Zombie 401(k) Accounts

By Kerry Pechter *Wed, Jul 31, 2013*

Who ya gonna call when former participants disappear, but their retirement accounts remain undead and their checks ($735,000, in one case) go uncashed?

Zombies are everywhere these days—even in 401(k) plans. Take for instance, the undead retirement plan accounts of long-departed former employees who leave their accounts, their money, and their plan providers in a kind of limbo. Checks sent to them are often returned to sender or go uncashed.

When these accounts accumulate, they can create administrative costs and even fiduciary headaches for plan sponsors and providers. As it happens, the same 2001 law that enabled the Bush tax cuts—EGTRRA—created a pathway for 401(k) plan sponsors and providers to outsource this problem and get the accounts off their books. A small, specialized industry has sprung up in response.

Millennium Trust of Oak Park, Ill., for instance, holds zombie money in rollover IRAs while it tracks down missing participants. PenChecks Inc., of La Mesa, Calif., has created a national registry to reunite uncashed checks with their rightful owners. RCP (Risk Compliance Performance) Solutions of Dresher, Pa., helps companies clean up the tax and reporting problems that zombie accounts can create. Centier and Inspira serve as safe-harbor IRA custodians for automatic rollovers.

You don't hear much about this corner of the 401(k) business. While financial advisors and big firms like Fidelity and TD Ameritrade compete avidly for large-balance, voluntary IRA rollovers, the world of small-balance forced-out IRAs, with its zombie accounts and orphaned checks goes largely unnoticed. But it's a multi-billion dollar subculture unto itself.

Forced rollovers

Terry Dunne (right) knows that subculture as well as anyone. As managing director of Millennium Trust's Automatic Rollovers unit, he oversees about $900 million in 150,000 accounts that have been rolled over by the firm's plan sponsor clients, including companies as large, well-known and varied as Alcoa, Halliburton, and Planet Hollywood. (Millennium Trust also custodies about $7 billion in self-directed IRA assets for registered investment advisors and other clients.)

"Other custodians don't want small accounts, or accounts where the participant is missing or non-responsive," Dunne told *RIJ*. "If you're a Fidelity, for instance, you won't make much money on the spread on your investment. And if you can't find that person, you can't reach into their other pockets [to increase your wallet-share]. In our case, the size of the account doesn't matter because we charge the same flat fee for opening up the account and managing the account."

There are about 600,000 opportunities for force-outs of small accounts per year from the nation's 401(k) plans, he said. He estimates that 15% to 20% of the participants who have been forced out become lost or unresponsive.

"We work with about 14,500 plans, and we have opened up about 325,000 accounts for missing and nonresponsive participants," Dunne said. "Each plan could be sending us one account a month or thousands per year. We work with about 150 large plan sponsors. Each year we open more and more accounts. Our goal for this year will be to open 125,000 to 150,000 accounts.

"Our standard fee is $25 to open an account, and $45 per year to manage it. The money is invested in a money market vehicle. We aggregate the money, and send it to a bank. The bank pays us a percentage, and we pay out a slightly smaller percentage to the client. [The spread] was a lot better when we started this business seven years ago, but it will come back."

Legal grey zone

Department of Labor (DoL) rules on automatic (or "default") rollovers are fairly clear. A plan sponsor can force out accounts owned by unresponsive or missing participants and worth $1,000 to $5,000 and outsource the matter to an IRA custodian. On amounts under $1,000, the employer can send a check, but if it comes back in the mail or goes uncashed, the account enters a legal grey zone.

Say, for instance, that plan sponsor Widgets Unlimited asks its plan provider to close an account of a former employee and send him or her a check for $1,000. The plan provider might withhold $200 for income taxes, triggering a 1099 statement, and send a check to the former employee for $800.

But what happens if the check is returned to sender or is never cashed? In that case, it enters a regulatory and administrative grey zone. Can the money stay at the plan provider, earning a float for the provider? The DoL says no, that it must go back to the plan. But should it go into a money market account, where it's safe from loss? Or into a qualified default investment alternative (QDIA), such as a target date fund? And what about the tax status of that $800 distribution? Is it qualified money or unqualified? If it's still qualified, should the $200 in withholding be restored to the account?

Plan sponsors may hesitate to ask the DoL for guidance on such matters, for fear of triggering an audit.

Within the automatic rollover business, reasonable people have been known to disagree. According to Dunne, the distribution remains qualified money, even if the withholding is never restored. (The clients will theoretically get a 1099-C and receive a credit for any erroneous withholding when they subsequently file their taxes.)

