

Forfeit This! What 401(k) Plan Sponsors Need To Know About Forfeitures

By Ary Rosenbaum, Esq.

One of my favorite movie scenes is from *Donnie Brasco*. You’ve got Al Pacino’s character, Lefty, leading his crew around Brooklyn, smashing open city parking meters with sledgehammers for a few dollars in dimes. The visual is absurd—seasoned wiseguys tearing apart public property for pocket change, just to meet their weekly take. But you know what? That scene always reminded me of a particular breed of ERISA litigators: constantly prowling for angles, looking to pry open something seemingly insignificant—like forfeitures—for their own payday. It’s not about protecting participants; it’s about finding any opportunity, no matter how small or laughable, to file a class action. Like busting open a parking meter for loose change, they’ll take whatever they can get, and 401(k) forfeitures are the next round of meters getting smashed. Forfeitures were once a sleepy corner of plan administration, hardly the stuff of major litigation. But that changed when plaintiffs’ attorneys started filing lawsuits that scrutinized every plan transaction like it was a RICO investigation. These cases have shined a light on something many plan sponsors misunderstand, ignore, or treat as an afterthought. So this article is your wake-up call. If you’re a plan sponsor, it’s time to take forfeitures seriously. Because if you mishandle them, even unintentionally, you’re painting a target on your back.

And if you’re a plan provider, especially a third-party administrator (TPA), it’s your job to help make sure your clients don’t end up getting hauled into court over dimes.

What Are Forfeitures, Anyway?

Let’s start with the basics. A forfeiture occurs when a participant terminates employment before becoming fully vested in employer contributions. The unvested portion gets kicked back into

Where Plan Sponsors Get It Wrong

In theory, the rules are clear. In practice? They’re about as clear as a windshield in a New York snowstorm. Here are the big-ticket problems:

1. Letting Forfeitures Sit Too Long

This is the equivalent of leaving a stack of cash in a desk drawer for years and forgetting about it. Forfeitures aren’t meant to collect dust. The IRS has been clear that they should be used in a timely manner. That doesn’t mean you get to wait five years until the amount builds up enough to pay your entire recordkeeping bill. The term “timely” isn’t defined precisely, but most practitioners interpret it as within the plan year following the year the forfeiture occurred. So if a participant terminates in 2024 and forfeits \$3,000, that amount should be used no later than the end of 2025. Letting forfeitures sit there can lead to plan disqualification—or at the very



the plan’s forfeiture bucket. That money doesn’t go to waste, it’s supposed to be used in a limited number of ways:

1. To pay plan expenses,
2. To reduce employer contributions,
3. To restore previously forfeited accounts if a participant is rehired (depending on the plan terms).

Pretty simple, right? Well, yes—until it’s not.

least, an operational error that needs to be corrected under EPCRS (the IRS’s correction program). And if you think plaintiffs’ attorneys won’t file a class action over stale forfeitures, think again. Remember, they’re after the parking meter dimes.

2. Using Forfeitures Inconsistently

You can’t use forfeitures to reduce employer contributions one year, then pay plan expenses the next, then go back again

like you're changing lanes on the LIE without signaling. Your plan document needs to say how forfeitures will be used. And once it says it, you need to follow it. A lot of plan sponsors think forfeitures are "free money" they can throw at any plan expense. That's not how this works. If your plan says forfeitures reduce employer contributions, then that's what they're supposed to do. You don't get to deviate because it's convenient. And if you're relying on a TPA to handle this, remember: garbage in, garbage out. If they don't know your intent, or if you haven't reviewed your adoption agreement in a decade, you may be misusing forfeitures without even knowing it.



3. Not Tracking Forfeitures Properly

I've reviewed hundreds of plans, and it never ceases to amaze me how often plan sponsors have no idea how much money is in their forfeiture account—or worse, don't even realize they have one. That's a big problem.

You need to know:

- When the forfeiture occurred
- How much was forfeited
- Whether the participant is entitled to a restoration
- How and when the money was used

That level of tracking takes diligence, not just a quarterly call with your recordkeeper where you nod along while half-paying attention. Ask for the forfeiture ledger. Review it. Make sure it aligns with plan terms. Don't assume the provider has it covered.

Why This Suddenly Matters

In the past, a forfeiture misstep might have triggered a slap on the wrist or a correction under EPCRS. Now? It's a potential class action. Plaintiffs' attorneys have figured out that ERISA's fiduciary duty provisions are a wide-open invitation to sue. Any deviation from plan terms, any perceived harm to participants, any technical foot fault, they'll claim it's a breach. We've seen it with revenue sharing. With stable value funds. With target-date series. And now, forfeitures are up next. Because if they can argue that misused forfeitures result in higher costs or improper benefits to the employer,

they've got a claim. It doesn't even matter if the forfeiture was used in good faith or if no participant lost a dime. The issue is process, not just outcome. If you failed to follow the plan terms, you're exposed.

How Plan Sponsors Can Protect Themselves

This isn't about panic. It's about preparation. You can avoid the parking meter mob by tightening your game. Here's how:

1. Review Your Plan Document

Start with the plan's language. What does it say about forfeitures? Can they be used to pay expenses? Reduce contributions? When? How? Once you know what the rules are, you can figure out if you've been following them.

If you're not sure, call your TPA or ERISA counsel, not your cousin Vinny.

2. Establish and Document a Policy

You need a written forfeiture policy. It should explain:

- When forfeitures are created
- When and how they're used
- Who approves the use
- How it's documented

Then, follow that policy. Audit it annually. If you need to change your process, amend your policy and update your plan if necessary.

3. Communicate With Your TPA

Don't assume they're handling it properly. Ask questions:

- Are we timely applying forfeitures?
- What's our current forfeiture balance?
- Can you show me how it was used last year?

A good TPA will have answers. A bad one will say, "I'll get back to you." You want the former.

4. Avoid Hoarding Forfeitures

This isn't your rainy-day fund. Use the money as soon as administratively feasible. Otherwise, it may look like you're benefitting the employer at the expense of participants, a huge no-no under ERISA.

5. Correct Past Mistakes

If you realize you've made errors, don't hide under your desk. Use the IRS correction programs. Document everything. Fix it before someone else forces you to.

Conclusion: Don't Get Smashed Over Dimes

Forfeitures are not exciting. They're not glamorous. But they are dangerous if mishandled. And in today's ERISA litigation climate, nothing is too small or too obscure to become a lawsuit. You can either take this seriously now, or you can end up like Lefty and his crew, smashing open parking meters for nickels and dimes because you were too sloppy to cover your weekly take. Don't be that plan sponsor. Review your forfeitures. Follow your plan. Tighten your operations. And as always, get good guidance. You can't control who files what lawsuit, but you can control whether they've got anything to stand on when they do. Because if you get sued over dimes, and your defense is, "We didn't know," you're going to wish you'd taken this more seriously. Forfeit this? No thanks. Not on my watch.

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