

# Employee Benefit News ebn

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## Retirement plans in a quandary

Complex issues arise when ex-employees don't cash their 401(k) balance checks

BY TERRY DUNNE

**“W**hat we've got here is a failure to communicate.” That famous line, from the 1967 movie “Cool Hand Luke,” summarizes the reason that retirement plans collectively — but unwillingly — hold billions of dollars that plan sponsors have unsuccessfully tried to distribute to former participants.

This often happens because these ex-employees haven't given their prior employers' HR/benefits departments instructions about what they want to do with the balances in their retirement accounts. When the plans try to contact them, they find many previous participants have moved without providing a forwarding address. Others actually haven't moved at all but ignore any communications about their retirement accounts.

The Department of Labor permits plans to cash out accounts of former employees with less than \$1,000 to reduce the cost and the time required to manage them. Sometimes an account's value is only a few dollars. In these instances, the account's assets are converted to cash, the appropriate amount is paid to the IRS and a check for the remainder is sent to the former employee's last known address. This is often when the failure to communicate begins. Some of these checks start returning, marked “address unknown.” This continues every year as more employees leave or are laid off and join the ranks of the missing.

Further, many former employees ask their company to close their retirement account and send them the funds, but for some reason the checks are never cashed. Thus, some companies are holding balances representing thousands of dollars in uncashed checks.

How big is this potential problem? A recent study shows that 50% of 401(k) participants leave their account with their ex-employer when

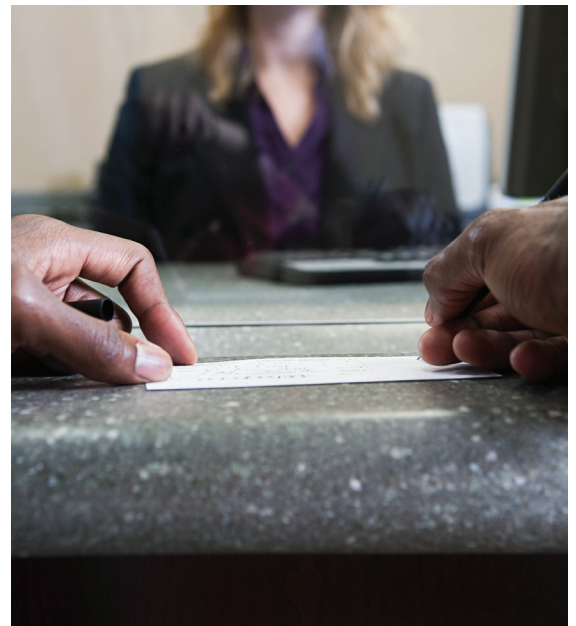
they change jobs. Granted, many of them left their accounts purposefully, but any plan administrator will tell you that too many ex-employees leave without providing any guidance.

### Complex questions arise

Many questions are raised when plan sponsors and service providers/financial institutions find themselves in this situation. Whom do the funds represented by these uncashed checks belong to? Who should

maintain possession of and be responsible for them? If a bank or financial institution issued the checks, do they control the float? Can the cash be redirected to the company? What happens if the plan is being terminated? Can the funds be escheated to a state? Is there a best practice to resolve this problem?

It all boils down to the stipulation by DOL that when a retirement plan issues a check to ex-employee participants, the funds technically remain part of the plan regardless of how long the check goes uncashed by a participant or a beneficiary. If the check is not cashed or rolled over by a participant, the plan should treat the account as continuing. It should be credited with the appropriate share of future earnings, if applicable, and the funds should remain available to them if and when they come calling for their retirement balance.



# 50

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The situation can be more complicated when a financial institution serves as a plan's custodian or recordkeeper and handles asset distribution. When this happens, the money represented by the checks may come off the plan books entirely, while the financial institution retains the float. It is logical that this situation is intended to be for a relatively short period of time while the exchange of funds is pending. But what happens when these transactions are not completed? And what are the plan's and the financial institution's responsibilities?

Ultimately, with uncashed checks, the plan fiduciary/administrator must recognize that the participants' balances remain plan assets and the plan sponsor retains ongoing fiduciary responsibility for them until they are restored to the plan or the participant receives the distribution. Plan sponsors have two options. They can ensure that the funds are restored to the plan or they can search for the participants and establish safe harbor IRA automatic rollovers for them.

