plans are not subject to the Employee Retirement Income Security Act of 1974 ("ERISA"). In lieu of ERISA provisions, governmental plans are often subject to pre-ERISA guidance from the Internal Revenue Service ("IRS") on a particular subject (*e.g.*, vesting at normal retirement age). Governmental plans may also follow ERISA provisions by analogy or as a "best practice." By following the ERISA rules on merger, the merger is structured in a way so that it is allowable under the Code and should be approved by the IRS.

B. Exclusive Benefit Rule

One of the threshold rules in the qualified plan world is the "exclusive benefit" rule. This rule dictates that plan assets cannot be used other than to pay benefits to members and beneficiaries and to pay reasonable administrative expenses. In this regard, Code § 401(a)(2) requires that for a plan to be qualified, it must be "impossible, at any time prior to the satisfaction of all liabilities with respect to employees and their beneficiaries under the trust, for any part of the corpus or income to be . . . used for, or diverted to, purposes other than for the exclusive benefit of the employees or their beneficiaries . . ." *See also* Treas. Reg. § 1.401-2(a). Accordingly, the IRS has held that "funds accumulated under a qualified plan in trust are intended primarily for distribution to employee participants." Rev. Rul. 72-240, 1972-1 C.B. 108. This exclusive benefit requirement applies to all qualified pension plans, including governmental plans, and, therefore, must be considered in any plan merger. Further, it extends to all assets held under a qualified plan, whether employee contributions, employer contributions or investment income. It is important to note that the exclusive benefit rule is incorporated into each of the Plans at WAC 415-02-756.

C. Qualified Plan Status

Pre-ERISA guidance provides that only qualified plans under Code Section 401(a) may be merged. Revenue Ruling 67-213. In a merger of governmental plans, it is important to ascertain or confirm the qualified status of each plan prior to the merger, as well as the qualified status of the "surviving" plan.

D. Consideration of Termination Issues

Pre-ERISA guidance also provides that, if the merger results in the termination of one plan, then all accrued benefits under the terminating plan must be 100% vested to the extent that benefits are funded. Code § 401(a)(7) (1974). Whether a plan is terminated is generally a question to be determined with regard to all the facts and circumstances in a particular case. A plan is not considered to be terminated merely because an employer consolidates or replaces that plan with a comparable plan. Treas. Reg. § 1.401-6(b)(1); Rev. Rul. 67-213, 1967-2 C.B. 149. A comparable plan is not necessarily one of the same type, but it is one of the same category (*e.g.*, defined benefit vs. profit-sharing). Rev. Rul. 67-213 (citing Treas. Reg. § 1.381(c)(11)-1(d)(4)). Therefore, in a merger of qualified defined benefit plans, the IRS could find that one (or all) of the merged plans had not terminated, but that determination is based on all the facts and circumstances involved in the merger.

E. Participant Elections

In some cases, policy makers may ask if they could give plan participants the option of whether or not to be part of a merger. Pre-ERISA, it was permissible to give participants the option of moving from one plan to another, so long as there was no option to receive a distribution. Rev. Rul. 67-213. However, at the current time, and as to a governmental plan, giving existing employees a choice among plans currently will not be approved by the IRS if the choice impacts the employees' pre-tax contributions and, as a result, creates a cash or deferred arrangement ("CODA"). Revenue Ruling 2006-43, 2006-35 I.R.B. 329; *see also* PLR 201532036.[1] While we recognize there are very few active employees (11) in LEOFF Plan 1, any active employees still would cause problems in terms of the IRS' prohibition on impermissible CODAs. Given the current prohibition in the IRS' position, we have set this potential approach aside, both because it would not seem to be a useful design in the circumstance and because it would raise issues that would likely significantly impede any resolution.

F. Assets/Liabilities

Pre-ERISA guidance applicable to governmental plans does not provide any specific guidance with respect to the treatment of the merger of assets and liabilities/benefits. Code §§ 401(a)(12) and 414(l) establish merger requirements for private sector plans, which requirements are intended to demonstrate compliance with the exclusive benefit rule. Government plans, such as the Plans are not required to follow these merger rules. Treas. Reg. § 1.414(l)-1(a)(1). However, we believe that certain essential elements of these federal laws provide a good road map

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[1] While Private Letter Rulings ("PLRs") are only binding on the taxpayer to whom they are issued, they are instructive on the IRS' views regarding the issues covered in them.

for a merger of plans and would demonstrate to the IRS the intent of the Legislature to comply with the exclusive benefit rule. We believe it would be difficult for the IRS to make an adverse decision on a merger that satisfied these essential IRS rules. In other words, a merger which complies with Code §§ 401(a)(12) and 414(h) does not violate the exclusive benefit rule.

