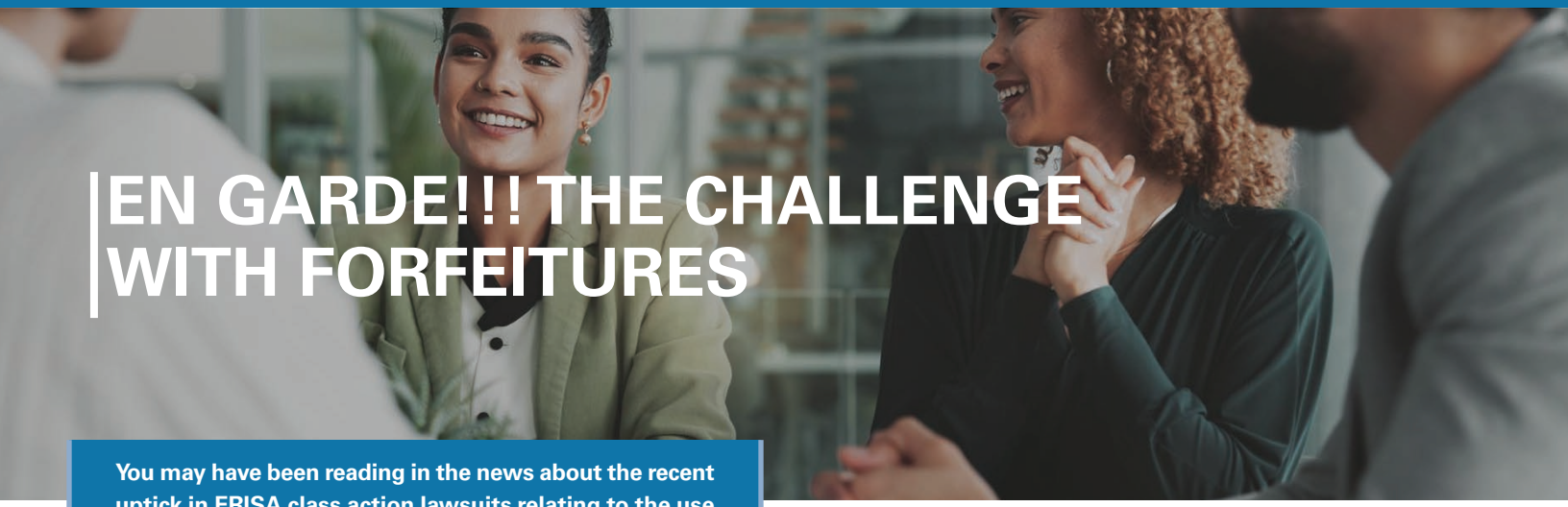

EN GARDE!!! THE CHALLENGE WITH FORFEITURES

You may have been reading in the news about the recent uptick in ERISA class action lawsuits relating to the use of forfeitures. This article will be relevant to your plan if you have employer contributions and apply a vesting schedule to those funds.

Summer 2025

What is a Forfeiture?

An Employer may design its retirement plan so that contributions it makes for its participants are subject to a vesting schedule. The vesting schedule means that the participant earns the right to those contributions over a period of employment, based on that schedule. For example, a plan may apply a five-year vesting schedule, where a participant earns 20% of their benefit for each year of service (i.e., becomes 20% vested after one year, 40% vested after two, etc.) The longest permissible vesting schedule is six years. A "year of service" is usually a plan year in which the participant is paid for 1,000 or more hours of service. If the participant stops working for the company prior to earning 100% vesting on the schedule, then the unvested portion is called a "forfeiture." The forfeiture is removed from the participant's account and placed into a forfeiture account. The forfeiture account acts like a suspense account for these funds until they are later used within the plan for certain purposes, based on the terms of the plan document.

How May Forfeitures be Used by the Plan?

There are three ways that forfeitures may be used within the plan:

1. To pay administrative fees;
2. To reduce employer contributions; and/or
3. The forfeiture may be allocated to eligible participant accounts to increase their benefits.

The plan document may state a specific use for the forfeitures from this list, or it may grant complete discretion to the Plan Administrator to select how (among the three options) the forfeitures will be used.