The case for these funds remaining assets of the plan until the checks are cashed, regardless of the scenario, is well-documented. In 1993, DOL stated that using the float from uncashed benefit distribution checks to generate earnings is a prohibited transaction because the benefit distribution checks constitute plan assets. A year later, DOL further clarified its position in an Information Letter to the American Bankers Association that stated amounts in disbursement accounts were no longer plan assets. DOL stated that this was erroneous and that any decision by a plan fiduciary or service provider to benefit itself by earned interest or float constitutes prohibited self-dealing even if the assets are moved to an account designated for distribution.

Additionally, in 2003, a DOL Field Assistance Bulletin indicated that for uncashed distribution checks there must be an agreement with the plan regarding any float earned on plan assets. It requires the agreement to disclose the float as a fee and describe the time frames for and the anticipated rates of returns.

Under no circumstances should the money go back to the employer instead of the plan or be used for plan purposes other than forfeitures, if allowed under the plan document. Even if the plan treats these amounts as forfeitures, the plan and the plan sponsor are responsible for reporting them and must pay a valid claim made by a missing or non responsive participant if the forfeiture account does not have sufficient funds.

States with escheat statutes are also prohibited from laying claim to uncashed checks connected with active plans. DOL has also stated that a plan should not escheat funds that belong to a non-responsive participant because state escheat laws relating to retirement funds generally are preempted by ERISA. In 1994, the state of Illinois attempted to claim uncashed checks relating to payments to participants in an ERISA-covered retirement plan. The state was unsuccessful because the court held that it could not claim the funds because uncashed checks were considered to be plan assets and the plan had not fulfilled its obligation to the participants to provide the promised benefits.

If a plan is to be terminated, immediate action is essential, since a plan cannot terminate until all assets are distributed. For defined contribution plans, DOL has issued a regulatory safe harbor for rollover distributions. To qualify for safe harbor protection, a fiduciary must provide notice, including a distribution election, to participants. If the participant doesn't respond, a fiduciary must continue to take steps, consistent with its duty under ERISA, to locate the participant before

making a distribution. If the participant still fails to respond or make an election, a fiduciary may then proceed to make a distribution to an IRA meeting the conditions of the DOL's safe harbor.

In circumstances where a fiduciary could not or chooses not to distribute to an IRA, DOL also has provided guidance on distributions from terminated plans to bank accounts and escheatment to state unclaimed property funds. Such distributions are not covered by the regulatory safe harbor.

## Finding solutions

It is pretty obvious that retaining uncashed checks in the plan can create certain problems for plan sponsors and ex-employees alike. The plan continues to incur costs associated with administering these accounts and, at the same time, participants remain disconnected from their retirement funds. There also is a fiduciary responsibility to attempt regular communications with all participants, including those represented by the uncashed checks. Should uncashed checks be handled improperly, fines and/or lawsuits could result.

As a result, plan sponsors and fiduciaries increasingly are looking for a solution to this problem. One solution is to rollover funds representing the interest of missing or non-responsive participants into automatic rollover IRAs.

Typically, the IRA provider will open an IRA in the name of the participant and invest the proceeds in an investment designed to minimize risk, preserve principal, provide a reasonable rate of return and maintain liquidity. This is in line with DOL guidelines for automatic rollovers. Examples include money market funds, interest-bearing savings accounts, certificates of deposit and stable-value products.

Most IRA custodians will conduct additional search efforts aimed at locating the participants. If the plan did mandatory withholding at the time of the initial distribution, an IRA can be set up for the balance rolled over. Additionally, a plan has the right to reclaim the withholding from the IRS, and the IRS refund could be added to the rollover.

Upon the transfer of the funds and the confirmation that IRAs have been established, the plan will have been deemed to have met its fiduciary responsibilities. It is no longer responsible for these funds nor does it have to continue to try to contact the former employees. Typically, these transactions can be completed at no cost to the plan sponsors and only modest costs to the participant.

There are a handful of custodians that have developed services that meet the DOL safe harbor requirements. To identify them, plan sponsors can turn to organizations such as the American Society of Pension Professionals & Actuaries, International Foundation of Employee Benefits Plans, National Institute of Pension Administrators or the Profit Sharing/401k Council of America. ■

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