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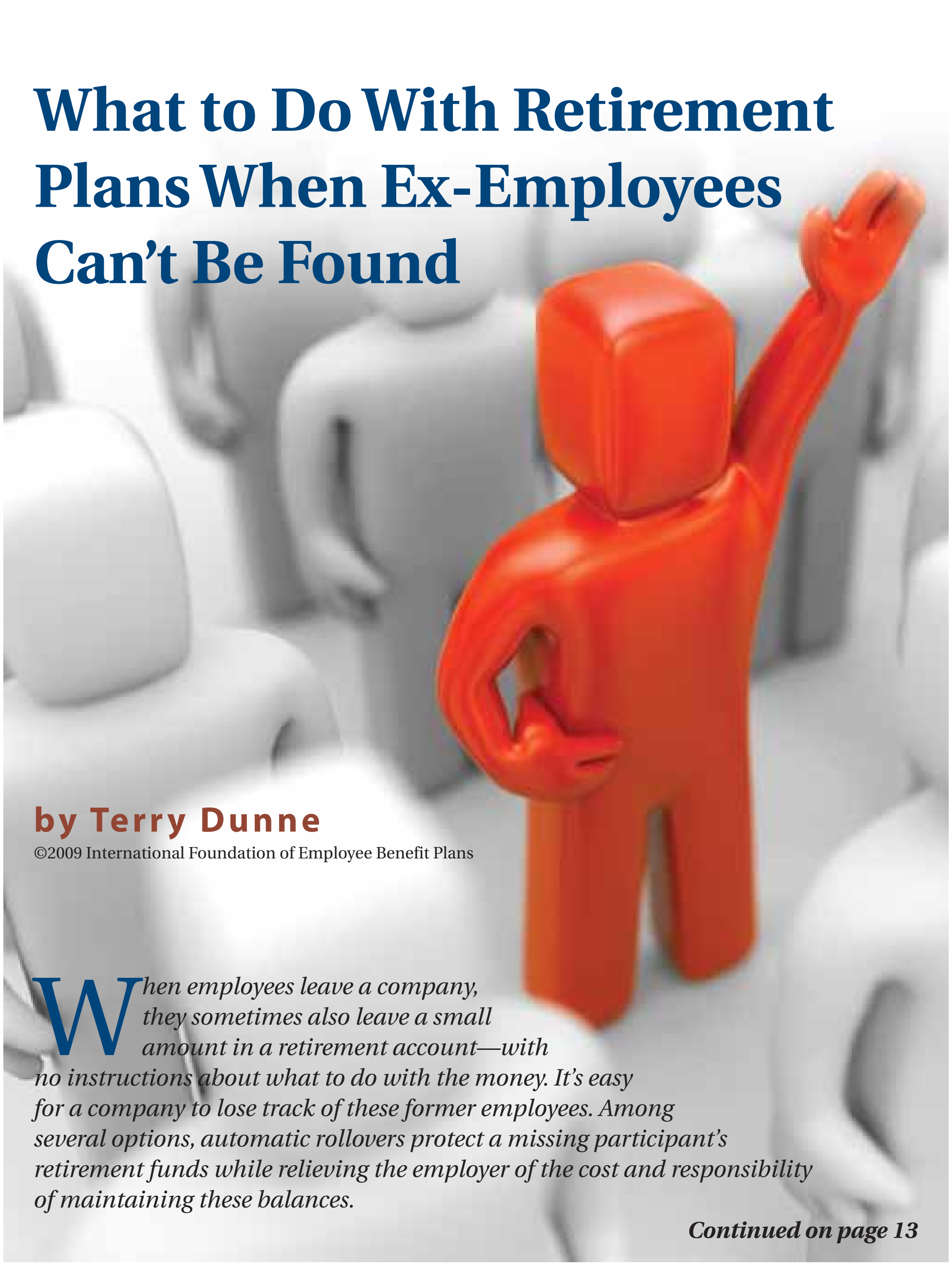

What to Do With Retirement Plans When Ex-Employees Can't Be Found

by Terry Dunne

When employees leave a company, they sometimes also leave a small amount in a retirement account—with no instructions about what to do with the money. It's easy for a company to lose track of these former employees. Among several options, automatic rollovers protect a missing participant's retirement funds while relieving the employer of the cost and responsibility of maintaining these balances.

