

Mitigating ERISA Litigation Risks: Forfeiture Usage in Retirement Plans

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A notable trend in ERISA litigation has emerged related to the usage of forfeitures to reduce employer contributions within retirement plans. Forfeitures most often occur in retirement plans that have a vesting schedule for employer contributions. When a participant terminates employment before their employer contribution becomes 100% vested, the unvested portion reverts to the plan's forfeiture account, which is considered an asset of the plan under IRC and ERISA regulations. Forfeiture provisions often give the plan sponsor some discretion as to the permitted use of forfeiture dollars.

In the most recent suits, plaintiffs allege employers have breached their fiduciary duty to act solely in the best interests of the plan and its participants by choosing to use forfeited funds to reduce future employer contributions to the plan instead of reducing the administrative expenses that are often borne by participants.

To reduce potential legal exposure to your plan, plan sponsors should consider the following risk mitigation strategies:

Review and Revise the Plan's Written Terms

Every retirement plan must have a written plan document that outlines how forfeitures are to be used. The document should clearly specify whether they can be used to offset employer contributions, pay plan administrative fees, or be reinvested into the plan through an allocation to participants. To enhance the plan's forfeiture provision, consider using clear language in the plan document that specifies an order of priority (i.e. first to be used for employer contributions, and if any remain, second to be used for plan expenses). Lastly, if the document allows for discretion by the fiduciary on how to use available forfeitures, consider revising the language to remove all discretion. An ERISA fiduciary has a fiduciary duty to follow a plan document, so long as it is not contrary to ERISA; and, if the plan document gives the fiduciary no discretion, the fiduciary arguably cannot be in breach of its duty.

Enhance Communication with Participants

Another important mitigation step to consider is enhancing communications with all participants on the use of forfeitures, including clearly communicating the forfeiture process and how forfeitures are to be used. This can be achieved with transparent language in the plan document, summary plan description or through other plan communications.

Establish a Monitoring System

Employers should set up an ongoing process for monitoring forfeitures, employer contributions and plan expenses. This involves regularly reviewing the plan's usage of forfeitures, ensuring that funds are allocated correctly, and verifying that contributions comply with the terms outlined in the plan document. Auditing the process periodically, even if not required, can ensure that no mistakes are made that could lead to legal issues later.

Given the current legal landscape around the use of forfeitures, plan sponsors should be proactive in reviewing their plan document with their providers to ensure it includes more precise language without fiduciary discretion to mitigate potential risk. If we can be of any assistance, please don't hesitate to reach out.

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