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PLAN DISTRIBUTIONS

To Escheat or Not to Escheat, Considerations When No One Responds

Plan fiduciaries of ongoing benefit plans continue to grapple with how to handle uncashed plan distribution checks. Until specific guidance is issued to fill in the gaps, questions remain as to whether it is prudent to escheat unclaimed funds to a state unclaimed property program.

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The issue of uncashed plan distribution checks in ongoing plans persists. A failure of a participant to negotiate a benefit check can occur for a variety of reasons, including a plan participant's simple failure to cash a distribution check; a failure to maintain current address information with the plan resulting in checks that are not received; a lack of a direct deposit arrangement on file with the plan (which can still be problematic even if one is in place if the participant has died and the plan

unknowingly continues to make direct deposit payments); job transitions; and the participant's failure to recall that there is a vested benefit with a particular plan; or the participant's death. In the retirement plan context, uncashed checks also commonly arise with respect to small balance cash-out distributions or required minimum distributions. Uncashed checks also can result from transactions that occur after what was thought to be issuance of a final distribution, such as a refund of loan repayments made after the loan has been paid off; employer contributions made to a participant's account after distribution; cash dividends issued to plans with company stock, and trailing dividends or other payments accrued to an account after the participant received a "full" distribution.

When checks are not received by the participant or the participant has gone missing, plan fiduciaries maintaining an ongoing plan are left without sufficient government guidance about how to properly and prudently address the matter. This problem has likely been exacerbated since 2020, given the relocation of many individuals during the global pandemic to various remote locations and the resulting changes in their addresses.

Field Assistance Bulletin 2014-01

In the context of terminating plans, there is guidance regarding how to handle accounts of missing participants. In Field Assistance Bulletin (FAB) 2014-01, the Department of Labor (DOL) opined that plan fiduciaries who reasonably determine that a participant or beneficiary cannot be located after making reasonable efforts to find them can distribute their plan assets to an individual retirement account (IRA), an interest-bearing federally insured bank account, or a state unclaimed property program (for example, in the state of each participant's last known residence or work location). A fiduciary cannot decide lightly not to roll over amounts to an IRA, especially due to the immediate tax and withholding obligations, but not every distribution is eligible for rollover. Importantly, the plan fiduciaries must first undertake reasonable search steps before abandoning efforts to find a missing participant, such as sending notifications by certified mail to the last known address, checking plan and employer records for address updates, running free electronic search tools, and reaching out to plan beneficiaries. Further, depending on the costs involved, additional search steps, such as the use of Internet search tools, commercial locator services, credit reporting agencies, information brokers, investigation databases, and

similar services may be warranted. The DOL further noted in FAB 2014-01 that plan fiduciaries considering escheat in this context should find out whether the state of the participant's last known residence provides searchable Internet databases that list the names of property owners, which may help participants locate their retirement funds; or whether the state pays minimal interest on unclaimed property funds. This DOL guidance, however, does not directly address the plan fiduciaries' obligation to locate missing or unresponsive participants in ongoing retirement plans.

2019 ERISA Advisory Council Report

Recognizing the need to reunite missing participants with their savings in the most effective way possible, the Advisory Council on Employee Welfare and Pension Benefit Plans (ERISA Advisory Council) published a report in November 2019 entitled *Voluntary Transfers of Uncashed Checks from ERISA Plans to State Unclaimed Property Programs* (Report). The ERISA Advisory Council's primary goal in the Report was to make recommendations to the DOL for issuance of guidance regarding the circumstances under which an ERISA plan fiduciary could prudently and voluntarily transfer uncashed distribution checks that are owed to a participant or beneficiary who cannot be reasonably located, from a retirement plan to state unclaimed property programs. The ERISA Advisory Council also posited that the guidance should clarify that uncashed checks are plan assets, which would encourage plan fiduciaries to handle them prudently. Importantly, however, the ERISA Advisory Council asserted that such guidance should not obstruct the ERISA preemption analysis, nor allow a participant to make a claim against the plan for payment after the benefit has been escheated.

To date, advisors to plan fiduciaries typically disfavor transferring checks to state unclaimed property funds because the available guidance from the DOL indicates that state unclaimed property laws are preempted by ERISA. [*See, e.g.*, Advisory Opinion 1994-41A (Dec. 7, 1994); Advisory Opinion 79-30A (May 14, 1979); Advisory Opinion 78-32A (December 22, 1978)] ERISA preemption protects plan fiduciaries from having to determine state unclaimed property programs to which the plan could be subject, especially if the employer operates in multiple states. It also serves to forestall situations whereby a participant or beneficiary could assert an ERISA Section 502 claim against the plan for a benefit payment that already was escheated to a state program,

subjecting the plan to exposure to pay out a benefit twice. Further, the DOL has examined uncashed check issues in its investigations of terminated vested participants, which leaves plan fiduciaries at risk for scrutiny of its uncashed check practices and enforcement actions. That being said, a safe harbor streamlined approach is warranted to address the gap in the guidance and resolve the issues presented.