In this respect, the Code takes a broader position than might be expected. Code § 401(a)(12) provides that, in the case of **a merger, consolidation or a transfer of assets or liabilities, each participant must receive benefits on a termination basis from the plan immediately after the merger or transfer which are equal to or greater than the benefits the participant would receive on a termination basis immediately before the merger, consolidation or transfer**. *See also* Treas. Reg. § 1.414(l)-1(a)(2) (Emphasis added). This treatment is not limited solely to a merger, but also includes consolidation where the assets may be used for the consolidating plans. A "merger" or "consolidation" means the combining of two or more plans into a single plan.… [A] merger or consolidation will not occur if two plans are not combined into a single plan, such as by using one trust which limits the availability of assets of one plan to provide benefits to participants and beneficiaries of only that plan." Treas. Reg. § 1.414(l)-1(b)(2).

A "transfer of assets or liabilities" occurs when there is a diminution of assets or liabilities with respect to one plan and the acquisition of these assets and/or the assumption of these liabilities by another plan. For example, the shifting of assets or liabilities pursuant to a reciprocity agreement between two plans in which one plan assumes liabilities of another plan is a transfer of assets or liabilities. However, the shifting of assets between several funding vehicles used for the assets of a single plan (such as between trusts, between annuity contracts, or between trusts and annuity contracts) is not a transfer of assets or liabilities. Treas. Reg. § 1.414(1)-1(b)(3).

In accordance with Treas. Reg. § 1.414(l)-1(b)(3), the term "benefits on a termination basis" means the benefits that would be provided exclusively by the plan assets pursuant to ERISA § 4044 and the regulations thereunder if the plan terminated. Treas. Reg. § 1.414(l)-1(b)(5). As noted above, for governmental plans, the pre-ERISA minimum vesting standards require 100% vesting of benefits accrued to: (i) the date of termination upon normal retirement, (ii) the date of plan termination, and (iii) the date or discontinuance of employer contributions to the plan.

Importantly, based upon WAC 415-02-753(3) "[t]he Plan may only be terminated by action of the legislature and employer contributions must be paid in accordance with state law. In the event the legislature took action to terminate a plan, in whole or in part, or discontinue employer contributions to the plan, any applicable state law and constitutional protections would apply to accrued benefits. In such event, pursuant to the state and federal rules, a plan member's accrued benefit under the plan is nonforfeitable to the extent funded."

G. Benefit Changes

To the extent that a merger results in benefit changes post-merger, there would have to be a state law analysis with respect to pension protections under state law; this would include an analysis of federal and state constitutional protections. From a federal tax law perspective, the accrued benefit of a plan member (at the time of the merger) under the plan must be protected to the extent funded. Given the funding status of LEOFF Plan 1, this means that all benefits under

LEOFF Plan 1 must be protected under SHB 2034, SSB 5085 or any other proposal which directs the merger, consolidation or termination of LEOFF Plan 1 and its assets. Similarly, under SSB 5085, the benefits of PERS Plan 1 and TRS Plan 1 members would also have to be protected.

H. Plan Terms

A qualified plan must always follow its written terms and conditions, so long as those terms do not violate relevant federal and state law. Thus, any transaction, such as a merger, must be reflected in each involved plan's terms via an amendment. This must be done before the merger occurs. The terms of the merger could be that two of the plans merge into another plan. Alternatively, the terms could be that a new plan is created, and the three existing plans would merge into the new plan. Separately, the amendment may state whether any of the plans are being terminated. Of course, a final analysis of the potential legal issues will depend on the structure of the merger as determined by the Legislature. It is important to note, as discussed in Question 3 (below), it should be anticipated that there will be a delay in the effective date of the merger (or termination) until the transaction receives approval from the IRS. Otherwise, the IRS may require that remedial actions be taken to undo the merger (or termination).

I. Taxation

To confirm that either a merger or a termination of LEOFF Plan 1 does not have a taxation impact on the members and considering the possibility that the SSB 5085 merger could include one overfunded plan with underfunded plans, we strongly recommend that a PLR be sought from the IRS. The purpose of the PLR would be to confirm that either the merger or a termination complies with the exclusive benefit rule and the pre-ERISA vesting requirements and does not result in any adverse tax consequences to the members (either the members of the merged plans or the LEOFF Plan 1 members).

J. On-going Compliance Post Merger

After the merger, the merged plans must be maintained in compliance with Code § 401(a).

