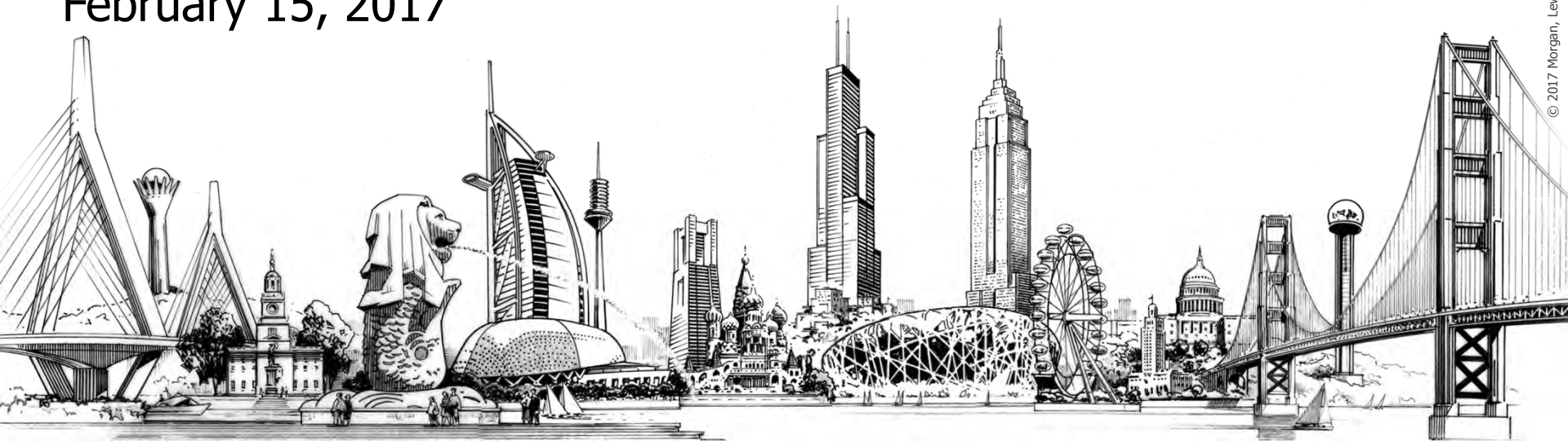


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LOST AND MISSING PARTICIPANT ISSUES

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Circumstances Where Lost and Missing Participants Become an Issue

- Unlocatable Participants for Whom a Benefit Remains Payable Under Plan
- Mortality Audits
- Beneficiary Research
- Uncashed Checks Resolution
- Defined Contribution Plan Terminations
- Participant Data Quality Analysis

Three Types of Participants

- This webinar will address three types of participants:
 - Lost participants;
 - Recalcitrant participants; and
 - Participants who have been paid but have uncashed checks.
- Each group is distinct, although participants with uncashed checks are often lost participants.

Fiduciary Responsibility

- Fiduciary responsibility under ERISA
 - Plan fiduciaries have a responsibility to pay benefits when due and to operate the plan for the exclusive benefit of participants and their beneficiaries. This responsibility includes taking reasonable steps to locate participants and taking reasonable steps to ensure payment of benefits.
 - Prudence standard applies. A plan fiduciary cannot ensure that payment is received, but is responsible for establishing and following a prudent process that is intended to ensure that benefits are paid when they are due.

Lost Participants

- Who is a lost participant?
 - A participant for whom no valid address exists;
 - A participant for whom the plan sponsor has conducted a diligent search; and
 - A participant for whom a benefit remains payable from the plan.

Lost Participants (continued)

- SPD should make clear that participants are responsible for keeping their addresses updated.
- Lost participants can be identified when amounts are payable from the plan and when required notices are sent, e.g., SAR, Annual Funding Notice and returned undeliverable.
- If notices are returned, then, at the least, participant should be placed on a “lost participant” list and steps should be taken to locate them.

Lost Participants (continued)

- Some Plan Administrators initiate a missing participant search only when a payment is due.
- However, rather than wait until a benefit is payable, when notices are returned to the plan sponsor as undeliverable it is advisable to initiate a search at that time.
- The more time that elapses between the first evidence of a lost participant and the date a benefit must be paid, the greater the chance of not finding the participant.

Lost Participants: Searching Methods

- DOL in FAB 2014-01 made it clear that a fiduciary has not discharged his/her obligation to locate a lost participant unless and until all of the following actions are taken:
 - Using certified mail
 - Checking related plan and employer records
 - Checking with designated plan beneficiary
 - Using free electronic search tools
- By its terms, FAB 2014-01 applies to terminated defined contribution plans. However, there is some indication the DOL expects the principles to be applied to all missing participant searches.

Lost Participants: Searching Methods (continued)

- IRS's and Social Security's letter-forwarding services are no longer in existence.
- Most companies use a private search firm and perform periodic updates to participant data.
- Despite use of search methods, there will be times when fiduciaries cannot locate participants.

