GROOM LAW GROUP

2019 Advisory Council on Employee Welfare and Pension Benefit Plans

Permissive Transfers of Uncashed checks from ERISA Plans to State Unclaimed Property Funds

Testimony of George M. Sepsakos and Kevin L. Walsh, Principals at Groom Law Group, Chartered

We are Kevin Walsh and George Sepsakos and are principals at the Groom Law Group, Chartered. We appreciate the opportunity to testify before the Council on this important issue. Our views reflected herein are based upon our work with both plan sponsors and service providers on these issues.

I. Summary

The uncashed check problem within the U.S. retirement system is not a new one. In fact, not only is it an issue in the U.S., but it is a problem in nearly every country that has a developed retirement system. In short, plan fiduciaries and service providers have struggled and continue to struggle with how to best preserve a participant's benefit that goes uncashed. Existing U.S. Department of Labor ("Department") guidance has not provided clear solutions. Recently, the issue of uncashed checks has received renewed focus in the retirement space due to recent enforcement activity by the Department, as well as recent interest in uncashed checks by the Government Accountability Office and the states. Plan fiduciaries and service providers want clear guidance that directs them to take specific action with respect to uncashed checks; there cannot be a replay of the 2013 where an Advisory Council report led to enforcement action rather than guidance.

In our experience, a participant's benefit distribution may go uncashed in a variety of circumstances. Within the context of a defined benefit plan, it is not uncommon for a check to go uncashed because the participant's address on file does not match their current address. After taking additional steps, plan fiduciaries occasionally find the participant, which can result in the participant cashing the check. However, locating a participant does not always solve the problem nor is it always reasonable for a plan to incur the expenses associated with attempting to locate the participant. In some instances, shocking as it may seem, participants simply do not want access to their retirement funds. Participants may choose not to cash their benefit for a variety of reasons, but most commonly participants may not want to cash their benefit because cashing the check would mean that the participant would lose access to Medicaid or other stipend that is issued by the government.

Within the context of a defined contribution plan, it is common for microbalances to accumulate due to revenue sharing or dividend payments that are issued to participants after they take their benefit distributions from the plan. It is not uncommon for a participant to simply fail to endorse a check for these microbalances although the benefit is paid to the correct address. Moreover, the amounts at issue can be such that it would be imprudent for a plan to spend additional resources to locate the individual or to encourage the individual to deposit his or her check.

Thus, plan fiduciaries need guidance about what to do both when checks go uncashed because a participant cannot be located but equally for when checks go uncashed because the participant appears to be choosing not to cash the check. Plan fiduciaries want clear guidance that provides a safe harbor and that discusses things like whether plan fiduciaries should aggregate multiple outstanding checks for determining what processes should be applied, and whether different steps are required for checks that are less than $10, less than $100, less than $5,000 or over $100,000. For example, fiduciaries should clearly be discouraged from spending more than $10 in an effort to pay a benefit of less than $10, and even $5 might be an unreasonable amount of additional expense to a plan. As discussed below, the Department has provided sub regulatory guidance to field offices that discuss how plan fiduciaries of terminated defined contribution plans should handle amounts that the fiduciaries have been unable to distribute. While we do not believe that the same search steps are appropriate here, the Department should provide similar guidance that provides a safe harbor for all plan fiduciaries and that allows plans to distribute stale check amounts or forfeit those funds after reasonable efforts have been made to pay a participant directly. However, any guidance issued by the Department should seek to balance the likelihood of connecting the participant to their benefit the risk of tax consequences to the participant, and the plan fiduciary's obligation to the plan's other participants

The Department should also encourage plans to utilize technological improvements that could reduce the total number of checks – including uncashed checks. The utilization of ACH and wire transfers could significantly reduce the number of outstanding uncashed checks; but we further encourage the Department to draft any guidance in a manner that would also facilitate additional payment systems as payment system technology continues to evolve.

II. Escheatment Generally

We understand that the Department is considering whether retirement plan fiduciaries may escheat stale checks to the states through an escheatment process. In this regard, the following provides a general background on escheatment and relevant guidance from the Department and the courts regarding the escheatment of retirement plan assets to the states.