K. Consolidation

In the case of consolidation, the exclusive benefit rule must be applied – in that the plan assets of one plan could only be used for the benefit and expenses attributable to that plan.

In a consolidation, the above-described issues of maintenance of qualified status, participant elections, and plan terms would still need to be considered. However, consolidation is not necessarily treated the same as a merger - the treatment depends on whether the plan assets of a consolidating plan are available to fund benefits for any other consolidating plan or not, and therefore does or does not raise issues with regard to vesting and valuation of benefits on a termination basis. *See* Treas. Reg. § 1.414(l)-1(b)(1)(v).

L. Reversion of Excess Assets

Under ERISA, for an employer to accept a reversion of excess assets, the plan must have always provided for such reversion or have been amended more than five plan years before the termination to permit a reversion. ERISA § 4044(d)(2). As a result, under ERISA, an employer is prohibited from amending a plan in conjunction with a plan termination to give excess assets back to the employer if the plan previously provided for a different allocation of excess assets. Even if an excess asset reversion to the employer is permitted, Code § 4980 imposes a tax of 20% of the amount of any employer reversion from a qualified plan. The 20% excise tax may be increased to 50% of the reversion from a qualified plan if the employer does not establish or maintain a qualified replacement plan or the employer does not provide a pro rata increase in the accrued benefits of all qualified participants. Code § 4980(d). However, the ERISA requirements related to plan amendments and the excise tax on a reversion of qualified plan assets to the employer specifically **do not apply to a governmental plan**. Code § 4980(c)(1)(B). As a matter of interest, the Treasury Regulations specifically recognize that a merger likely would involve a "lower funded plan." Treas. Reg. § 1.414(l)-1(b)(6). These rules are all part of the federal plan insurance provisions of ERISA and the Pension Benefit Guarantee Corporation, and consequently, the parallels and basics are quite different between governmental plans (not covered by the federal plan insurance program) and nonqualified governmental plans. Therefore, we would not anticipate using these provisions in the governmental setting and do not suggest that the plan amendment(s) must be in place for five plan years because these are ERISA requirements.

Based upon WAC 415-02-753, without further amendment to the Plans by the Legislature, the Legislature could discontinue or modify employer contributions to the remaining/resulting plan as part of the merger under SSB 5085. It is important to note that if a merger involving LEOFF Plan 1 included a reduction in employer contributions in the merged plan, such a reduction in employer contributions would not constitute a reversion of excess assets for purposes of either ERISA § 4044 or Code § 4980. Given that WAC 415-02-753 contemplates the possibility of a plan termination, it is important to consider that any reversion of excess assets must be considered under state law for whether the excess assets revert to the state or to a combination of the state and participating employers. Presumably, state law may consider the respective contributions made to LEOFF Plan 1 by employers in determining the methodology for the reversion of excess assets. Certainly, we defer to the AG's office on whether participating employers would share in such a reversion.

IV. QUESTIONS PRESENTED

Question No. 1: What are the tax implications and likely IRS concerns for a closed public plan with a funded status in excess of 149%? Is it projected to keep increasing?

***Response*:** As more fully discussed above, the IRS' primary concern for closed public plan with a funded status in excess of 100% (including a funded status in excess of 149% that is projected to keep increasing) is whether any use or reversion of LEOFF Plan 1 assets violates the exclusive benefit rule under Code section 401(a)(2) or the requirement that participants in a merged plan receive benefits at least equal to or greater than the benefits the members would have received on a termination basis immediately before the merger under Code section 414(l). Further, from a state law perspective, there certainly would be questions of whether any diminution violates the vested rights of plan members or their constitutional protections as set forth in *Bakenhus v. City of Seattle*, 296 P.2d 536 (Wash. 1956) and its progeny.

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Otherwise, the IRS typically does not have concerns with the fact that a governmental plan is overfunded and does not require that an overfunded plan either be i) amended to enhance benefits or ii) merged or terminated to allow a reversion of excess assets.

Question No. 2: What are the tax implications and likely IRS concerns for:

(a) A merger of closed public plans as contemplated in SSB 5085; or

(b) A restatement and termination of a closed public plan as contemplated in SHB 2034?

Response: As discussed in Response to Question No. 1, the IRS' primary concern with either a merger as proposed under SSB 5085 or a restatement and termination as proposed under SHB 2034 is whether the exclusive benefit rule is being violated with regard to LEOFF Plan 1 or whether the participants in a merged plan receive benefits at least equal to or greater than the benefits the members would have received on a termination basis immediately before the merger under Code section 414(l). Further, the new merged plan replaces the existing plans which are being merged together. A merger, on its own, does not trigger a reversion to the plan sponsor.

