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DOL Guides Fiduciaries On Missing Plan Participants

Missing participants have long plagued any plan administrator closing down a defined contribution plan. On September 30, 2004, the United States Department of Labor (DOL) issued new guidance in the form of a Field Assistance Bulletin directed to DOL's enforcement staff on the obligations of plan fiduciaries to handle the account balances of missing plan participants when terminating a defined contribution plan. Field Assistance Bulletin 2004-02 (the "Bulletin") supplements the DOL's previous guidance on defined contribution plans. Although the Bulletin focuses on terminating plans, much of the guidance offered by the DOL would apply equally to ongoing plans and gives plan fiduciaries much needed direction on lost participants.

In order to complete a plan termination, all plan assets must be distributed as soon as administratively possible after the plan is terminated. This distribution process can be delayed, however, when a plan fiduciary attempts to contact plan participants for direction regarding the distribution of their account balances, but is unable to reach them. The Bulletin squarely addresses this issue, and gives welcome guidance on the preferred methods a plan fiduciary should use to locate plan participants and to distribute their accounts as quickly as possible.

Methods for Searching for Missing Participants

There are numerous methods a plan fiduciary can use to locate missing plan participants. According to the Bulletin, four of these methods are so nominal in price and have such potential for effectiveness that they are essential to any proper search. A prudent ERISA fiduciary should employ *all* of the following:

- ♦ Using *certified mail* to contact the participant;
- ♦ Checking the *records of related plans* for the participant's current address or contact information;
- ♦ Attempting to contact the designated *plan beneficiary* for the participant's updated contact information; and

- ♦ Using either the IRS *letter-forwarding program* or the Social Security Administration's letter-forwarding service.¹

The Bulletin discusses additional search options for a plan fiduciary to consider if the above methods are ineffective. These optional methods include the use of internet search tools, commercial locator services and credit reporting agencies. The DOL cautions that the decision to use these optional methods must be made carefully, particularly if the participant's account balance is relatively small and the cost of the services will be charged to the participant's account.

Distributions For Missing Participants

Where a plan fiduciary has used the search methods described in the Bulletin and is not able to locate participants, the DOL recognizes that the plan fiduciary must still distribute the benefits in order to complete the plan termination process. The Bulletin takes the position that plan fiduciaries must first consider rolling those account balances over into individual retirement plans, such as individual retirement accounts or annuities (together, IRAs). This approach is preferred by the DOL, primarily because it preserves the value of the retirement benefit by transferring the entire account balance and deferring the income tax consequences for the participant.

Although the preferred method, transfers to IRAs raise issues. The Bulletin acknowledges that the mere act of choosing an IRA for rollover purposes raises its own set of fiduciary concerns because the process of choosing a plan and a plan custodian/trustee is a fiduciary decision. The DOL's solution is to look to the new regulations on automatic rollovers (see our Management Alert at www.seyfarth.com/db30/cgi-bin/pubs/092904.pdf) which provide an existing safe harbor for plan fiduciaries who are making automatic rollovers to IRAs for participants with account balances of \$5,000 or less. The Bulletin says that, for DOL enforcement purposes, plan fiduciaries applying the automatic rollover safe harbor rules to

¹ The IRS Program is available free of charge for requests involving 49 or fewer potential recipients. For 50 or more letters, the cost is \$1,750 plus \$.50 per record. The Social Security Administration Program charges a \$25 fee per attempted letter. For more information on the IRS program, see IRS Revenue Procedure 94-22, which can be found at <http://www.irs.ustreas.gov/pub/irs-tege/rp94-22.pdf>. Details on the Social Security Administration program can be found at <http://www.ssa.gov/foia/ltrfwding.htm>.

distributions for lost participants will be treated the same, regardless of the size of the account balance. Thus, fiduciaries should choose a rollover option that is designed to preserve the principal and comply with the other provisions of the automatic rollover safe-harbor regulation.

At this point, it may be difficult to locate an IRA provider that will accept missing participant rollovers, but we expect this to change as financial institutions adapt to this and the recent guidance on automatic rollover accounts.

Alternatives to IRAs

The Bulletin suggests some alternative arrangements the plan fiduciary could make if they are unable to locate such a provider, including transferring the balance to a federally insured bank account in the participant's name or transferring the balance state unclaimed property funds. Selection of an appropriate interest rate and evaluation of bank charges would rest on the plan fiduciary. Also, these options have a number of tax consequences for the participant. The Bulletin makes it fairly clear that these options are inferior to the IRA option.

One distribution method that the Bulletin opposes is the use of 100% income tax withholding on the missing participant benefits. Some plans have deposited the entire account balance as tax withholding with the IRS under the participant's Social Security number to fully distribute the plan account. The DOL and the IRS found that under the IRS's current data processing methods, this option poses problems because the deposited amounts may not be matched with the participant's income tax liabilities. For this reason, the DOL determined that using this distribution method would not be in the best interest of participants, would violate ERISA's fiduciary requirements, and should therefore be avoided.

Other Issues Raised By The DOL's Recommendations

Finally, the Bulletin discusses the implications of the USA PATRIOT Act (Act) on its recommendations. Under the customer identification and verification provisions of the Act, a financial institution must verify the identity of each customer who opens a new account. Since the plan fiduciary would not be considered a customer (because they have no ownership interest in the funds), and the participant is missing entirely, the DOL recognized a potential conflict between their guidance on distribution to individual retirement plans and the terms of the Act. The United States Treasury Department has responded to this issue, however, and requires that identification verification of the participant need not take place until the participant first contacts the institution to assert ownership or control over the account.

If you have any questions concerning the Department of Labor guidance on this issue, please contact the Seyfarth Shaw LLP Employee Benefits Group attorney with whom you work or any Employee Benefits attorney on the website at www.seyfarth.com.

ATLANTA

One Peachtree Pointe
1545 Peachtree Street, N.E., Suite 700
Atlanta, Georgia 30309-2401
404-885-1500
404-892-7056 fax

BOSTON

Two Seaport Lane, Suite 300
Boston, Massachusetts 02210-2028
617-946-4800
617-946-4801 fax

CHICAGO

55 East Monroe Street, Suite 4200
Chicago, Illinois 60603-5803
312-346-8000
312-269-8869 fax

HOUSTON

700 Louisiana Street, Suite 3700
Houston, Texas 77002-2797
713-225-2300
713-225-2340 fax

LOS ANGELES

One Century Plaza
2029 Century Park East, Suite 3300
Los Angeles, California 90067-3063
310-277-7200
310-201-5219 fax

NEW YORK

1270 Avenue of the Americas, Suite 2500
New York, New York 10020-1801
212-218-5500
212-218-5526 fax

SACRAMENTO

400 Capitol Mall, Suite 2350
Sacramento, California 95814-4428
916-448-0159
916-558-4839 fax

SAN FRANCISCO

560 Mission Street, Suite 3100
San Francisco, California 94105
415-397-2823
415-397-8549 fax

WASHINGTON, D.C.

815 Connecticut Avenue, N.W., Suite 500
Washington, D.C. 20006-4004
202-463-2400
202-828-5393 fax

BRUSSELS

Boulevard du Souverain 280
1160 Brussels, Belgium
(32)(2)647.60.25
(32)(2)640.70.71 fax

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