A. What is escheatment?

Escheatment refers to the process states use to seize or take custody of property that lacks a recognized owner.[1] Escheatment is distinct from other ways that property is transferred to a state (e.g. eminent domain, taxation, fines, sales, and gifting) in that it is not initiated with the intent that the state permanently acquires the property nor is it used as a punishment.[2] Property subject to escheat has typically either been abandoned or left unclaimed by its owner.[3] The specific types of property that may be subject to escheat vary by state. State escheatment statutes typically enumerate the types of property that may become escheated and only those listed types are considered property for the purposes of escheatment.[4] Where any ambiguity exists, there is a

---

[1] Barbara A. Sangiuliano, *UNCLAIMED PROPERTY: AN OVERLOOKED AREA OF RESPONSIBILITY FOR TAX PRACTITIONERS*, 16-OCT J. Multistate Tax'n 20, 20-21 (2006).
[2] David C. Auten, Modern Rationales of Escheat, 112 U. Pa. L. Rev. 95, 96 (1963).
[3] Sangiuliano, *supra*; James N. Johnson, § 18:4.Absolute versus custodial escheat, 3 Tex. Prac. Guide Real Trans. § 18:4.
[4] Johnson, *supra*.

presumption *against* the state's power to escheat.[5] Though escheatment statutes are generally designed to deal with the particular issues that arise with intangible property, tangible property, such as the contents of a safe deposit box, can also be covered by escheat statutes.[6] In addition, a state may only escheat property that is either located within, or has arisen from a transaction occurring within, its territorial boundaries.[7]

B. Do all states escheat?

All 50 U.S. states and the District of Columbia have escheatment statutes.[8] Each state follows one of two distinct approaches to escheatment – absolute escheatment or custodial escheatment. Under absolute escheat statutes, the state gains title to unclaimed property while custodial escheat statutes allow states to become temporary custodians of unclaimed property.[9] Both approaches allow a validated owner to recover either their property or its monetary value.[10] In 1954, the Uniform Law Commission utilized the custodial approach to craft a model escheatment law aimed at addressing issues raised by unclaimed property.[11] Now in its fifth revision, 39 states and the District of Columbia have adopted some version of the Uniform Unclaimed Property Act (UUPA).[12] Earlier this year, Vermont introduced legislation to adopt the 2016 version.[13]

a. Uniform Law Commission's Uniform Unclaimed Property Act (UUPA)

The UUPA defines the conditions under which a state may escheat property and outlines the various steps in the escheatment process. The UUPA sets a dormancy period after which unclaimed property is presumed abandoned. This base dormancy period may be extended or reduced for certain types of property.[14] For example, the 1954 and 1966 versions of the UUPA established a base dormancy period of seven years, but extended that period to 15 years for traveler's checks and reduced it to one year for proceeds from a business dissolution.[15] Later iterations of the UUPA have further changed both base and type-specific dormancy periods. Most UUPA states use either the 1981 or 1995 versions which set the base dormancy period at five years.[16] For IRAs and other retirement plan distributions, the 1981 version applied the base dormancy period of five years while the 1995 version reduced that period to three years.[17] However, over half of states that have adopted the 1981 versions currently have a dormancy period of three years or less for retirement plan distributions. This is in keeping with the overall nationwide trend – 37 states and the District of Columbia have set a three-year dormancy period for retirement plan distributions. While a few outlier states have dormancy periods of less than three years (Arizona – two years; Oregon – two years; Nebraska – 30 days), the remaining states

---

[5] Elizabeth M. Bosek, 30A C.J.S. Escheat § 12.
[6] *Id*; Auten, *supra*.
[7] Bosek, *supra*.
[8] GAO Report. GAO-19-88. Retirement Accounts. Federal Action Needed to Clarify Tax Treatment of Unclaimed 401(k) Plan Savings Transferred to States
[9] Johnson, *supra*.
[10] *Id*.
[11] Sangiuliano, *supra*.
[12] Uniform Laws Commission. https://www.uniformlaws.org/
[13] *Id*.
[14] Unclaimed Property Act Summary. 2013. Uniform Law Commission.
[15] Sangiuliano, *supra*.
[16] Unclaimed Property Act Summary. 2013. Uniform Law Commission.
[17] *Id*.

have dormancy periods of five years with the exception of Oklahoma, which sets a dormancy period of seven years. The 2016 version of the UUPA retains the three-year dormancy period for retirement account distributions.[18]