Importantly, if the IRS found either a violation of the exclusive benefit rule or that the requirements for a merger were not met, the results could range from (i) the IRS requiring the State to cease the merger/plan termination, (ii) the IRS requiring the State to make necessary amendments to the merger/plan termination to address any concern(s) raised by the IRS, or (iii) the ultimate penalty by the IRS of disqualification of the underlying plans and/or the merged plan. While we recognize the disqualification of a governmental plan would be an extreme result, which typically only would be considered if the merger/plan restatement and termination disregarded the exclusive benefit rule under Code section 401(a)(2), or did not provide benefits to participants in the merged plans/restated plan which were at least equal to or greater than the benefits the members would have received on a termination bid basis immediately before the merger, and the plans were not willing to correct the error, the fact that at least one of the proposals contemplates a reversion of LEOFF Plan 1 assets to the State without IRS approval of a merger/plan termination increases the risk of adverse tax consequences to the Plan(s) and its participating members. In this regard, if the merged plan or restated plan were disqualified, the negative tax implications could affect all members of the merged plans/restated plan as the members would be taxed on their vested benefits. For instance, if the IRS disapproved of the merger under SSB 5085, the negative tax implications could affect LEOFF Plan 1, PERS Plan 1 and TRS Plan 1 members. We previously described this adverse tax consequence as "catastrophic to members." While we recognize this is a sanction that is applied in only extremely rare circumstances, in our experience this is because the consequences are so dire that instead of disqualifying a plan, the IRS reaches a settlement with the plan sponsor to resolve the matter. Certainly, short of disqualification, if the IRS disapproved of a merger or plan restatement, it would require the merged

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plans/restated plan to be restored to the position(s) each would have been in prior to the merger or plan restatement, including the payment of interest on each plan's respective assets. Last, there also is a risk of penalty by the IRS for the merger or plan restatement which it deems to violate the exclusive benefit rule.

Question No. 3: How could any such IRS concerns as contemplated in the bills be eliminated or mitigated?

Response: In order to confirm that the merger or termination and restatement transaction involving LEOFF Plan 1 would be approved by the IRS, as we have recommended in the past, DRS and/or the Plan(s) should seek a favorable determination letter on the new merged plan (SSB 5085) or on the restated and terminated plan (SHB 2034) in order to ensure the Plan's(s') qualified status under the Code. Unfortunately, the ability of an existing plan to obtain a new determination letter has been curtailed by the IRS' Revenue Procedure 2016-37 (existing plans no longer are able to get a current determination letter except at plan termination). However, under SSB 5085, and consistent with our prior advice, the new merged plan likely could seek a determination letter based on the creation of a new plan. Further, under SHB 2034, a determination letter could be sought for the terminated plan. Accordingly, we recommend that for any plans being merged and/or terminated, DRS seek a PLR from the IRS to confirm that the merger/plan termination would not result in any adverse tax consequences to any affected members of the merged plans (a Private Letter Ruling and a Determination Letter filing are separate filings with the IRS). Finally, to the extent that SHB 2034 contemplates a reversion of assets to the State, we highly recommend that a PLR be sought to approve both the termination of LEOFF Plan 1 and the reversion of the surplus assets to the State. It is important to note that given the current regulatory environment in Washington DC, we anticipate that either or both a Determination Letter filing or a PLR filing would take a year or more (more likely over a year) before receiving the IRS' final review/ruling. Under the IRS' current procedures, because the IRS will not rule on a hypothetical transaction or question, neither a Determination Letter filing nor a PLR filing can be made until after a law has been passed by the Legislature and signed by the Governor. Therefore, we recommend that an effective date reflect sufficient time to allow for these filings with, and rulings by, the IRS. These separate filings would happen simultaneously. Further, it is important to note that, if the IRS does not agree with the transaction, it may choose not to issue either a favorable determination letter or a favorable PLR. In such instances, the IRS will allow either i) the transaction and/or request to be amended to address the IRS' concerns or ii) the determination letter and/or PLR request to be withdrawn. As previously mentioned in response to Question No. 2, if the IRS determines that the transaction violates the exclusive benefit rule, it is possible that the IRS could require the transaction to be undone and for the involved plan(s) be restored to the position(s) in which it (each) would have been in had the transaction not been implemented.

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Question No. 4: Please provide examples of other governmental plans that have taken analogous actions (either merged or been terminated). Are you aware of other governmental plans that have had a long, or longer-term, funded status above 105%?

