Making Sense of the Uncashed Retirement Plan Check Dilemma

a whitepaper by Lowell M. Smith, Jr.

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Summary

The problems surrounding uncashed pension checks go well beyond the sheer numbers. There are plan asset regulations, "Float" issues on interest on the funds awaiting transfer, notification requirements and the appropriateness of any corrective actions.

The largest issue is that there is no clear guidance from the U.S. Department of Labor or the Internal Revenue Service on all aspects of the issue.

What appears to be clear is that each service provider (recordkeeper, paying agent, trustee or other entity that deals with uncashed checks for its clients) and plan sponsors should develop a policy on what to do with uncashed checks.

The practical solutions are to return all or some of the checks to the plan or move them to an Individual Retirement Account (IRA). In either case, attempts to locate the person to whom or for whom the uncashed check was written is a key component of that policy. It may also be appropriate to factor in the cost of such search efforts since these costs are often deducted from the final amount dispersed.

This paper examines the regulatory issues surrounding uncashed checks as well as potential common sense solutions for dealing with those issues.

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Discussion & Analysis

Every service provider issuing checks to individuals from retirement plans has issues with those checks not being cashed in a timely manner, if at all. In 2011, the U.S. Department of Labor (DOL) estimated that each year $15 million in retirement plan distribution checks go uncashed.[i] Many in the industry think this number is actually higher, but there is no good way of reporting them.

The problem is typically greater when the check is sent to terminated participants with vested balances of less than $1,000. These individuals have not responded to notices or requests to affirmatively direct what to do with their funds, often because they are "lost participants" with no good mailing addresses available.[ii]

For both plan sponsors and service providers like recordkeepers, trustees and paying agents, these uncashed checks create a myriad of issues that can cause additional work and fiduciary liability. For example:

1. The Department of Labor holds that each distribution remains a plan asset until the check is cashed or a wire transfer is successfully made.[iii]
2. If the funds for these checks are held in an interest-bearing account, this "Float" arrangement is subject to scrutiny by the DOL.[iv]

To make matters worse, the DOL and Internal Revenue Service (IRS) have not clearly defined a resolution to this problem.

Plan Asset Considerations

It has been argued that once a distribution is processed, it no longer is a plan asset. The DOL does not agree with this finding and has spoken in public of its opinion that funds awaiting a check to be cashed are plan assets.

Since uncashed checks are plan assets, it is incumbent upon plan fiduciaries to work with their service providers and attempt to locate these participants in order to get them to take action. Unfortunately, this is expensive, time-consuming and sometimes impossible to do.

If the fiduciaries do not take these actions and at some point wants to terminate the plan, then the steps defined in DOL Field Assistance Bulletin (FAB) 2004-02 will apply. These steps include sending certified mailings to the best address available and tracking receipt. If you don't get a receipt, it is advisable that the plan:

- Use an electronic search process to find a better address.
- If the electronic search fails to produce a better address, conduct an extensive search of other records, such as health care records, for beneficiaries.

- If all those efforts fail to get a signature on a certified letter, as a last resort utilize the Social Security Administration letter forwarding process at a cost of $35 per letter to try to locate the individual.

When plans have lost participants, including lost uncashed check participants, this can add months to the plan termination process.

Float Issue

Funds transferred to a checking account for the plan, placed in an account at a service provider awaiting the final transfer of the funds to an IRA or other retirement program, or held in a terminated participant's checking account, are typically held in an interest bearing account.

The earnings from these types of account arrangements are called a "Float". DOL Advisory Opinion 93-24A made it clear that a Trustee is violating the self-dealing provisions under ERISA Section 406(b)(1) by retaining the Float without disclosing it to its customers.[v]

The DOL eventually clarified the responsibilities of a plan sponsor with regard to monitoring the Float in DOL FAB 2002-3. In this Bulletin, the DOL states that if a service provider can receive the Float (and not return the proceeds to the plan), the plan sponsor needs to ensure:

- The arrangement is comparable with what other service providers do in this situation and is reasonable.
- Review the circumstances where a Float can be maintained and ensure that the provider cannot create additional income or take actions like delaying transaction processing to enhance the Float.
- Review the float amounts paid when reviewing all compensation paid to the provider as part of its fees for service reviews.

DOL FAB 2002-3 also states that in order for the service provider to avoid a "self-dealing" violation under ERISA Section 406(b)(1) related to Float arrangements on distributions, the provider must take the following steps:

1. Disclose situations when the Float is generated and maintained.
2. Disclose when the Float period commences and ends and adhere to timeframes for mailing checks, electronically transferring funds or any other processes that may affect the duration of the Float.
3. Disclose either the rate of the Float or how the rate is determined. An example would be that the Float on funds pending distribution is based on prevailing money market rates.