Once the dormancy period has been reached, the UUPA requires holders of abandoned property (e.g. banks and other financial institutions) to attempt to give notice to the property owner and make a report to the state that includes the last known address of the owner.[19] The property must then be delivered/paid to the state, at which point the state assumes liability for the transferred property.[20] The state is then responsible for publishing a notice listing the abandoned property in a newspaper in the county of the property owner's last known address.[21] After three years, the state may sell any abandoned property that remains unclaimed and the proceeds become part of the state's general revenue fund.[22] If a property owner comes forward, the state must return the property or the monetary value of the property and any applicable interest or dividends to the owner once the owner's claim has been validated.[23] In order to ensure property holder compliance with escheat statutes, the UUPA includes provisions for state administrator auditing of holders required to report unclaimed property.[24]

b. Non-UUPA State laws

Ten states – Connecticut, Delaware, Massachusetts, Mississippi, Missouri, New York, Ohio, Pennsylvania, and Texas – have escheat statutes, but have chosen not to adopt any version of the UUPA.[25] Generally, these statutes are similar procedurally to the UUPA. The provisions in the escheat statutes of four of these states – New York, California, Texas, and Ohio – illustrate how and why states may choose to enact independent escheatment statutes.[26]

New York's base dormancy period is three years which is in line with most other states. The state may also sell escheated property after 15 months. Retirement plan disbursements fall under the provision for "wages" and have a dormancy period of three years.

Like New York, California has a base dormancy period of three years, specifies the text of the notice from property holders to property owners, and has a lower waiting period before escheated property may be sold relative to the UUPA. In California, escheated property may be sold 18 months after the state takes possession. California's statute also has a specific provision for distributions from employee benefit plans. This provision sets a dormancy period of three years but prohibits escheatment if the plan contains a forfeiture clause or authorizes the plan administrator to declare a forfeiture for any funds for which a beneficiary cannot be found after a specified period of time.

Unlike New York and California, Texas's escheat statute does not specify the text of the notice to property holders but Texas similarly sets a base dormancy period of three years, which

---

[18] Unclaimed Property Act, Revised. 2016. Uniform Laws Commission. https://www.uniformlaws.org/
[19] *Id.*
[20] *Id.*
[21] *Id.*
[22] *Id.*
[23] *Id.*
[24] Unclaimed Property Act, Revised, *supra*.
[25] Uniform Laws Commission. https://www.uniformlaws.org/
[26] New York Abandoned Property Law §§ 101-1502; Cal. Civ. Proc. Code §§ 1500-1582; Tex. Prop. Code Ann. §§ 72.001-77.308; Ohio Rev. Code Ann. §§ 169.01-169.99

also applies to IRAs and retirement accounts. Additionally, Texas allows the comptroller to sell escheated property at their discretion with no mandated waiting period.

Ohio's base dormancy period is five years but it follows the national trend and sets a dormancy period of three years for IRAs and retirement plan disbursements. As with the later versions of the UUPA, the Ohio statute limits property finder arrangements.

c. Effectiveness of State Escheatment

Whether state escheatment is seen as effective depends largely on which rationale for escheatment is used as a barometer of success. States have been effective at modifying the escheatment process in ways that increase the revenue generated from unclaimed property. Decreased dormancy periods, expansions of the types of property subject to escheat, and aggressive use of contingency fee-based auditors are factors that have influenced increased revenue generation from escheat statutes.[27] However, the more reliant a state is on the revenue generated from unclaimed property, the less likely it is that unclaimed property will be returned to its rightful owner. This trend suggests that states may not be effective property custodians.

While the exact value of nationwide unclaimed property is unknown, available data from 2006 indicated that over 5 billion dollars annually was collected from unclaimed property across all states.[28] One estimate of the cumulative amount of unclaimed retirement savings puts that number at 100 billion dollars.[29] A GAO survey with data from 17 states showed that $35 million in unclaimed retirement savings was received across all of those states in 2016.[30] The most common sources of this unclaimed property in 2016 were assets and uncashed checks from employer retirement plans, such as 401(k) plans.[31]

In addition to following UUPA guidelines for sending notification letters and publishing notices of unclaimed property is newspapers, other strategies states use to locate property owners include using television newscasts, publishing online educational videos, maintaining an accessible database of unclaimed property, group presentations, using social media, kiosks and booths in public places, and database matching with other agencies.[32] An analysis of 2011 survey data from the National Association of Unclaimed Property Administrators ("NAUPA") indicated that, on average, 39.5% of the total value brought in from unclaimed property was returned to the property owner.[33] There was, however, significant variation across the participating jurisdictions (42 states and the District of Columbia) with recovery rates between 2.27% and 88.8% reported.[34]

Additionally, where a high percentage of a state's budget is made up of unclaimed property, there is a negative relationship with property owner recovery – the larger the share of