Notably, the Report did not recommend that guidance addressing voluntary transfers to state unclaimed property programs should exclude other available options for addressing uncashed checks, such as involuntary rollovers or transfers to taxable accounts or forfeiture-and-restoration methods. Rather, the intention of the ERISA Advisory Council's recommendation is that the guidance should confirm that the plan fiduciaries can decide the extent to which it engages in any voluntary transfers to state programs, including the ability to choose to transfer uncashed checks below a certain amount or only of a certain type while utilizing other options for larger uncashed checks or different types of payments. The recommendation also included a request that ultimate DOL guidance state that a plan fiduciary shall not be treated as failing to satisfy the duty of prudence to the extent assets are transferred to a state unclaimed property program that meets minimum standard requirements.

While outside its domain of authority, the ERISA Advisory Council recognized that a federal clearinghouse approach to uncashed checks might be preferable to the voluntary state-by-state escheat approach outlined in its Report, if one could be developed. A centralized repository would have the dual advantages of solving the fiduciary dilemma while providing ready access by the participants to lost funds. In late October, 2020, The Securing a Strong Retirement Act (SECURE Act 2.0) was introduced in Congress [H.R. 8696], which includes a provision to create a national online lost and found for retirement accounts, based on data that employers already are required to report to the Treasury Department. Passage of this law, or others that have previously, or will be, introduced with similar provisions, and any rollout of a national lost and found database or repository for uncashed checks, will need to be monitored.

Recent Department of Labor Guidance

In addition to the foregoing, on January 12, 2021, the DOL's Employee Benefits Security Administration (EBSA) announced guidance in

three different forms pertaining to the location and distribution of retirement benefits to missing or nonresponsive participants. The first part of the guidance set forth Best Practices that fiduciaries of defined benefit and defined contribution plans should consider implementing to minimize a missing plan participant population (Best Practices), which also would minimize uncashed check issues. The second part of the guidance was Compliance Assistance Release No. 2021-01 to foster consistent investigative processes and case-closing practices among EBSA's Regional Offices conducting terminated vested participants audits and to facilitate voluntary compliance efforts by plan fiduciaries. These investigations focus on plans that have systemic plan administration issues, particularly those related to keeping track of terminated vested participants and beneficiaries. The third part of the guidance was FAB 2021-01, addressing the DOL's temporary non-enforcement policy of violations under Section 404(a) of ERISA against plan fiduciaries of terminating defined contribution plans or qualified termination administrators (QTA) of abandoned plans in connection with the transfer of a missing or non-responsive participant's or beneficiary's account balance to the Pension Benefit Guaranty Corporation (PBGC) in accordance with the PBGC's missing participant regulations. The PBGC procedure is an alternative to rollovers to an IRA, or transfers to certain bank accounts or to a state unclaimed property fund, so long as the plan fiduciary or QTA complies with the guidance in the FAB 2021-01 and acts in accordance with a good faith, reasonable interpretation of Section 404 of ERISA. Under this guidance, the DOL would not be precluded from pursuing violations under Sections 404 or 406 of ERISA for a failure to diligently search for participants and beneficiaries prior to the transfer of their account balances to the PBGC or from pursuing violations under Sections 107, 209, or 404 of ERISA for a failure to maintain plan and employer records. Notably, to the extent FAB 2021-01 conflicts with the distribution guidance of FAB 2014-01, FAB 2021-01 controls.

Making Use of the Guidance Available

As part of their responsibility to prudently manage plan assets, plan fiduciaries of ongoing plans must take heed of the various forms of guidance available, and follow proactive procedures suitable to their facts and circumstances, to locate missing participants and beneficiaries and mitigate the risk of uncashed

distribution checks. It would be prudent for plan fiduciaries that have reasonable procedures in place to address these issues to review and update those procedures in light of the most recent guidance. For plan fiduciaries that have not discussed these issues with plan service providers, such as recordkeepers, or generally are not aware of the status of uncashed checks or missing participants and beneficiaries in their plan, the time to take action is now. Consider the following:

- *Review current status of uncashed checks from the plan.* It is important to identify the scope of any plan distributions that have resulted in uncashed checks that remain unresolved. It is not uncommon for plans to undertake self-audits of uncashed distribution checks and learn that there are significant accumulations of uncashed checks in the records, despite having procedures to otherwise address them. In the event of any changes in plan service providers or acquisitions, it also is important to ensure that the plan history on uncashed checks is properly maintained and transferred to the new plan service providers. Once the scope of any potential problem is identified, action steps can be taken to address the immediate cases, and to solidify ongoing procedures to monitor these issues for future distributions.
- *Update participant address and contact information and verify against death records.* Plans commonly have outdated contact information for plan participants and beneficiaries. It would be prudent to revisit contact information periodically, especially for terminated vested participants and participants in pay status, and to document the participant address verification procedures. Consideration also can be given to advising participants in the summary plan description of their obligations to advise the plan of address and other contact information changes after termination of employment, along with setting forth other requirements for requesting distributions from the plan. A campaign could be undertaken at desired intervals (for example, annually or semi-annually) to request that all participants with accounts in the plan update their addresses and contact information with the plan. If these participants are non-responsive, the plan fiduciaries should consider next steps, such as review of other plan or employer records that may include contact information or reaching out to designated beneficiaries for assistance. It is prudent to periodically cross check terminated vested

participants, and those in pay status, against death records to ensure that payments are not distributed to the deceased. Given the amount of change that occurred in 2020 alone with job transitions and relocations, participant verification projects are timely.