So, not only does a service provider need to carefully draft and provide a copy of its Float policy to the plan sponsor, it also needs to make sure that it does not prolong that Float period. If a provider takes no action on uncashed checks, the DOL could argue that the reason this was done is to gain additional revenue, which is prohibited under ERISA Section 406(b)(1) regarding dealing with plan assets in their own interest or in their own account (self-dealing).[vi]

No Clear DOL or IRS Guidance

There is no definitive guidance from either the DOL or IRS on what to do with funds for uncashed checks or the steps that are required to resolve the problem. In the fall of 2013, the ERISA Advisory Committee meeting focused on this issue with the intent to ultimately issue guidance in a Field Assistance Bulletin. This proposed bulletin would presumably address:

- Requirements for searching for individuals with uncashed checks.
- Options for dealing with the funds if a person cannot be located.
- The extent to which fees can be charged to the participant for search and check reissuance services.
- Accounting for these assets on the Form 5500 filings.
- Recovering tax withholding requirements: if the funds are placed in an IRA, returned to the plan or placed in another type of arrangement.
- Other types of funding requirements, such as placing the accounts in Traditional or Roth IRA accounts.

However, even without definitive guidance, both agencies have addressed parts of the issue. One of the suggestions – actually an initial suggestion of the Department of Treasury – is to escheat the funds to the state of last known residence. However, ERISA preemption of state laws prohibits the escheatment of funds of an ERISA-covered plan. As stated earlier, since the DOL considers uncashed checks a plan asset, they cannot be escheated.[vii]

Both the IRS and DOL have stated publicly that rolling uncashed checks to an IRA is a permissible solution. It is unclear whether this pertains to any size IRA, or only IRAs under $5,000 and eligible for Automatic IRA Rollover or cash-out.[viii]

Some guidance was provided by the Department of Labor in an informal question and answer session with the American Bar Association's Joint Committee on Employee Benefits on May 7, 2009.

During that session, in response to a question about what to do with uncashed checks from an Active Plan, the DOL did state that if a plan had a cash-out provision under 29 CFR Section 2550.404a-2(d) that covers automatic rollovers, those funds can be rolled to an IRA.[ix]

However, the DOL has yet to formally address what to do with uncashed checks for amounts not eligible for automatic IRA rollover.

Framing the Solution

This lack of definitive guidance forces a plan and service provider to take a best practices approach and develop and document its policy regarding that approach. When developing that policy, the plan and service provider should consider two primary items:

1. The steps and efforts it will take to try and locate the participant to resolve the issue (i.e., cash the check or roll it over to another plan or IRA).
2. If step one fails, determine the best way to create an account in which to move the funds for the future benefit of that former plan participant.

Searching for Check Recipients

It is important when framing the policy to keep in mind that most of these uncashed checks are for smaller dollar amounts when determining the search steps that will be undertaken. Some steps can be costly, and since it is permissible and common to charge the accountholder the cost of the search and any check reissuance fees, the fee can severely reduce the amount of benefit to the participant. Given that fact, some policies limit the search process to the following steps:

2. Run a list of all uncashed check names through an electronic search process to determine if a better address can be located.
3. Send a letter to the best known address and wait a period of time – often 30 days after assumed receipt – to move the funds.

This method is relatively inexpensive, thus maintaining as much of the funds for the benefit of that participant as possible should she/he be located. More conservative options may include:

- Having the plan sponsor review all records to find a beneficiary and contact that individual in an attempt to find the participant. This often does not work because the beneficiaries frequently have the same address as the unresponsive participant. This also adds time and cost to the process.
- After getting the best address, send letters via certified mail. This too adds additional cost to the process.

Previously, it was accepted practice to utilize the Social Security Administration letter forwarding service. However, the SSA discontinued this service as of May 19, 2014. With the IRS having discontinued their location services in 2012, there is no longer a government-sponsored program available for locating missing payees. This makes the previously mentioned methods more important than ever.

Moving the Funds

The policy needs to also determine what to do with funds from uncashed checks when all search steps fail. Since escheating the assets to the state is NOT an option, it is reasonable to consider one of the following options:

- Move funds to an IRA created for the benefit of the participant. This method is often the most advantageous to the plan. Given the limited guidance from the Department of Labor, it is clear that uncashed check amounts (minus any fees related to searches) that could qualify for automatic rollover can be moved to an IRA. It is less clear whether larger amounts can be moved to an IRA, but some policies do this as well. The other question is whether to move the funds to a Roth or Traditional IRA. If records can separate out the portion of the distribution that came from a Roth source, this may be possible.