---

[27] T. Conrad Bower, Inequitable Escheat: Reflecting on Unclaimed Property Law and the Supreme Court's Interstate Escheat Framework, 74 Ohio St. L.J. 515 (2013).
[28] Robert S. Peters & Matthew J. Beintum, *GOING FISHING: STATE BUDGET DEFICITS DRIVE AN EXPANDING NET OF UNCLAIMED PROPERTY COLLECTIONS*, 19-JUL J. Multistate Tax'n 28, 29 (2009).
[29] GAO Report, *supra*.
[30] *Id.*
[31] *Id.*
[32] *Id*; NAUPA 2016 Unclaimed Property Program Outreach Methods Survey.
[33] Darrin Wilson & Derek Slagle. *Hidden treasure: a study of unclaimed property management by state government.* 30 J. Pub. Budg. Account. Financ. Manag. 1 (2018).
[34] *Id.*

the budget that unclaimed property makes up, the less likely owners are to recover their property.[35] Conversely, there is a positive relationship between a state having a dedicated unclaimed property marketing staff and owner recovery.[36]

III. Current Guidance

The Department has taken the position that ERISA preempts the various states' uniform unclaimed property laws, and fiduciaries cannot be required by state law to distribute unclaimed funds to those states. Instead, the fiduciary has discretion regarding whether or not the plan will distribute unclaimed funds to the state. However, there is a tension between the fiduciary's decision regarding whether to distribute stale check amounts to unclaimed property funds and the fiduciary duty under ERISA to act in the sole interest of the participant or beneficiary. This tension may arise from the lack of a clear definition of what a "reasonable search" is to find plan participants and the taxes that would generally be imposed by escheating assets to the states. The fiduciary must make the decision of whether distributing funds to states is consistent with their responsibilities under ERISA.

a. Compulsory Escheatment

ERISA plan assets cannot be compelled to escheat. The Department and courts have repeatedly reached this conclusion.

Advisory Opinion 78-32A spoke to the Illinois Unclaimed Property Act, and the presumption of remitting to the state financial department upon abandonment of claims. Though the act was limited to inactive trusts, the Department found ERISA preempted the state act. In 1979, Advisory Opinion 79-30A, the Department analyzed the California unclaimed property law, stating again that ERISA supersedes the state law. In 1994, the Department issued Advisory Opinion 94-41A which analyzed the Texas state statute. There, the Department concluded that the act would affect the core function of the plan by reducing assets, thus highlighting the inconsistency with the fiduciary duty to the participant, and the choice to distribute. In 1995, the Department spoke directly to the issue of preemption, in a letter by the Pension and Welfare Benefits Administration. The letter stated the unclaimed property laws would not only require fiduciaries to distribute, but also determine when unclaimed funds are abandoned, file reports to the state and issue notices to participants, facing penalties for not complying. The Department stated these laws are again preempted by ERISA as they directly conflict with the method of distribution, an administrative decision within the role of the fiduciary. The letter also highlighted an additional tension of fiduciaries duty to the plan participant, noting that the requirement to forfeit at a particular time would eliminate cases in which additional searches would have been successful.

In addition to the Department, the courts have analyzed ERISA's preemption of state unclaimed property statutes. In 1999 in *Commonwealth Edison v. Vega*, (finding ERISA preemption of Illinois Disposition of Unclaimed Property Act) and as recently as 2018 in the case of *Scudder v. Colgate*, (finding ERISA preemption of NJ Uniform Unclaimed Property Act). 174 F.3d 870 (7th Cir. 1999); 2018 WL 4188456 at *4.

---

[35] *Id.*
[36] *Id.*

b. Voluntary Escheatment

Existing Department guidance also generally discourages plan fiduciaries from escheating plan assets. The Department has addressed voluntary distribution of unclaimed funds to states, however, all of the existing guidance muddles the analysis such that fiduciaries worry that making the decision to escheat may leave them vulnerable to allegations of fiduciary breach.

In 2013, the ERISA advisory council reported on locating lost or missing participants, stating that escheatment to states was one of a few options. However, the council noted they were largely unsupportive of voluntary escheatment, stating it is unlikely to meet the goal of successfully providing participants with their benefits. Similarly, FAB 2014-01 highlights the tension between fiduciary duty to act in the sole interest of participants and the potential adverse consequences to the plan participant, if funds are distributed to states.

