Tackling the **50-Year Old** Un-Cashed Check Problem

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The growing problem of un-cashed pension checks has been making the news more of late. But if you think the problem is a new one, think again. I have personally been involved with this issue since 1966. And our company, PenChecks, has been working on solutions since 1994.

Over the years, many institutions adopted policies of simply sitting on these unclaimed funds. Others chose to return the funds to the plan as forfeiture – even if benefit payments had been previously taxed and eliminated from the employee's salary deferrals. Most of these institutions have no policy in place to restore the taxes withheld. Instead, they apply the forfeited funds against fees or reallocate them among the remaining participants.

The problem with this approach is that it takes money from employee salary deferrals without any regulatory authority to do so. Recognizing this, some institutions transfer the taxed benefit balances to a traditional IRA. However, this action is also not covered under either Roth IRA or 401k rules, which means the institutions must develop systems that can distinguish between already-taxed funds and earnings that will be taxed once the distribution is made. Some institutions have already developed the capabilities to simultaneously track pre- and post-tax contributions. However, if the transfer of taxed benefit balances to an IRA becomes an industry standard, all institutions will need to have such systems in place

THE PENCHECKS APPROACH

At PenChecks, we have devised several alternative solutions to un-cashed checks, all of which depend on who originated the initial distribution.

When we're contracted to disburse a retirement benefit payment as a lump sum payout, we guarantee the check will not become stale-dated. After 60 days, we initiate a search for the participant. If the search fails to locate the participant we stop payment on the check and immediately restore the taxes. If necessary, we also establish a default IRA or return the funds to the plan to restore the participant's account balance under the plan.

We restore the taxes because participants that don't file a tax return within three years lose the tax credit generated by the withholding taken from the benefits distribution. If the funds are forfeited (the default practice of many record keepers), participants also lose the ability to recapture them. And if a plan gets terminated, the forfeiture disappears forever.

Rolling over unclaimed accounts into an IRA gives participants a better chance of finding their money. However, this approach has its own challenges. Some IRA administration programs may not be capable of distinguishing and tracking taxed versus un-taxed dollars. Accordingly, to avoid double-taxing monies from which taxes were previously withheld, a plan sponsor using this method should verify that the IRA provider and its system can record, track and monitor this distinction. Also, to further preserve the principle balance of the IRA, the fees charged against the IRA should be paid first from earnings and then from principle, if and only to the extent necessary.

To address this challenge, PenChecks creates a taxable savings account as an alternative for already-taxed benefit payouts. This insures that the funds will be escheated to the state of the participant's last known residence according to that state's dormancy period (usually two years), and guarantees that ongoing fees will not deplete the funds. While most states will hold on to escheated accounts in perpetuity, they do not pay interest on the funds.

Rather than dictating how the funds should be directed, PenChecks prefers to educate plan sponsors on the pros and cons of using a taxable savings account versus a default IRA, and have them make the final decision. We favor the taxable savings account for several reasons. First, we issue an annual 1099Int (instead of a 5498 for the IRA), while automatically withholding 10% of the earnings above $25 for tax purposes. If the plan participant files a tax return, they will discover the tax credit and hopefully try to find out where it came from. If the account still goes unclaimed, we escheat the funds, issuing a 1099R with a code indicating it is a non-taxable distribution. If we didn't pay any taxes on the earnings, we show that the earnings component is taxable.

In the IRA scenario, the account could be charged administrative and asset management fees for every year the funds remain in the IRA. The IRA also accumulates earnings (and will continue to be charged fees) until the required minimum distribution kicks in when the participant reaches age 70-1/2 even if the plan participant hasn't been found, the record keeper must still make the required distribution or face significant penalties to the IRA.

When the participant reaches age 70-1/2 we calculate the minimum required distribution and transfer that sum to a taxable savings account (TSA). We repeat the process for the second year, and in the third year we transfer the remaining balance into the TSA. From there we look to the escheat rules of the state of the participant's last known residence. When the appropriate time period has elapsed, we escheat the funds to the appropriate state.

Based on our experience, PenChecks **recommends** the following:

1. For any benefit payment that goes un-cashed, the originator must retrieve the taxes. If the account exceeds $5,000, simply return the funds to the plan and re-establish the participant's account. If less than $5,000, establish a default IRA.

2. When establishing a default IRA, set a holding period based on the unclaimed property dormancy period of the state of the participant's last known address, usually two to five years. At that point it can be escheated to the appropriate state, or perhaps even the Pension Benefit Guarantee Corporation.

3. All default IRAs and taxable savings accounts should be registered with the National Registry of Unclaimed Retirement Benefits (NRURB), a wholly-owned subsidiary of PenChecks that does not charge a fee for its services.

Currently there exists a great deal of inconsistency in processes and procedures throughout the industry. Yet, a solution is possible, starting with everyone acknowledging the gravity of the problem. To date, regulators have been reluctant to take action other than to claim that all these funds – taxed or not – still count as qualified money. Until regulators issue the necessary guidance, the inconsistencies in how these situations are administered will continue.

ABOUT PENCHECKS

PenChecks Trust Company of America (PenChecks Trust) is a state-chartered, non-depository trust company and the largest independent provider of outsourced benefit distribution services and Default/Missing Participant IRAs in the country.

With 20 years in business, PenChecks Trust is an expert and industry-leading provider of unique and comprehensive solutions for a myriad of trust resolution issues. Services include automated and branded solutions for benefit payment processing, uncashed/stale dated checks, Abandoned Plan/QTA services and Taxable Savings Accounts. Customers include financial institutions, third party administrators, plan advisors, and plan sponsors.

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