Lost Participants: Payment Situations

- Lost participant payment situations
 - Plan termination and distribution must be made
 - Participant's benefit is less than cashout threshold in plan and needs to be distributed, e.g., less than \$1,000
 - Participant has reached mandated distribution date – either normal retirement date (NRD) (when plan requires commencement) or age 70½

Lost Participants: Plan Termination

- Plan Termination Distributions:
 - Defined Contribution (DC) Plan
 - If plan sponsor maintains another DC plan in a controlled group, it must transfer account balance of a lost participant to other plan
 - If no other plan is maintained in controlled group, then plan sponsor should (in order of DOL preference) initiate a rollover, set up an account in a federally insured interest-bearing bank account, or consider escheating to state
 - In all cases, distribution of the account balance triggers withholding and a 1099-R
 - Can't do 100% withholding

Note: PBGC has proposed creating a lost participant program for terminated DC plans.

Lost Participants: Taxable Event

- A participant's distribution is taxable once made, even if he/she did not receive the payment
- It is important not to send payments to lost participants without prior verification of address
- A participant may claim at a later date, if he/she is located, that he/she never received the check and ask that prior tax reporting be undone, but that is difficult to do and impossible if closed year
- While not required, it may be advisable to maintain a permanent check register or bank payment record to verify whether checks were ever cashed

Lost Participants: Plan Termination

- Defined Benefit (DB) Plan Termination
 - PBGC missing participant program will take benefits of missing participants.
 - Withholding should not be applied in this instance and no 1099-R will be issued.
 - PBGC or insurer will issue 1099-R and withhold taxes when distribution occurs.
 - Unclear if PBGC will take cashout amounts. If not, it is reasonable to follow DC approach.

Lost Participants: Nonforfeitable Benefits

- IRS requires certain benefits to be nonforfeitable.
- Nonforfeitable right cannot be extinguished by a subsequent event.
 - Benefits payable to a participant who is lost cannot be “permanently” forfeited if the participant resurfaces.
 - Benefits must be reinstated either through the forfeiture account in a plan or through additional contributions by the sponsor if necessary to reinstate the benefits.

Lost Participants: When Is a Benefit Forfeitable?

- When is a benefit forfeitable?
 - Terms of plan should control.
 - Treas. Reg. section 1.411(a)-11(c)(1) states that “if an accrued benefit is immediately distributable, section 411(a)(11) permits plans to provide for the distribution of any portion of a participant’s nonforfeitable accrued benefit only if the applicable consent requirements are satisfied.”
 - A benefit is immediately distributable if it is payable prior to the later of age 62 or the plan’s normal retirement age (NRA).

Lost Participants: When Is a Benefit Forfeitable? (continued)

- Once a benefit is no longer immediately distributable, a plan may distribute the benefit in the form of a QJSA in the case of a benefit subject to section 417 of the Internal Revenue Code or in the normal form in other cases without consent.
- A cashout is an exception to the above rule.
- If participant consent is required for a distribution prior to NRA or age 62, if later, a forfeiture cannot occur before then because participant consent to distribution is required – a plan cannot assume that a lost participant has consented to distribution until it is no longer immediately distributable.
- The DOL's views on forfeitures are unclear.

Lost Participants: Cashouts

- Cashout Amount
 - If a plan has a cashout provision, and a participant is missing, the plan can provide for a forfeiture of that benefit, i.e., if amount does not exceed \$1,000
 - Plans may consider a mandatory rollover for missing participants with benefits of \$1,000 or less. Many IRA providers now accept these small amounts.
 - Forfeited benefit is subject to reinstatement without interest if participant resurfaces and makes a claim for benefit
 - Forfeiture action keeps benefit in plan, and if it is a DB plan, absolves plan of PBGC premium payments on missing participant

Lost Participants: Cashouts (continued)

- If a benefit is not distributed, then there is no withholding and no 1099-R at this time.
- If the amount exceeds \$1,000 but is less than \$5,000, the plan administrator should roll over the amount to an IRA established for that purpose by the plan. No forfeiture – instead, the benefit is now in a vehicle outside of the plan.
- In this case the benefit is distributed and there is no withholding applied because of the rollover, but 1099-R would be issued to the participant's last known address and to the IRS.
- The Plan should retain records of the rollover in the event the Participant later surfaces searching for the benefit.

