

Client Alert

Current Issues Relevant to Our Clients

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Lenders Should Keep an Eye on Church Plans

Lenders occasionally make loans to borrowers that sponsor “church plans.” “Church plans” are generally exempt from ERISA, including ERISA’s funding and lien rules. Often “church plans” are sponsored by non-profit hospitals, universities and other entities that have a religious affiliation. The IRS has generally ruled that the plans of such entities are exempt “church plans.” Plaintiffs in a recent California Federal district court decision and in lawsuits in process against large health care systems in four other jurisdictions have argued that the ERISA exemption for “church plans” should be limited to plans of actual churches. Depending on how these cases develop, lenders may want to analyze “church plans” in the same way that ERISA-covered pension plans are analyzed.

ERISA Requirements

Retirement plans that are covered by ERISA must comply with the requirements of the Employee Retirement Income Security Act of 1974 (“ERISA”), including requirements relating to reporting and disclosure to participants and governmental entities, fiduciary duties for those who manage plan assets, vesting and participation standards, claims and appeal procedures by participants and their beneficiaries and prohibited transactions between a plan and a party related to the plan. Further, ERISA requires that “defined benefit plans” (*i.e.*, plans that promise to pay a specified benefit to a plan participant in the future) that are covered by ERISA pay insurance premiums to the Pension Benefit Guaranty Corporation (“PBGC”), the governmental entity that guarantees pension benefits for participants. Finally, ERISA requires defined benefit plans to satisfy strict funding requirements. Employee benefit plans that qualify as “church plans” are not generally covered by ERISA and, therefore, are exempt from these requirements.

Court Cases

Recently, a lower Federal court in California ruled that the retirement plan of Dignity Health, a non-profit hospital, is not a church plan because Dignity Health is not a church. In denying Dignity Health’s motion to dismiss, the court’s ruling essentially ignored over 30 years of IRS rulings, including recent rulings issued directly to Dignity Health, that a church plan need only be maintained by a tax-exempt entity that is associated with a church. The court

agreed with the plan participant plaintiffs, indicating that only plans established directly by a church qualify as a church plan.

What This Means to Lenders

The plaintiffs in the *Dignity Health* case and the other four cases ask that the defendants bring the pensions plans “into compliance” with ERISA. In addition to making required payments of civil penalties and attorney fees for the plaintiffs and paying losses to participants who may have been harmed due to the failure of the plans to comply with ERISA, the financial implications to the defendant plan sponsors would include funding the plans in accordance with ERISA’s (and the Tax Code’s parallel) funding requirements. Although such funding requirements would not necessarily require an immediate lump sum payment of the amount of underfunding, such funding requirements may require a plan sponsor to substantially increase its contributions to its plans. Further, if church plans are no longer exempt from ERISA, plan sponsors will also be required to pay potentially expensive insurance premiums to the PBGC. Additionally, because the plan will be subject to the PBGC’s regulation, to the extent that the plan is poorly funded and the plan sponsor is having financial challenges, the PBGC could step in to take precautionary actions that may be unfavorable to a lender, including placing a statutory lien on the assets of the plan sponsor and members of its controlled group.

It is important to note that the ruling in the *Dignity Health* case is only one lower court ruling, is likely to be appealed and/or settled and is contrary to decades of rulings by the

IRS. Nonetheless, lenders who have made or will make loans to borrowers who sponsor church plans should continue to monitor the *Dignity Health* case and the other cases challenging church plan status. Lenders may also wish to review with borrowers that maintain church plans the funded status of their plans as well as the provisions in their lending documents.

For More Information

Please contact Gary Polega at 312.845.2994 or your primary contact at Chapman if you have any questions.

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