Forfeitures must be used by no later than 12 months following the end of the plan year in which they arose. For example, suppose you have forfeitures that arose in 2024 when a participant terminated employment and took their vested interest. That forfeiture must be used no later than the end of 2025. If the plan provides that forfeitures are used to pay plan expenses, the plan can use them to pay for the annual Form 5500 preparation or the 2024 Form 5500 audit, even if those invoices are paid in the summer of 2025.

Why Are Employers Getting Sued?

There are a few variations of the lawsuits that have been filed, but participant-plaintiffs are essentially arguing that Plan Administrators, as fiduciaries to the Plan, are violating their duty of loyalty and prudence by using the forfeitures in a way that indirectly benefits themselves. In particular, when the plan permits the Plan Administrator to choose whether to use forfeitures to pay for plan expenses (which would otherwise be paid by participant accounts) or reduce employer contributions, the employer that uses forfeitures to reduce its contribution is prioritizing the employer's financial interests over the best interests of the plan and its participants.

Although the Internal Revenue Service has long approved the language permitting discretionary forfeiture use, and the language mentioned above is consistent with the historically permissible options outlined in the Internal Revenue Code, these new claims by the participant-plaintiffs have had some success in the courts. However, courts in different areas of the country are ruling differently, and none of the cases has yet been decided by an appeals court.

To avoid being a possible target for these often frivolous lawsuits, many employers are amending their plans or adopting a written administrative policy that clearly states how forfeitures will be used. The idea: remove the discretion, and you remove the potential for the claim of fiduciary breach for making the "wrong" choice.

What Should a Plan Sponsor Do Now?

Plan Sponsors should talk to their third-party administrators ("TPA") or service providers to determine what the language of their plan document currently says. In some plan documents, the language permits the Plan Administrator to "elect to use any portion of the Forfeiture Account to pay administrative expenses incurred by the Plan." It may go on to say that forfeitures may also be applied at the direction of the Plan Administrator in any of three different options. This type of language is fully discretionary and open-ended, which is precisely what the lawsuits are trying to prevent.

Plan Sponsors may request that their TPA or document service provider prepare an amendment to the Plan to formalize a mandatory use for forfeitures in the future, removing the discretionary language. This has the best chance of avoiding a claim that the sponsor has improperly used the forfeitures. Even if this language dictates that forfeitures are used first to reduce employer contributions and are only used to pay expenses thereafter, the lack of discretion eliminates the potential for courts to find that there was a choice made that constitutes a fiduciary breach.

If you have any questions about the use of forfeitures or about how you can alter your plan document to clearly state the intended use, let us know. Remember: we are your ERISA solution!

Used with permission of author Alison J. Cohen, Esq. of Ferenczy Benefits Law Center. This article recently appeared in their Flash in the Plan! series. You can subscribe to their newsletters here: https://ferenczylaw.com/flashpoint-sign-up/.

Addressing the Challenge of Uncashed Distribution Checks

Uncashed distribution checks present a persistent and often overlooked challenge for retirement plan sponsors. Despite the best efforts of plan administrators, some participants fail to cash their distribution checks, leading to administrative burdens, fiduciary concerns and potential compliance issues. A recent publication by Retirement Management Services (RMS) sheds light on this issue and offers practical guidance for employers seeking to manage and mitigate the risks associated with uncashed checks.

Uncashed checks can arise for various reasons. Participants may have moved without updating their contact information, may not recognize the check as legitimate or may simply forget to deposit it. Regardless of the cause, the responsibility for addressing these uncashed funds ultimately falls on the plan sponsor. This creates a fiduciary obligation to act in the best interest of the participant while ensuring compliance with IRS and Department of Labor (DOL) regulations.

Sponsors are encouraged to maintain up-to-date contact information for all plan participants and to follow up promptly when checks remain uncashed. This may involve sending reminder letters, making phone calls or using certified mail to confirm receipt. In some cases, plan sponsors may also consider using electronic payment methods to reduce the likelihood of checks going uncashed in the first place.

The IRS and DOL have issued guidance on how to handle these situations, including the use of forfeiture accounts and escheatment to state unclaimed property programs. However, these options come with their own set of rules and potential pitfalls. For example, using a forfeiture account may require the plan document to explicitly allow for such treatment. Escheatment laws, which allow the government to assume control of unclaimed property, vary by state. As such, plan sponsors must carefully evaluate their options and consult with legal or compliance experts as needed.

