



Fiduciary Pension Partners

## Don't Take Forfeitures for Granted



Retirement plans have long subjected employer contributions to vesting schedules, rewarding tenure by increasing the participant's ownership in those contributions in proportion to their years of service. However, several law firms have recently challenged this long-standing and common practice, arguing that using forfeitures to offset employer contributions is not in the best interests of participants or beneficiaries, as ERISA requires.

### What Are Forfeitures?

“Vesting” in a retirement plan means ownership, according to the IRS. More specifically, this means that workers vest, or own, a certain percentage of their account in the plan each year, depending on a timeline established by the plan. Amounts that are not vested — earned, by virtue of their hours or service — may be forfeited by employees when they are paid their account balance. Vanguard reports that more than half of the plans it administers impose vesting requirements on employer contributions.

Now, when a worker leaves prior to becoming 100% vested in those contributions, those “forfeited” account balances may, according to established regulatory guidance, be either (1) used to offset employer contributions, (2) applied to reduce plan expenses, or (3) reallocated to the remaining participants in the plan.

### Committee Considerations

The litigation filed thus far has alleged that the decision on how to reallocate plan forfeitures by the plan fiduciaries was a fiduciary decision and not in the best interests of participants — even though the IRS allows plans to make this decision. In fact, this practice has been common among retirement plans for decades.

While these cases are still working their way through the courts, in view of how many plan committees routinely make decisions on the disposition of forfeitures, careful consideration on those determinations going forward would be prudent.



As a result, retirement plan fiduciaries may want to consider the following:

1. Review the plan document to confirm how/if it says forfeitures are to be reallocated (some of the suits have alleged that plan committees have not followed the terms of the plan document).
2. If the plan document leaves the decision to the plan committee, in consultation with an ERISA attorney, consider amending the document to remove that decision from plan fiduciaries — either by spelling out a specific order of reallocation, or by leaving that decision to those not affiliated with the plan (say, the board, as a plan design decision).
3. Consider immediate vesting for eligible participants. Note that this has cost and communication implications. Recent research by Vanguard finds that vesting does not provide a systematic retention benefit, though there is a 2.5% recovery of employer contributions for the average plan.

In short, don't take forfeitures for granted.

#### Sources

<https://www.chubb.com/content/dam/chubb-sites/chubb-com/us-en/business-insurance/chubb-special-report/chubbspecialreport-primer-on-401k-forfeiture-litigation.pdf>

<https://www.irs.gov/retirement-plans/plan-participant-employee/retirement-topics-vesting>

<https://institutional.vanguard.com/insights-and-research/report/how-america-saves.html>

[https://corporate.vanguard.com/content/dam/corp/research/pdf/does\\_401k\\_vesting\\_help\\_retain\\_workers.pdf](https://corporate.vanguard.com/content/dam/corp/research/pdf/does_401k_vesting_help_retain_workers.pdf)

<https://www.irs.gov/retirement-plans/issue-snapshot-plan-forfeitures-used-for-qualified-nonelective-and-qualified-matching-contributions>

*This material was created to provide accurate and reliable information on the subjects covered but should not be regarded as a complete analysis of these subjects. It is not intended to provide specific legal, tax or other professional advice. The services of an appropriate professional should be sought regarding your individual situation. The "Retirement Times" is published monthly by Retirement Plan Advisory Group's marketing team. This material is intended for informational purposes only and should not be construed as legal advice and is not intended to replace the advice of a qualified attorney, tax adviser, investment professional or insurance agent. (c) 2021. Retirement Plan Advisory Group. Fiduciary Pension Partners is not affiliated with Retirement Plan Advisory Group but subscribes to its annual services offering. Fiduciary Pension Partners is a registered investment adviser with its principal place of business in the State of New Jersey. Registration does not imply a certain level of skill or training.*