Former Employees with Plan Assets are Still Plan Participants

Plan Sponsors should understand that terminated employees who left their account balance in your plan, are still considered participants under ERISA. As such, they have the same rights as current employees. They cannot contribute to their account under the plan but otherwise they have the same ERISA protected rights as plan participants.

One protected right is to receive all ERISA required notices that current participants receive. The distribution of notices to former employees can be challenging. With online notice distributions now allowed, it may ease this problem a bit, but losing track of former employees through undeliverable mail or emails can be troubling.

Participant direction of investments and notice of investment changes is another obligation that is more difficult with terminated employees. A fundamental fiduciary responsibility is to provide sufficient investment information such that participants can make consistently informed investment decisions. In the event the stock market goes through a bear market cycle, former employees may become disgruntled if they did not receive proper and required investment information based on which they may have prevented financial losses.

Small account balances belonging to former employees can be problematic for plan providers as well as plan fiduciaries. This can lead to greater administrative recordkeeper costs. In addition, having terminated employees in your plan may cause your plan to be subject to an annual plan audit at a potential cost of around $15,000.

One step many plans take to mitigate this exposure to some extent is to adopt a cash-out limit (usually $1,000 or $5,000). With a cash-out limit, terminated participant accounts may be distributed after communicating that they need to take a distribution directly or a rollover to an Individual Retirement Account or another qualified plan. For participant accounts in excess of $5,000 you must obtain consent from employees requesting to take their account balances out of the plan. It is advantageous for plan sponsors to persistently reach out to former employees to request they take their money out.

The Department of Labor (DOL) has been focused on missing participants with dormant accounts. As with any fiduciary task as part of your annual request that former employees take their money it is advisable that all correspondence (both sent and returned) be documented to evidence your communication efforts. Internet searches can be helpful to find those who leave no forwarding address.