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Dealing with Uncashed Distribution Checks and Missing Participants

It is estimated that uncashed checks account for billions of dollars, representing a fortune of uncollected funds belonging to plan participants or beneficiaries that they are not able to use and also represent serious issues for fiduciaries.

Uncashed distribution checks occur when retirement plan participants fail to cash or deposit a distribution check from their defined contribution plan, for a variety of reasons, including:

- An incorrect mailing address;
- A lost or misplaced physical check;
- A distribution check that was not anticipated (e.g., mandatory cash out of account balances of $1,000 or less); or
- As the result of inaction on the part of the participant.

The uncashed checks issue is a problem that has gained the attention of the Department of Labor (DOL) and Internal Revenue Service (IRS). The DOL estimates that each year $15 million in retirement plan distribution checks go unclaimed because plan participants, or their beneficiaries, have failed to cash distribution checks. And it's rapidly becoming a material issue for retirement plans.

This article will focus on defined contribution plans, although defined benefit plans have issues as well, especially since benefits may not be payable until normal retirement age, which could be well after participants terminate employment, allowing lots of time for them to go missing.

Uncashed Checks are Plan Assets

Plan sponsors retain fiduciary responsibility of the funds represented by uncashed checks. Therefore, it is the fiduciary's responsibility to work with their service providers and attempt to locate these participants in order to get them to take action.

The failure to take steps to locate and pay terminated participants can be considered a breach of fiduciary duty, potentially resulting in personal liability to plan fiduciaries.

What Should Plan Sponsors Do?

Unfortunately, there is no clear guidance from the IRS or DOL regarding how to administer these checks. Until guidance is issued by regulators, plan sponsors should take a best-practices approach while working with ERISA attorneys and service providers to develop policies and processes for managing uncashed checks, outlining those processes in plan documents (along with recording the rationale behind the choices made) and making sure the processes are implemented properly. At a minimum, plan documents or written procedures should describe:

- The steps that will be taken to locate lost or non-responsive participants;
- The time frames for banks or the plan administrator to report uncashed checks to the plan; and
- How the funds from uncashed checks will be handled if the participant cannot be located.

Searching for Missing Participants

Plan fiduciaries must make a reasonable effort to locate missing participants and should keep accurate records of all efforts to locate them. The DOL has provided steps for finding participants for terminating defined contribution plans. This guidance can be useful for ongoing plans as well.

Required Steps

The minimum steps a fiduciary must take to find lost participants are:

Send a notice by certified mail: This method allows the sender proof of mailing via a mailing receipt and verification that mail was delivered.

Check related plan and employer records: Check other plan records as well as records for other company benefits such as health insurance plans.

Check with the participant's plan beneficiary: Check with the designated beneficiary to see if he or she can provide contact information that may help locate the missing individual.

Use free internet search tools: These tools include search engines, public records databases, obituaries and social media sites.

Reasonable Additional Steps

If none of the required search methods is successful in locating the participant, the plan fiduciary needs to consider whether it would be prudent to use other methods, such as fee-based internet search services, commercial locator services and credit reporting agencies.

If the cost of using these services will be charged to the participant's account, the plan fiduciary will need to consider the size of the participant's account balance in relation to the fees that would be incurred when deciding whether to use any of these alternatives.

What are the Options if the Participant Cannot be Found?

Due to the lack of regulatory guidance regarding uncashed checks, the challenge for plan sponsors is how to appropriately handle these assets while meeting their fiduciary responsibilities. The best practice solutions available to plan sponsors depend on whether a plan is ongoing or terminating and the plan document provisions. They include:

Return Funds to the Plan

If the account balance exceeds $5,000, return the funds to the plan and reestablish the participant's account so that new earnings will accumulate. The plan sponsor must decide how to invest the assets, address restoring withheld taxes and determine if interest should be added to the account. If Form 1099-R was previously submitted to the IRS, a corrected one should be filed.

