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LIFE INSURANCE

Missing persons report

What can plan sponsors can do when ex-employee participants disappear or ignore them?

By Terry Dunne

Virtually every retirement plan faces a growing problem that costs time and money and could actually cause it to fall out of compliance with various regulations. The problem is caused by ex-employees who still belong to the plan but end up being classified as missing or non-responsive because they can't be located or never acknowledge communications about their retirement accounts. The problem manifests itself in the cost and effort required of the plan to:

- Continue making regular attempts to reach all participants.
- Provide ongoing accounting and reporting for each account.
- Enable the distribution of all assets of a plan scheduled for termination.

The solution: automatic rollovers

Fortunately, there is a solution. The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) created the automatic rollover IRAand enables plans to cash out participants with balances of less than $1,000 and to rollover retirement funds from missing and non-responsive participants with assets of $5,000 or less to an IRA custodian that will create and administer an IRA in each former employee's name. These rollovers must be covered under the Department of Labor's (DOL) safe harbor provisions such as:

- The rollover must be offered by a state or federally regulated financial institution.
- Rolled-over funds must be placed in an investment designed to minimize risk, preserve principal and provide a reasonable rate of return.
- Fees and expenses cannot exceed those charged by the IRA provider for other IRA accounts.
- Plan sponsors must provide information about the Automatic IRA provider in a Summary Plan Description or a Summary of Material Modifications.

Once funds are transferred into a qualifying IRA, plan sponsors are not required to monitor the IRA provider and have no responsibility for the IRA provider's compliance. In most cases, the IRA custodians will attempt to reunite these individuals with their funds by continuing to search for them.

What about uncashed checks?

A related problem is uncashed distribution checks. Retirement plans collectively, but unwillingly, hold billions of dollars of checks that they've unsuccessfully distributed to former participants. The funds represented by these checks are plan assets and rightfully belong to the participants, so plan sponsors are responsible for returning them to the plan and administering the funds.

Several scenarios contribute to this problem. The DOL permits plans to cash out accounts of former employees with less than $1,000 in the plan. The assets are converted to cash, the appropriate amount sent to the IRS and a check for the remainder mailed to the former employee's last known address.

Many checks are returned marked "address unknown" and many others are just never cashed. The same problem occurs for larger amounts when a participant requests a distribution and doesn't receive or cash the check.

Maintaining these funds in the plan can be problematic:

- The plan continues to incur costs associated with administering the accounts.
- The participants remain disconnected from their retirement funds.
- The funds may not be accumulating interest or earnings.
- Fiduciary responsibility still requires plans to attempt regular communications with all participants, including those represented by the uncashed checks.
- If uncashed checks are handled improperly, fines or lawsuits could result.

In this scenario, plan sponsors have two options. First, they may wait for these individuals to request their funds while continuing to try to reach them. The second option is to declare them missing or non-responsive, in coordination with the terms of the plan. This allows them to use automatic IRA rollovers for account balances of less than $5,000 and fit within the DOL's safe harbor requirements. They can transfer larger amounts but without the safe harbor protection.

Under no circumstances should the money go back to the employer or be used for plan purposes other than for forfeitures, if allowed under the plan document. The DOL also stipulates that a plan should not escheat (return to

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a state) funds that belong to a missing or non-responsive participant. State escheat laws relating to retirement funds are generally preempted by ERISA. This may only be an option if it serves as a possible solution for terminating plans.

When a plan is being terminated

According to the DOL, all terminating plan assets must be distributed as soon as administratively feasible after the date of termination in order to complete the process under Internal Revenue Code requirements. Prior to any distribution, the Code requires a plan administrator to contact all participants for affirmative directions regarding distribution of their account balances. As in the scenario discussed above, some participants may not respond to these notices.

In these cases, the plan sponsor must follow the DOL's recommended search procedures for locating them prior to distributing benefits and effectively winding–up a plan's financial affairs. If this fails, DOL's direction is that plan sponsors must always consider using the automatic rollover process for assets belonging to missing participants.

Per the DOL, fiduciaries that choose investment products designed to preserve principal should be treated as satisfying their fiduciary duties and are deemed to be in compliance with the relevant requirements of the automatic rollover safe harbor regulation.

The Automatic Rollover Process

An IRA custodian, selected by the plan sponsor, will open an IRA in the name of the participant and place the proceeds in an investment designed to minimize risk, preserve principal, provide a reasonable rate of return and maintain liquidity. Most IRA custodians will conduct additional search efforts aimed at locating the participants.

Typically, these transactions can be completed at no cost to the plan sponsor and at a very reasonable cost to the participant.

A problem that can be expected to grow

Surveys show more people are participating in their employers' retirement plans. Yet the length of their employment is often only a few years, creating a scenario where many will be classified as missing or non-responsive. Plan sponsors would do well to prepare for this scenario.

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