- *Identify missing participants.* As periodic campaigns reveal missing participants, plan records can be updated to flag these issues sooner rather than later. The plan can then undertake additional research using the available search methods set forth in guidance such as FAB 2014-01 and EBSA's Best Practices guidance to locate the missing participants or make a reasonable determination as to whether they will ever be located.
- *Differentiate between uncashed checks that were received versus those that were not received.* In Revenue Ruling 2019-19, the IRS noted that, if a participant receives a distribution check from a qualified plan but fails to cash the check, it is still included in gross income that year, subject to applicable withholdings, and reportable on a Form 1099-R. Last year, the IRS also issued Revenue Ruling 2020-24, which instructs that retirement plans should issue a Form 1099-R for amounts transferred to a state unclaimed property fund, reflecting applicable withholdings on such amounts. Compliance with these withholding and reporting obligations should be in place for such payments no later than January 1, 2022. Notably, the IRS issued Revenue Procedure 2020-46 to provide relief from 60-day rollover requirements where plan participants self-certify that they have been unable to complete a rollover due to their distribution having been made to a state unclaimed property fund. This relief allows them to later complete the rollover of the amount distributed, and any amount that was withheld for income tax, within 30 days of no longer being prevented from doing so (that is, presumably within 30 days of the participant being able to locate and obtain their distribution that had been escheated to a state unclaimed property fund). While the IRS guidance does not address whether transfers from ongoing plans to state unclaimed property funds is permissible, it signifies their position on this issue from a tax perspective. Thus, plan fiduciaries should ensure that they are monitoring when checks are received and reporting those distributions properly, as well as reporting any transfers to state unclaimed property funds properly.

- *Review service agreements with recordkeepers and their uncashed check policies, as well as plan terms.* Plan fiduciaries should confirm their service provider's uncashed check policies and review their terms in service agreements or request a copy of their procedures. Typical service provider procedures state that, when a distribution check remains uncashed within 120 days from its date of issuance, the check will become void. If that occurs, steps generally are undertaken to locate the participant and reissue the check but, if the participant cannot be located after reasonable diligence, the plan is left without guidance. As a result, checks could remain in an uncashed or voided state indefinitely, unless the plan fiduciaries analyze their available options and take action, which they may have to defend later in the absence of specific guidance. Plan fiduciaries should ensure that they are familiar with the service agreement terms, as well as any plan document provisions, and determine whether any additional procedures are desired as part of the service so that they can be addressed in an agreed-on approach.
- *Compare current practices for addressing uncashed checks for consistency with plan terms, service agreement terms, and currently available guidance.* Once the applicable terms are confirmed, it is important to determine that they, in fact, are being followed in plan administration. Then, if the plan fiduciaries identify current accumulations of uncashed checks that were not received by the intended parties, decisions can be made regarding how to handle them in accordance with applicable plan document and service agreement terms, as well as the available guidance from the DOL and IRS, as applicable. The plan fiduciaries will need to make a prudent determination as to whether the particular type of distribution (that is, whether it is an eligible rollover distribution) that was made and uncashed can be forfeited subject to restoration, rolled over to an IRA, deposited to a federally-insured bank account, or escheated to a state unclaimed property program. Even though there are gaps in the current guidance, plan fiduciaries will need to make a reasonable determination that they can prudently assert under the circumstances.
- *Document prudent process for any use of state unclaimed property programs.* Based on the current guidance for terminating plans, escheat of missing participant distributions to a state unclaimed property program appears to be a last resort approach to enable a plan to wind up. Thus, it would be prudent to await specific guidance as to the minimum standards that should be met before voluntarily escheating a plan distribution from an ongoing plan to a state unclaimed property program. If, based on all of the facts and circumstances, escheat is deemed as the most viable option in a particular scenario, then it would be prudent to document the reasons for this determination, and demonstrate adherence to the factors set forth in FAB 2014-01 and subsequent applicable guidance in implementing such an option. That being said, in the absence of a safe harbor, use of such an option is not without risk and is most difficult to assert as prudent and reasonable.
- *Monitor release of new guidance.* The issuance of new guidance in response to the Report, as well as passage of SECURE Act 2.0 or other laws with provisions creating a national lost-and-found database or repository for uncashed checks, must be monitored. Plan fiduciaries should incorporate any new guidance into, and make any necessary updates to, its uncashed distribution check policies and procedures accordingly.

Conclusion

Until guidance is issued providing plan fiduciaries with specific guideposts—or even a safe harbor—for handling uncashed distribution checks in ongoing plans, plan fiduciaries should maintain and consistently follow prudent policies that are based on a thorough analysis of the available guidance. A proactive and well-reasoned approach will best serve the plan participants and beneficiaries, and provide plan fiduciaries with support to defend their actions if called on to do so in a government audit, or otherwise. ■

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