Distributed funds are subject to income tax and withholding, premature distribution penalties, as well as reduction of interest accrual, ultimately decreasing the value of the fund. In January of 2019, a GAO report was issued that addressed unclaimed checks and the transfer to states. The report noted that additional issues arise from distribution due to varying plans, such as different distribution amounts. For example, small amounts were more common because of federal law restrictions, however, due to rollover contributions accounts larger than $1,000 may be cashed out and unclaimed.

IV. Issue of Voluntary Escheatment

While we understand that the Department believes that guidance currently supports voluntary escheatment of assets by a plan fiduciary, the current marketplace has not reached that conclusion. In our experience, plan fiduciaries tend to avoid escheating ERISA plan assets, including uncashed check amounts, given the lack of clear guidance surrounding escheatment and the Department's rigorous enforcement initiatives regarding missing participants. Moreover, while FAB 2014-1 does permit voluntary escheatment in limited circumstances, the guidance only directly applies to terminated defined contribution plans.

Similarly, plan service providers also tend to avoid escheatment of retirement plan assets.

Given the lack of clear guidance, plan fiduciaries are in a terrible position. They are responsible for assets that, in many cases, should realistically give up on trying to locate or trying to further encourage to deposit their checks. Often times, plans incur additional plan expenses to recordkeep these accounts and by continuously searching for the owner of the stale checks. Accordingly, the retirement system would better operate if the Department provides clear guidance.

V. Other Options

While this meeting is focused on escheatment, we want to highlight that there are other approaches that the Department could mandate.

- Provide guidance directing plans to open IRAs for all individuals using stale checks. This provides the advantage of keeping the funds in the retirement system, while it would allow plans to stop subsidizing the cost of individuals who fail to keep their addresses up to date or who refuse to cash checks at the expense of the plan as a whole.

- Direct plans to forfeit the amount of the stale checks after reasonable efforts have been made, with an understanding that plans that have exhausted reasonable efforts should not be required to take any additional efforts until the participant comes forward and indicates that he or she would like to have a check reissued so that the check could be deposited. This provides a benefit to all other plan participants as it would allow for plan expenses to be subsidized by participants who appear to decline their benefits. This approach would also be consistent with existing Treasury regulations.

- Central entity for escheatment. Some countries have adopted or are considering adopting (e.g., Canada) a central entity for escheatment for retirement plans. This would benefit plans and participants by helping plans reduce costs, providing a clear answer of what to do with the funds, and also allow participants to look to a single place to be reconnected with their funds. However, absent Congressional action, the creation of a central entity could be vulnerable to legal challenge.

VI. Possible Forms for Escheatment Guidance

Should the Department ultimately conclude that the escheatment of stale checks is the correct alternative, it could issue guidance that tracks FAB 2014-1 but that provides a clearer safe harbor either directing plan fiduciaries to escheat or prescribing an exhaustive list of specific factors that a plan fiduciary should consider when deciding whether voluntary escheatment is appropriate. It would be helpful if the Department also provided a safe harbor for determining when to give up on attempting to pay/locate individuals that recognizes the need to balance compliance with the directive of a plan document to pay participants against the statutory prohibition against incurring unreasonable expenses.

We also believe that the Department should incorporate guidance from the IRS on this issue and explain that, after a reasonable and diligent search process, that funds could be forfeited and released benefit of other plan participants until the participant returns to their plan to claim the benefit. When the Department and the IRS or other agencies issue different or conflicting guidance, plan fiduciaries are left in a worse place than if no guidance were issued. Thus, coordination with the IRS is paramount.

Lastly, we think that the Department should recognize and support the retirement plan marketplace's use of alternative technologies to furnish the participants their benefit. In this respect, the Department should encourage plans fiduciaries to use ACH, wire technologies, and other new forms of payment that would permit the plans to make benefit payments to participants without requiring the sending of a paper check through the U.S. mail. In our view, these efficient technologies would result in significantly fewer uncashed checks within the U.S. marketplace. Any system that is based on paper mail, to the extent it is not already outdated, is likely to become outdated in the coming years.

VII. Key Recommendations

- Guidance is needed. Plan fiduciaries cannot remain in a position where they are concerned that escheatment may give rise to fiduciary breach claims. Similarly, plan fiduciaries cannot remain in a place where they feel compelled to incur speculative and often unnecessary plan expenses and costs.

- Until guidance is provided, the Department should not initiate an enforcement initiative. The regulated community is becoming hesitant to engage with the Advisory Council in light of the results of the 2013 missing participant discussions. There, the regulated community made clear that guidance is needed and instead, the Department initiated an enforcement initiative. The regulated community is still waiting on guidance six years later.