Lost Participants: Payment at NRD or Age 70½

- Benefits due to be paid at NRD or age 70½
 - Some plans require a distribution to commence at NRD, and others permit participants to defer payments to age 70½
 - If a participant is missing, forfeited benefit is subject to reinstatement if participant resurfaces
 - Do not issue check, withhold taxes, or issue 1099-R

Recalcitrant Participants

- Who Is a Recalcitrant Participant?
 - A participant who is not missing, but refuses to return election forms when payment is due
 - This can occur at NRD or at age 70½
 - Cashout situation is different because law provides for automatic distribution with 20% withholding if a participant does not elect rollover or cash for a distribution

Recalcitrant Participants (continued)

- Notify participant regarding payment deadline
- Provide multiple opportunities to elect payment
- Make clear in communications what will happen if participant does not return election forms (e.g., if Plan so provides, commencement in normal form, with assumptions re: marital status and age of spouse if no response by deadline)

Recalcitrant Participants: QJSA Payment

- For DB plan, if Plan so provides, assume participant is married and assume spouse is same age (or another reasonable assumption) and commence payment of annuity
 - Not every Plan provides for default commencement of benefits in the normal form
 - Questions exist on whether a recalcitrant participant in fact is missing (a 50% excise tax should be a sufficient motivation for a rational person)
 - If participant contacts plan administrator to correct spouse's age or to claim single status, adjust benefit going forward based on correct data; however, arguably no requirement to adjust payments already made
- Withhold taxes as required and issue 1099-R

Uncashed Checks

- Most frustrating and common situation for plan administrators
- Uncashed checks can occur due to participant error or lack of attention by participant
- Uncashed checks are often triggered by bad address (hence recommendation that missing participant searches be done frequently to reduce bad addresses and that payment generally not be made if address is not verified)

Uncashed Checks (continued)

- Can reduce number of uncashed checks by not sending checks to lost participants – conduct search efforts first before sending checks
- Uncashed checks can occur in cashout situations where payment is automatically triggered at termination of employment and if participant does not elect rollover or cash, or at other mandated distribution events, when distribution in cash is automatically made
- An alternative is to conduct a mandatory rollover for small amounts of \$1,000 or less if the Participant's address is not verified after a reasonable search
- Checks treated as distributed in the year paid (not year cashed) and withholding applied and 1099-R issued

Uncashed Checks: Who Retains?

- What happens to uncashed checks retained by the plan?
 - If retained by the plan, then uncashed checks are returned to the plan and deposited in the trust, and continue to be treated as plan assets. If retained by the plan, fiduciary responsibility continues for unpaid amount.
 - If uncashed checks are attributable to a missing participant, then DB plan can take position that benefit is forfeited and remove participant from PBGC rolls. Not possible if participant is not missing but has not cashed check – no forfeiture can occur if plan has valid address.

Uncashed Checks: Taxation

- Taxation and withholding triggered in year of distribution
 - Taxable event deemed to have occurred in the year of distribution
 - Impermissible to take position that 100% income tax withholding applies to distribution of lost participant
 - 1099-R due with respect to year of distribution

Uncashed Checks: Taxation (continued)

- If participant resurfaces, participant may be issued new check net of the taxes previously withheld. No new 1099-R issued since taxable event occurred in year of distribution.
- Participants who hold on to checks to cash in subsequent years often surprised that the taxable event is not deferred.

Uncashed Checks: Fiduciary Oversight

- Fiduciary retains responsibility to select fund holder and establish a process for uncashed checks
 - Can delegate responsibility to fund holder subject to prudent selection and periodic monitoring
 - No formal IRS or DOL guidance on how to handle uncashed checks
 - Reasonable documented procedures recommended that should be triggered with each uncashed check without need to submit issue to plan fiduciary for resolution

Plan Provisions

- Plan document should include section on missing participants, and when a forfeiture is deemed to occur.
- Plan should be clear regarding mandated benefit commencement date, i.e., is it NRD or is there a deferral option to age 70½?
- Plan administration section should include proper delegation authority.
- Plan should specify participant responsibility to provide address updates.

Published Guidance

Published guidance on lost participants:

- http://www.dol.gov/ebsa/regs/fab_2004-2.html (DOL guidance on lost participants in a terminating DC plan)
- <http://www.pbgc.gov/prac/terminations/missing-participants.html> (PBGC guidance on missing participants in a terminating DB plan)
- <http://law.justia.com/cfr/title29/29-9.1.5.17.16.html> (Title IV regulations on missing participants in a terminating DB plan)

Published Guidance (continued)

- <http://www.irs.gov/pub/irs-drop/rp-12-35.pdf> (IRS announces that plan administrators can no longer use its letter-forwarding program to find lost participants)
- <http://www.dol.gov/ebsa/programs/ori/advisory94/94-41a.htm> (DOL opinion that state escheat law is preempted as applied to amounts in an ongoing plan)

Published Guidance (continued)

- <http://www.law.cornell.edu/cfr/text/29/2550.404a-2> (DOL automatic rollover regs that allow you to roll over to an IRA for lost participants who have amounts under \$1,000)
- <http://www.ssa.gov/foia/html/ltrfwding.htm> (information on Social Security letter-forwarding program)

QUESTIONS?

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