Response: Based upon our work with other governmental plans from around the country, we certainly are aware of other situations involving the merger or consolidation of plans, whether state or local. Often this has included a merger of local plans into the state's plan(s) or the merger of state plans into a single plan. In our experience, these mergers have been allowable because they preserve the vested rights of members in the merged plans and the mergers have not involved a diversion or reversion of assets from the plans. In this regard, we certainly are aware of PLR 200216034 (which was raised by RFFOW President, Michael Duchemin and has been presented as potentially prohibiting a merger involving LEOFF Plan 1). However, it is important to note that PLR 200216034 involved the transfer of assets from one overfunded plan of the employer to two underfunded plans of the employer. Critically, the transaction involved in this PLR did not involve a merger of plans. Accordingly, the rulings in PLR 200216034 are not analogous to the transactions proposed under SHB 2034 and SSB 5085. Notwithstanding, as we have consistently advised regarding a potential merger transaction involving LEOFF Plan 1, any such transaction must comply with the exclusive benefit rule and, therefore, compliance with the rules regarding plan merger could be important in reflecting that the exclusive benefit rule is not being violated by the proposed transaction.

With regard to plans which have a long, or longer-term funded status above 105%, we offer as reference the Research Update presented at the National Association of State Retirement Administrators ("NASRA") Annual Conference in August 2025 (https://www.nasra.org/publicfundsurvey). While the median public pension funding level based upon NASRA's public funds survey dated July 2025 is 77.6%, there certainly are governmental plans which are funded at or above 100%. Generally, plans which have had historical funding at or above 100% have used the extra funding to award benefit enhancements, often in the form of an *ad hoc* cost of living adjustment. However, we are not aware of any state level governmental plans that have done a merger, termination or spin-off of a well-funded plan in order to achieve a reversion of excess assets.

Question No. 5: Does SHB 2034 meet the technical requirements for a restatement and termination?

Response: Based on our review of SHB 2034, we believe it reflects an acceptable restatement of LEOFF Plan 1 into a new plan with a subsequent termination of the existing LEOFF Plan 1.

Question No. 6: Does SSB 5085 meet the technical requirements for a merger?

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Response: We believe that SSB 5085 meets the technical requirements for a plan merger and presents less risk to the State to DRS and to the involved plans because it does not contemplate a reversion of plan assets as part of the contemplated merger.

Question No. 7: Must a plan's entire membership be 100% retired in order for a plan to be terminated?

Response: No. A plan may be terminated even if there are active participants. As discussed in Section III.D., pre-ERISA guidance provides that if a plan is terminated, then all accrued benefits under the terminating plan must be 100% vested to the extent that benefits are funded. Code § 401(a)(7) (1974). Whether a plan is terminated is generally a question to be determined with regard to all the facts and circumstances in a particular case. A plan is not considered to be terminated merely because an employer consolidates or replaces that plan with a comparable plan. Treas. Reg. § 1.401-6(b)(1); Rev. Rul. 67-213, 1967-2 C.B. 149. To the extent that active members remain at the time of the plan's termination, then the rights of the active employees must be addressed, including whether to spin-off the active employees to a plan which will continue post-termination.

Question No. 8: Is SHB 2034 a plan termination?

Response: Yes. Given that SHB 2034 proposes to restate LEOFF Plan 1 in a new plan (to include a transfer of sufficient assets to pay the benefits accrued under LEOFF Plan 1), then to terminate LEOFF Plan 1 with a reversion of the excess assets, we believe that SHB 2034 reflects a proposal to terminate LEOFF Plan 1.

Question No. 9: Is a termination required for a reversion of assets?

Response: As discussed in Section III.L., under ERISA, for an employer to accept a reversion of excess assets, the plan must have always provided for such reversion or have been amended more than five plan years before the termination to permit a reversion. ERISA § 4044(d)(2). As a result, under ERISA, an employer is prohibited from amending a plan in conjunction with a plan termination to give excess assets back to the employer if the plan previously provided for a different allocation of excess assets. Code § 401(a)(2) does allow for a limited reversion of assets when an employer in a multiemployer plan makes a contribution as a result of a mistake of fact or law. However, this exception is limited to a reversion within six (6) months of the contributions being determined to have been the result of a mistake. Otherwise, the anti-diversion rule under Code § 401(a)(2) provides that no assets may revert to the employer/plan sponsor until the plan and trust are terminated.

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As always, if you have any questions or comments regarding this information or our analysis, or if you wish to discuss these issues further, please do not hesitate to let us know.

Very truly yours,

ICE MILLER LLP

Robert L. Gauss

Audra J. Ferguson

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