Continued on page 13

What to Do With Retirement Plans

Continued from page 1

Virtually all organizations that offer retirement plans share a common problem. Employees leave the company with small balances in their retirement accounts and fail to transfer those funds or even leave instructions as to what to do with the money. Worse yet, many of them can't be easily located to resolve the issue. This forces the company to put forth effort to locate these participants, bear the administrative cost for these accounts and accept the fiduciary responsibility they present.

As workers switch jobs or are terminated at record levels, there is a spike in the number of these missing or nonresponsive participants. Some companies may have a few of these situations while others count several thousand in this category. Many organizations are turning to automatic individual retirement account (IRA) rollovers as a way to clean up their small balances.

The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) created automatic rollovers.[1] The act allows companies to roll over the retirement funds from missing and nonresponsive participants with assets of $5,000 or less to a custodian that will create and administer an IRA in the ex-employee's name. Initiating an automatic rollover eliminates the time, costs, compliance issues and fiduciary liabilities associated with these missing and nonresponsive participants. The process is typically handled at no cost to the plan sponsor or record keepers, and only minimal fees are assessed to participants.

Retirement accounts of missing and nonresponsive participants in active retirement plans are not the only type of account that qualifies for rollover treatment. Companies that opt to terminate their retirement plans often have accounts for former employees who have disappeared without leaving distribution instructions. For these plans, the U.S. Department of Labor (DOL) provides the steps that the plan sponsors must take to search for missing participants before embarking on an automatic rollover program.

Still other plans are actually abandoned by the sponsoring company. *Abandonment* is a definitive status declared when no plan contributions or distributions have been made in 12 months and the plan sponsor cannot be located. But there are people who worked for these companies that have money in the abandoned plan. When a plan is officially declared abandoned, those accounts can be transferred to a custodian specializing in IRA rollovers.

Prior to instituting an automatic rollover for terminating or abandoned plans, DOL provides mandatory search methods that a company must use in an effort to find missing ex-employees. These include certified mail, checking related plan records, checking with the beneficiary designated by the participant, and making use of either the Internal Revenue Service or Social Security Administration letter-forwarding services. In addition, DOL recommends using Internet search tools, commercial locator services, credit reporting agencies and more. If participants remain missing after the search steps have been used, then plan fiduciaries have satisfied their Employee Retirement Income Security Act fiduciary responsibility when they roll over the accounts into IRAs. One of the important differences for terminated and abandoned plans, compared with active plans, is that any size balance can be rolled into an IRA.

And in all cases—active, terminating and abandoned—once the IRA rollover happens, the individual is no longer considered a participant in the original plan and the company has satisfied its fiduciary duties. When the fiduciaries and the IRA provider follow DOL's safe harbor regulations, the fiduciaries are not required to monitor the IRA provider and have no responsibility for the IRA account.

A DOL requirement for a company's safe harbor protection is that it has a formal rollover agreement with the IRA custodian. Some of the common elements of such agreements include plan fiduciary responsibilities, custodian responsibilities, initial investment of the IRA, fees and expenses, confidentiality and liability.

The important nature of these agreements makes it critical that an organization establish clear selection criteria for choosing its rollover partner. This should include the amount of time a firm has been providing the service, the number of rollover accounts it has established, the rollover technology it offers and the breadth of its client service to all parties during the initial rollover process as well as for future accounts.

One way to identify potential candidates is to contact pension, benefit or retirement associations such as ASPPA (American Society of Pension Professionals & Actuaries) or NIPA (National Institute of Pension Administrators). Many of these and similar organizations hold annual or semiannual conferences that bring together plan sponsors and administrative professionals. Another approach is to conduct an Internet search of IRA custodian Web sites.

If a plan fiduciary does not find an IRA provider to handle the rollover distribution, alternative arrangements can be made. Plan fiduciaries may establish an interest-bearing, federally insured bank account in the name of the missing plan participants, or they have the option of transferring missing participants' account balances to state unclaimed property funds in the state of each participant's last known residence or work location.

IRA Custodians Not All Alike

IRA custodians are not identical in the way they approach automatic rollovers. The ideal partner is a firm that will accept all of a company's small accounts. Many financial services firms are not interested in small IRA accounts and are not structured to efficiently open and administer a large number of them. Some will accept rollover accounts only if the value is more than $1,000. Another critical difference is that some providers continue the search for missing participants while others do not. It might also be important to note which companies offer Roth IRAs for rollovers from Roth 401(k)s.