Another important consideration is the documentation of all the efforts made to contact participants and resolve uncashed checks. Maintaining a clear audit trail can help demonstrate fiduciary prudence and protect the plan sponsor in the event of an audit or legal challenge. It is extremely important to have a written policy in place that outlines the steps to be taken when a check remains uncashed beyond a certain period.

By taking a proactive, well-documented and compliant approach, employers can fulfill their fiduciary duties, reduce administrative burdens and ensure that participants receive the benefits they are entitled to.

Source: Retirement Management Services – "Uncashed Distribution Checks"

https://www.consultrms.com/Resources/59/Plan-Sponsor-Tips-and-Help/212/Uncashed-Distribution-Checks

Divorce and the Retirement Plan

When a participant in a qualified retirement plan undergoes a divorce, the participant's account balance may be an asset that is split with the former spouse. As the plan exists for the exclusive benefit of its participants, a court order is required to transfer the participant's benefits to the ex-spouse. Once approved by the plan administrator, this court order is called a Qualified Domestic Relations Order (QDRO).

The QDRO is a judgment, decree or order that must be issued by a state authority (usually a court). It can be part of the divorce settlement or it may be a separate document. Because of the serious nature of separating the participant's account balance, the QDRO is more than just an agreement made by both parties — it must also be signed by a judge.

A QDRO will describe how to divide the participant's account balance between the participant and the ex-spouse, referred to as the alternate payee. In some cases, a set dollar amount will be allocated; in others, a percentage of the account may be designated. In the latter case, the amount assigned to the alternate payee represents the given percentage of the participant's total vested account balance as of a specified valuation date. This percentage will apply to all sources — such as deferrals, matching or profit sharing — unless specified by the QDRO. Any interest and investment gains/losses that accrue between this valuation date and the date the funds are separated into an account for the alternate payee are often factored into this final calculation. If the participant has outstanding loans, the QDRO will usually indicate how the loans are handled.

Contributions such as deferrals and employer matching made after the valuation date are credited to the participant's account. Earnings and losses are applied to the account balances. Once the division is complete, the alternate payee's portion (either dollars or shares) is transferred to an account in the alternate payee's name.

If the plan allows, the alternate payee may be paid out in a cash or rollover distribution. Not all plan documents allow the alternate payee to receive a distribution before reaching normal retirement age, so it's important to follow the terms of the plan. In addition, the QDRO cannot violate the provisions of the plan document by requiring a plan to provide an alternate payee or participant with any type or form of benefit not otherwise provided under the plan.

Although the most common situation for a QDRO is a divorce, it can be issued in other situations, such as to a dependent in the case of child support. If the alternate payee is a minor child or legally incompetent, the order can also require payment to the individual with legal responsibility for the alternate payee.

If a participant or their attorney provides you with a copy of a divorce decree that references the plan or a QDRO, please contact us immediately, and we will work with you to ensure it meets the requirements of the plan.

Important note for defined benefit plans: For 2025 plan years, PBGC premiums are due one month earlier than usual, specifically on the 15th day of the ninth month after the beginning of the plan year. For calendar year plans, this means the premium is due on **September 15, 2025**, instead of the usual **October 15**. This accelerated deadline is due to a provision in the Bipartisan Budget Act of 2015.

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Upcoming Compliance Deadlines for Calendar-Year Plans

September 15

Required contribution to defined benefit plans, money purchase pension plans and target benefit pension plans.

Contribution deadline for deducting 2024 employer contributions for those sponsors who filed an extension for Partnership or S-Corporation tax returns to extend the March 15, 2025, deadline.

Due date for 2025 **PBGC Comprehensive Premium Filing** for defined benefit plans.

September 30

Deadline for certification of the **Annual Funding Target Attainment Percentage (AFTAP)** for Defined Benefit plans for the 2025 plan year.

October 15

Extended due date for the filing of **Form 5500** and **Form 8955-SSA** for plan years ending **December 31, 2024**.

Contribution deadline for deducting 2024 employer contributions for those sponsors who filed a tax extension for C-Corporation or Sole-Proprietor returns for the **April 15, 2025**, deadline.

Due date for non-participant-directed individual account plans to include Lifetime Income Illustrations on the annual participant statement for the plan year ending **December 31, 2024**.