“We say that uncashed checks are still assets of the plan, and that as long as the plan searches for that person, and the person remains missing or non-responsive, they can be rolled over [to an IRA],” Dunne told RIJ.

A national registry

Others interpret the law differently. PenChecks, one of Millennium Trust’s competitors, also accepts custody of automatic or default IRAs from plan sponsors and tries to find the missing participants. But, once a check is sent out, it disagrees with the policy of returning the money to the plan or continuing to treat distributions as qualified money.

On its website, Penchecks says, “After much research, PenChecks believes that if the institution cannot restore the taxes withheld under where appropriate to restore the funds back to qualified status in order to establish a Default /Missing Participant IRA then the most appropriate approach is the funds should escheat to the participant’s state once the applicable period of time has elapsed.”

If the plan sponsor or provider hasn’t sent a check yet, it can find former participants through the National Registry of Unclaimed Retirement Benefits, which was established by PenChecks. Former participants can go to the registry and search for lost money by Social Security number. When participants make themselves known, PenChecks notifies the plan sponsor so that the provider can pay out the account.

For checks that have already been sent out, PenChecks created the Missing Distributee Program. Recordkeepers or institutions can transfer these amounts to PenChecks. According to the Penchecks’ website, “The assets are held on an after-tax basis in an interest bearing account legally separate from the assets and liabilities of PenChecks. PenChecks performs a search for the participant, registers the account with the National Registry of Unclaimed Retirement Benefits and starts the escheat clock running based on the participant’s state of residence. This is an efficient outsourcing service that allows clients to clear these checks from their books and avoid monitoring and dealing with all the different escheat laws in all the states.”

“There are no laws around the tax status of uncashed checks. Nobody has any real clear guidance on how you deal with them,” said Mark D. Sweatman, president of RCP Solutions’ Retirement Plan Management Services division, which helps companies mitigate their exposure to fiduciary violations related to uncashed checks, but doesn’t take custody of rollover IRAs. “The destination for that money could be a rollover IRA or an escheat account, depending on whether it’s considered after-tax or pre-tax money. We consult with ERISA counsel at the plan sponsor and say, how do you want to handle this? It’s up to the plan sponsors where they want to put the money after mitigation.”

As for why a check might go uncashed, there are several possibilities. “We’ve seen an outstanding check for as much as $283,000," Sweatman told RIJ. "People put it under a pile and never get to it. People move and the new homeowner throws away their mail instead of forwarding it. We've seen plan conversions where the old recordkeeper is holding uncashed checks and the new recordkeeper doesn't want them. We see it everywhere. It's a problem for sure, and the larger the company, the larger the problem."

The forgotten $735,000

Reuniting people with their money may be the most rewarding part of this business. Dunne said that his two dozen phone reps can locate about 80% of the missing participants whose qualified accounts they inherit fairly quickly and often with the help of credit reporting agencies. Generally, about one in five people roll their IRAs out of Millennium Trust as soon as learn that the money is there.

Dunne never ceases to be surprised at the way some people can forget about the money in their retirement accounts. "Not everybody cares about money to the same degree that you and I do," he told *RIJ*. "Many people just forget that they have this money."

Many of them are young. "Say you're a giant retail store like Marshall Field's and over the course of time you employ lots of young women anywhere between the ages of 19 and 24. They work for six to eighteen months and they quit. Over the next five years they might move once or twice, or get married and change their name. Eventually you have no way to track them down any more," Dunne said.

"We get their Social Security number and date of birth, two pieces of information that don't change. We find them and say, 'You have a retirement account with $1,200 in it.' They say, 'Are you kidding me? That's great!' And that solves a problem for Marshall Field's, which is in the business of selling dresses, not tracking people down."

Not all of the amounts are trivial. "The biggest amount we ever handled was $735,000. We found the person in Japan. We were too polite to ask how they managed to forget a sum that large. I have a feeling it wasn't their only money. He was happy that we found him, of course. He left the money with us for six or eight months. Then he rolled it over to [Charles] Schwab," Dunne told *RIJ*.

A change in the law helped create the automatic rollover business and a change in the law could also squeeze it. "A big risk for us is that they expand the dollar amount that's eligible [for force-out accounts] to a number north of $25,000," Dunne said. "It would bring more players into the market. When an individual leaves a given company, the advisors are interested in any balance north of $50,000. They want to meet with the participants, and get them into an IRA in their broker-dealer. There's tremendous [competition] around those larger accounts."

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