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WHITE PAPER

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Resolving the Un-Cashed Pension Check Problem

INTRODUCTION:

Resolving the Un-Cashed Pension Check Problem

Un-cashed retirement benefit distribution checks present a growing problem for plan sponsors, institutional plan providers and third-party administrators. Current estimates place the total value of these un-cashed checks in the billions of dollars. And proper management of these assets represents but one of many problems – including 1099R preparations, tax withholding, recurring benefit payments, escheatment issues, and missing participant account balances – surrounding the larger issue of abandoned retirement plans. Within the last five years, financial services firms have finally recognized the complexity of the problem, and have begun exploring different methods of managing un-cashed pension check funds. Yet, the situation remains unsettled at best.

Plan administration costs continue to grow. Escheating of un-cashed checks, long considered the default position for many plan sponsors and institutions, is increasingly viewed as untenable. Lack of clear regulatory guidance from the IRS and DOL allows for a wide variety of interpretations on how to handle unclaimed participant funds. And continuing failure of plan sponsors to uphold their fiduciary responsibilities increases the risk of costly lawsuits.

Where do we go from here?

INSIDE

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A MULTI-FACETED PROBLEM

As far back as the late ‘60s, many large companies employed outside auditors to verify the movement of their retirement plan funds and the proper negotiation of plan checks. In most cases, banks credited participants with interest on their funds for as long as the un-cashed checks were held. Since that time, however, auditing un-cashed checks has taken a back seat to other issues raised by the enactment of ERISA and new audit requirements.

As a result, most institutions adopted policies of simply sitting on these unclaimed funds. Others chose to return the funds to the plan as a forfeiture – even if benefit payments had been previously taxed and emanated from the employee’s salary deferrals. In addition, most institutions have no policy in place to restore the withheld taxes, which only adds to the complexity of the problem. 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. ERISA does not authorize any company or institution to give away vested employee account balances that consist of money withheld from their salary. Yet, some institutions have adopted this as their default solution. And once an account is forfeited, the plan participant has virtually no chance of restoring it.

Considering the complexity of plan mergers and terminations, as well as limited record keeping on forfeiture accounts, escheating the funds to the appropriate state might seem like the better alternative. Yet, even escheatment does not offer an ideal solution. Most state unclaimed property programs do not proactively search for participants with un-cashed checks. Most states hold on to the funds in perpetuity, however they keep the float rather than paying interest on the funds. And once escheated, the funds lose their qualified status.

Currently, many institutions simply transfer the taxed benefit balances to a traditional IRA account. However, this action is also not covered under Roth IRA or 401k rules, and not all institutions have systems in place that can distinguish between already-taxed funds and earnings that will be taxed once the distribution is made. Other organizations have begun using automatic rollover IRAs as a potential solution, yet even this approach is not without problems.

3 STEPS TO PROPER OVERSIGHT

Given the current lack of regulatory guidance regarding un-cashed pension checks, the challenge for plan sponsors is how to appropriately handle the assets while upholding their responsibilities to plan participants. Based on 20+ years' experience of successfully managing retirement plan distributions, PenChecks recommends a three-step process for accomplishing these goals.

1. The plan sponsor prepares a list of all distributions and asks the financial institution to verify all checks that have not cleared.
2. For checks that have not cleared, the plan sponsor instructs the institution that issued the checks to credit any interest to the participants' accounts and recover any taxes that might have been withheld. When appropriate, the plan sponsor also provides new addresses for plan participants.
3. The plan sponsor also instructs the institution to issue a corrected 1099R for each un-cashed check. Funds totaling less than $5,000 can go into a default IRA or back into the plan. Funds exceeding $5,000 must be put back into the plan.

Following these steps will resolve the un-cashed check problem while upholding the plan sponsor's oversight responsibilities. However, many companies don't have the time or resources for this approach. In those situations, turning the un-cashed checks over to a company that specializes in the distribution of retirement assets offers a cost-effective alternative.

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1 Prepare a list of all distributions and ask their financial institution to verify all checks that have not cleared.

2 For checks that have not cleared, instruct the institution to credit any interest to the participants' accounts and recover any taxes that might have been withheld.

3 Have the institution issue a corrected 1099R for each un-cashed check.

THE PENCHECKS APPROACH

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Over the years, PenChecks has devised several alternative solutions to un-cashed checks, all of which depend on the source of the initial distribution.

When we contract 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, 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.

Restoring and rolling over unclaimed accounts into an IRA gives participants a better chance of finding their money. However, because the money has already been taxed before going into the IRA, participants will get double taxed when they claim their funds. And in most cases, the fees charged against the IRA come from the initial principal rather than the earnings, which can erode the value of the plan.

To avoid these problems, 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 last known residence (usually within two years), and guarantees that ongoing fees will not deplete the funds.

For several reasons, PenChecks recommends a taxable savings account (TSA) over a default or traditional IRA for those funds where the taxes were not restored. 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 learn 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.

With a default IRA, the account could be charged ongoing administrative and asset management fees. The IRA also accumulates earnings (and will continue to be charged fees) until the required minimum distribution kicks in at age 70½. Even if the plan participant hasn't been found, the record keeper must still make the required distribution or face significant penalties.

When the participant reaches age 70½, we calculate the minimum required distribution and transfer that sum to a 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.

Working together, we can solve these and other challenges we face in administering a very complex business.

FINDING THE RIGHT SOLUTION

Currently there exists a great deal of inconsistency in processes and procedures regarding the handling of un-cashed pension checks. In order for plan sponsors to uphold their fiduciary responsibilities, PenChecks recommends the following:

- 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.
- 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.
- All default IRAs and taxable savings accounts should be registered with the National Registry of Unclaimed Retirement Benefits (NRURB), which does not charge a fee for registering the account.

No solution is perfect, but following these steps can help to protect the plan sponsor against potential lawsuits while increasing the odds of putting the money into the hands of the rightful plan participant.

As an industry, we face many hurdles in resolving the issues inherent with un-cashed checks. Any feasible solution must begin with acknowledging our fiduciary obligation to participants, followed by clear regulatory guidance from the IRS and DOL. Working together, we can solve these and other challenges we face in administering a very complex business.

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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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