Clearly, the IRA providers view their rollover service as a revenue source but differ in their approach to fees. Some charge the plan sponsor to establish the rollover relationship process, and most charge the participant a modest establishment fee and annual fee. Some also have termination fees if a participant is ultimately identified and chooses to close the IRA account.

The level of technology the IRA providers have in place may be an important consideration. This begins with the ability to interface with the plan sponsor's accounting or human resources software to

Continued on next page

effect the electronic transfer of participant information and funds. The sponsor or its record keeper normally will send the custodian a single wire or check covering the cumulative value of all accounts being rolled over, but some IRA providers will also accept individual automatic clearing house (ACH) transfers or checks. Not only must this technology handle the rollover of a large number of accounts initially but also the ongoing transfer of a smaller number of accounts on a regular basis.

The automatic rollover process arose from the need for an effective and cost-efficient way to reunite hard-to-find ex-employees with their retirement plan funds while relieving plan sponsors of this burden. This responsibility is assumed by the IRA provider and begins when the plan sponsor, its third-party advisor or its record keeper provides participant information such as the name, last known address, Social Security number, birth date and plan balance. This information is normally transmitted in a password-protected or other secure electronic format.

The task of finding these individuals begins when the rollover has been completed and the IRA is established. Typically, a search starts with the mailing of a welcome kit that is either received by the participant or returned because the address provided is wrong. This welcome kit may include the adoption agreement, custodial agreement and disclosure statement. The adoption agreement confirms contact information and asks for beneficiary information. It should be pointed out that once an IRA is created, the beneficiary designation of the participant's original company plan is no longer valid.

If the welcome kit is returned, some IRA providers then employ external search companies to aid in their search procedures. These external search firms often have access to additional information not easily obtainable through a typical internal search. If a new address is discovered, a letter is sent instructing the participant to contact the IRA provider to confirm his or her identity. If a Social Security number is missing or invalid, search attempts must be performed annually in accordance with IRS guidelines.

Each IRA that is established is typically designated as a traditional IRA unless otherwise indicated by the plan sponsor. The initial investment made for the participant must preserve principal, maintain liquidity and provide a reasonable rate of return while minimizing risk. A FDIC-insured bank money market vehicle or a money market fund are common initial investment vehicles. The interest rate will change with Federal Reserve fund rate changes and general interest rate fluctuations. Sometimes an annuity is the preferred investment. If the participant makes contact with the custodian and decides to continue the IRA, other investment choices are available including CDs, mutual funds, stocks and bonds. Some custodians permit IRA holders to invest in alternative investments such as real estate as well.

Plan sponsors must also be aware of the level of client service that they and plan participants will receive when the balances are rolled over to a custodian. Many of these new IRA holders may not be familiar with this type of retirement account. Diligent custodians maintain Web sites that contain extensive information about IRAs and their own IRA custodial processes. It is also beneficial when the custodian offers multiple channels of communications for clients with questions, comments and requests for assistance including telephone, e-mail, fax and personal appointments, if desired. Some custodians provide IRA holders with online access to their account information.

IRAs, like all retirement plans, require detailed, accurate and regular reporting to the participant as well as to taxing bodies. The custodian is responsible for accurately managing and recording all of the investment and distribution transactions as well as preparing tax documents and other financial reports as required. Many companies employ innovative technology systems to perform these services and keep participants informed.

It has become far too common for ex-employees to disappear leaving no instructions as to how they want their retirement benefits handled by plan sponsors. This leaves companies with potentially endless duty, expenses and fiduciary responsibility to find and communicate with these missing and nonresponsive ex-employees. Fortunately, IRS and DOL published guidance in EGTRRA and later in the Pension Protection Act of 2006 that provides plan sponsors a safe harbor for rolling over plan balances into an IRA that can be established in the name of the ex-employee. This allows a plan sponsor to effectively outsource participant accounts to a qualified IRA provider, saving money, time and valuable personnel resources and at the same time preserving tax-deferred retirement savings for former employees. **B&C**

Endnote

1. Automatic rollovers are available for most defined contribution and defined benefit plans, yet terminating and abandoned defined benefit plans should be handled in connection with the Pension Benefit Guaranty Corporation.

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