- Return the funds to the plan and place them into an individual account or forfeiture account. This method is acceptable but pushes the responsibility for looking for this lost participant back to the plan sponsor. Also, if you choose to place the funds in an individual account, a decision needs to be made on what investment to utilize or to restore that account to its pre-distribution allocation. The conservative view is to invest the funds in a money market or similar vehicle.
- Use a combination of methods. Some plans and providers may move funds of uncashed checks of amounts less than $5,000 or $1,000 to an IRA, and amounts over that threshold are returned to the plan.

Regardless of method, an organization may also want to consider correcting, if possible, any withholding made on the distribution prior to moving the assets back to the plan or transferring them to an IRA.

Documenting the Policy

No matter what search, cost-sharing or funding methods are used in resolving uncashed check issues, the key for a service provider or plan is to document and follow a clearly defined process. For a service provider issuing these checks, once a policy is set many utilize negative consent from the plan sponsor. Essentially, they notify the plan sponsor of the policy, and the plan sponsor needs to opt out and then resolve the issue themselves. For plan sponsors, carefully review your provider's policy. If the service provider does not have an acceptable policy, then the plan sponsor needs to develop and implement its own policy.

Conclusion

When formulating and executing a policy and procedure for dealing with uncashed pension checks, it may be advisable that the policy include:

- Consistently applied timeframes for taking corrective actions. For example, the search process will begin if the check is not cashed or funds are not successfully transferred within 90 days of issuance or of request.
- The rationale for making the choices in the policy (i.e., in order to preserve as much of the assets in the distribution as possible).
- The process used in attempting to locate the affected participant and what costs may be borne by that individual.
- The corrective action to be taken (return to plan or rollover to an IRA) by account size, including the handling of any tax withholding done on the initial distribution.

If the policy is created by the service provider, the plan sponsor should review and agree to it. From a service provider prospective, a form of consent (negative or affirmative) is advisable.

Source Summary

[i]Gina Martellacci, CPA, *Uncashed Checks – A Plan Sponsor's Headache*, https://www.johnsonlambert.com/news-blog/2012/12/11/uncashed-checks-%E2%80%93-plan-sponsor%E2%80%99s-headache (December 11, 2012).
[ii]Internal Revenue Code §411(a)(11)
[iii]Rebecca Moore, Unanswered Questions About Uncashed Checks, statement attributed to Susan B. Halliday, Senior Benefits Law Specialist with DOL at 2013 ASPPA Annual Conference, http://www.plansponsor.com/NewsStory.aspx?id=6442495476 (October 29, 2013).
[iv]DOL Field Assistance Bulletin (FAB) 2002-03, issued November 5, 2002.
[v]DOL Advisory Opinion 93-24A, issued September 13, 1993.
[vi]ERISA §406(b)(1).
[vii]DOL Advisory Opinion 94-14A, issued April 20, 1994
[viii]Internal Revenue Code §401(a)(31)
[ix]Questions and Proposed Answers for the Department of Labor Staff for the 2009 Joint Committee of Employee Benefits Technical Session, Question 6, held May 7, 2009

Disclaimer

About the Author | Lowell M. Smith Jr.

Mr. Smith has more than 30 years of experience in the retirement and financial services industries. His experience includes: managing a daily valuation recordkeeping operation; managing complex systems-development projects; designing and implementing website strategies; developing products and services for financial organizations; managing a compliance practice; and developing financial services and consulting firms.

Prior to co-founding Inspira, Mr. Smith was a primary architect in the development and implementation of a retirement start-up, Invesmart, Inc. (currently owned by The Standard). Prior to joining Invesmart in 1999, Mr. Smith was a Senior Consultant and Director of Operations Consulting for Universal Pensions, Inc. (UPI/Ascensus).

Mr. Smith worked nine years in Washington, D.C. for the ERISA enforcement arm of the U.S. Department of Labor. While at the DOL, he developed policies and procedures for investigating employee benefit plans, developed targeting reports, managed field office financial and labor relations operations, developed computer systems, and created and monitored the annual investigative planning process for DOL and ERISA-enforcement nationwide.

Mr. Smith is co-author of *401(k) Plans: A Comprehensive Compliance and Planning Guide*, published by John Wiley & Sons. He is also the author of *The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA): A Practical Review of the Legislation*, a book detailing the pension provisions of the 2001 tax law.

Mr. Smith has been a member of the Board of Trustees of the American Benefits Council and is the former National President of the Worldwide Employee Benefits Network (WEB). He is also a member of the Society of Professional Asset-Managers & Recordkeepers and has instructed for both the Certified Employee Benefit Specialist (CEBS) and Certified Financial Planning (CFP) programs through Robert Morris University in Pittsburgh, PA.

Mr. Smith is a 1981 cum laude graduate of Catawba College and received his M.P.A. from The Pennsylvania State University in 1983.