Addressing the Pension Plan Un-Cashed Check Problem

The problem of un-cashed pension checks has been with us for decades. Moreover, it 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. But with these unclaimed funds now totaling billions of dollars and growing daily, the issue can no longer be ignored.

As far back as the late ‘60s, many Fortune 1000 companies recognized the problem and employed outside auditors to verify the movement of 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.

All of which begs the question: *How did this problem manage to stay under the radar for so long?*

For starters, regulatory guidance from the IRS and Department of Labor (DOL) regarding proper management of un-cashed pension checks has been slow in development and does not address all facets of the problem. At the same time, many plan sponsors have failed to grasp the significance of the problem. Comparing the dollar value of un-cashed checks to the total value of the trust, they judged the matter to be insignificant – assuming it even appeared on their radar screens at all.

As a result plan sponsors turned their attention to other fiduciary concerns such as selecting custodians, record-keepers and investment platform providers, plan compliance, audit rules for larger plans, and other issues deemed more important.

THE INDUSTRY **AWAKENS** TO THE PROBLEM

Within the last five years, plan sponsors and institutions have recognized the enormity of the un-cashed check problem, and have begun exploring possible solutions. Some of these solutions offer promise, while others raise troubling questions, such as the practice of forfeiting a participant's un-cashed 401k account balance even though neither the plan document nor regulations support such an action.

In fact, in the entire history of forfeitures, no regulation has ever deemed it appropriate to forfeit an employee's salary deferrals and reallocate them to pay plan expenses for other employees. Yet, some institutions have adopted this as their default solution, making it a worst-case scenario for the plan participants whose accounts are forfeited.

ERISA does not authorize any plan sponsor or service provider (e.g., a financial institution) to give away vested employee account balances that consist of money withheld from their salary. More important, once an account is forfeited, the employee has virtually no chance of restoring it. Considering the complexity of plan mergers and terminations, as well as limited record keeping on forfeiture accounts, it would be better to simply escheat the funds to the appropriate state.

Even so, escheatment does not offer an ideal solution. Most state unclaimed property programs do not proactively search for participants with un-cashed checks. They keep the float rather than paying interest on the funds. And once escheated, the funds lose their qualified status.

A better solution, and one we have employed at PenChecks for two decades, involves acting as the successor custodian and implementing an extensive search process to locate plan participants. Depending on the size of the account balance, this can include using a private investigator and registering the individual with the National Registry of Unclaimed Retirement Benefits (NRURB) – at no cost to the plan sponsor, institution or participant. In addition, the funds retain their qualified status if placed in an IRA account.

Every 18 months, the NRURB runs its entire database through a search engine. Depending on instructions from the plan sponsor or institution, each account is set up in a taxable savings account or IRA. If these accounts go unclaimed, they will eventually be escheated according to the rules of the state of the participant's last known residence.

PENCHECKS TRUST

WORKING TOGETHER FOR A SOLUTION

At PenChecks, no check executed out of our system remains un-cashed. If not negotiated within 90 days of issuance, every check is completely reversed and all withheld taxes are restored. This gives the plan sponsor the option of establishing a default IRA or returning the funds to the plan and reinstating the participant's account balance. Our approach isn't the only possible solution. But it does give plan sponsors and institutions an effective tool and a reasonable, documented process for upholding their fiduciary responsibilities to their clients and their employees.

Meanwhile, for the DOL to consider un-cashed checks to be plan assets (regardless of whether taxes are withheld) without supporting regulation leaves the industry at the mercy of the best sales pitch. If these checks are to be treated as plan assets, the DOL must provide appropriate guidance. For example, the funds could be returned to the plan as an after-tax benefit without violating rules that might disqualify the plan.

Or, funds attributable to salary deferrals could be returned to the plan as a separate Roth IRA. Accounts under $5,000 could be set up in a Roth unless the taxes were restored. Then the account could be returned to the plan in its prior status or placed in a Rollover IRA.

The IRS and DOL face many challenges in resolving the un-cashed check issue. Yet, as the primary regulatory agencies, the responsibility for issuing appropriate regulatory guidance rests squarely on their shoulders. Crafting a workable solution won't require rocket science. But it must begin with everyone acknowledging the scope of the problem and their fiduciary obligation to their clients and to the industry as a whole. Working together, we can solve these and other challenges we face in administering a very complex business.

ABOUT PENCHECKS

Peter Preovolos is a founder and CEO of PenChecks, Inc., the largest independent provider of outsourced benefit distribution services and Default/Missing Participant IRAs in the country.

Founded in 1994, PenChecks is an expert and industry-leading provider of unique and comprehensive solutions for a myriad of trust resolution issues, including automated and branded solutions. Customers include financial institutions, plan advisors, third party administrators and plan sponsors.

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