Forfeit the Account Balance

Many plans include provisions that allow account balances under $1,000 to be forfeited. If the participant comes forward in the future, the plan must make him or her whole by reinstating the forfeited amount and paying the distribution. If sufficient funds do not exist in the plan's forfeiture account at the time payment is requested, such amounts will need to be paid by the plan sponsor.

The plan should have rules and procedures addressing the time frames and circumstances in which assets may be forfeited if accounts remain unclaimed and the procedures for reinstatement if later claimed. To provide for possible future distribution requests, should a participant reappear, the plan sponsor must keep records of the forfeited account balances of missing participants.

Forfeiting funds without making reasonable efforts to locate missing participants raises compliance issues, especially if the plan uses forfeitures to reduce employer contributions.

Roll Over Assets to an IRA

The DOL has provided guidance on using automatic rollovers to roll assets of less than $5,000 into an IRA in the name of the missing or unresponsive participant or his or her beneficiary. Rollover IRAs are a viable transfer option for active plans with a mandatory cash out provision. Moving uncashed check assets into IRAs can:

- Preserve the tax-deferred status of participants' retirement accounts;
- Simplify plan administration;
- Lower overall plan costs; and
- Reduce potential fiduciary risk.

By utilizing automatic rollover IRAs, plan sponsors will be deemed to have met their fiduciary responsibilities, freeing them from the ongoing fiduciary and administrative burden of uncashed checks/unclaimed plan assets.

Most IRA custodians will take multiple steps to locate the participant to reunite him or her with the newly created account, conducting research in an attempt to locate and notify the appropriate parties. The plan sponsor should be careful to choose a rollover IRA custodian that has effective search procedures in place, as well as a proven record of reuniting plan participants with their assets.

Regulations provide a safe harbor method to satisfy fiduciary duties in selecting the IRA provider and the default investment. Specifically, an automatic rollover of a cash out distribution will satisfy the safe harbor if the following conditions are met:

- The rollover amount cannot be more than $5,000, unless from a terminating defined contribution plan;
- The account balance must be rolled over to an entity authorized by the IRS to act as an IRA custodian, such as a trust company, bank, credit union or registered mutual fund;
- The rolled over money must be invested in a product that meets requirements relating to preserving principal and providing a reasonable rate of return and liquidity;
- The fees and expenses for the IRA cannot be more than the fees and expenses the IRA provider charges for similar, non-automatic rollover IRAs; and
- The participant must have the power to enforce the terms of the IRA.

Withholding 100% of the Participant's Account Balance is **not** an Option

In the past a popular practice was to simply pay the entire amount of the distribution to the IRS as income tax withholding. Although very clean and efficient from the plan sponsor's perspective, the IRS issued guidance indicating such practice was not acceptable. Therefore, sponsors should no longer pursue 100% withholding as an option.

Preventive Action Tips

Plan sponsors should take actions to reduce the occurrence of missing participants and uncashed checks such as:

- Periodically review and cancel uncashed checks and take appropriate steps in accordance with the plan document and procedures;
- Include reminders on all plan communications to participants to update their contact information;
- Require beneficiary contact information on beneficiary designation forms;
- Do searches immediately when mail is returned;
- Request a personal email address and/or cell phone number during the exit process and emphasize that any change of address must be reported to the employer;
- If the plan document calls for mandatory cash outs and/or rollovers, do so promptly. Failure to proceed is a violation of plan terms; and
- For balances under $200, pay out the participant ASAP after termination as no withholding or distribution forms are required.

Conclusion

Uncashed checks remain plan assets and fiduciaries remain responsible for appropriately managing the funds and making sure missing participants receive their money.

In the absence of formal regulatory guidance for dealing with uncashed checks and missing participants, it is important to have written procedures in place for addressing these issues and documentation that the procedures were followed.

As the saying goes, an ounce of prevention is worth a pound of cure. In the case of uncashed checks and missing participants, there are many steps a plan sponsor can take to keep these potentially bothersome situations from becoming big headaches.

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