



Automatic Enrollment Arrangements



By: Tim McCutcheon

Internal Revenue Code

- Qualified Automatic Contribution Arrangements (QACA)
 - Safe Harbor ADP/ACP
 - Code sections 401(k)(13) and 401(m)(12) (Applies to any plan subject to 401(k) or 401(m))
 - Proposed regulations – “may rely”
- Eligible Automatic Contribution Arrangements (EACA)
 - Participant 90 day refunds and delayed ADP/ACP corrections
 - Code section 414(w) (Applies to 401(a), 403(b) and govt. 457(b) plans)
 - Proposed regulations – “may rely”
- Traditional Automatic Contribution Arrangements (TACA)
 - Negative election is a cash or deferred election
 - Treas. Reg. section 1.401(k)-1(a)(3)(ii) (Applies to any plan subject to 401(k))

ERISA

- Qualified Default Investment Alternatives (QDIA)
 - ERISA section 404(c)(5) & Final regulations
 - Fiduciary relief for default investments
- Pre-emption
 - ERISA section 514(e), 502(c)(4) & Final regulations
 - State laws preempted

QACA - Safe Harbor 401(k) Plan

- Minimum contributions
- Automatic enrollment in elective deferrals
- Two year cliff vesting schedule
- Notice to participants
- Most other corresponding 401(k)(12) rules:
 - Plan year requirement
 - Nonelectives may be used to satisfy 401(a)(4)
 - Etc.

QACA Minimum Contributions

- Minimum contributions
 - Matching contribution 100% first 1% and 50% of next 5% (3.5% total assuming 6% deferral), or
 - 3% Non elective contribution
- Many 401(k)(12) rules apply
 - Limits on HCE matching contributions
 - Conditional notice/amendment
 - Remove match midyear with notice
 - Distribution restrictions as 1.401(k)-1(d) (No hardship)

QACA - Automatic Enrollment

- Qualified percentage (no more than 10%):
 - 3% until end of plan year following plan year of auto enrollment (could be up to two years)
 - 4% following year
 - 5% following year
 - 6% subsequent years
- Option not required to apply to current participants ***with an election in effect***. Apparently have option to reduce existing elections.
- Track service vs. provide 6% for all years
- Uniform percentage
- Lower rates OK for statutory limits and hardship suspensions

QACA Vesting

- Minimum 2 year cliff vesting
 - Not much of an inducement in plan with one year wait unless sponsor has high turnover
- Plans with existing match source
 - If all matching contributions have less favorable vesting schedule should be OK
 - If matching contributions have more favorable vesting schedule (401(k)(12) Safe Harbor) could be an issue

QACA - Notice

- Full traditional safe harbor notice *plus*:
 - (1) The level of elective contributions, which will be made on the employee's behalf if the employee does not make an affirmative election;
 - (2) The employee's right under the automatic contribution arrangement to elect not to have elective contributions made on the employee's behalf (or to elect to have such contributions made in a different amount or percentage of compensation); and
 - (3) How contributions under the automatic contribution arrangement will be invested (including, in the case of an arrangement under which the employee may elect among 2 or more investment options, how contributions made under the automatic contribution arrangement will be invested in the absence of an investment election by the employee).

QACA – Notice (Cont)

- Provided no more than 90 and no less than 30 days before beginning of each plan year. If immediate eligibility, no more than 90 and no later than the eligibility date
- And must be “ ... provided sufficiently early so that the employee has a reasonable period of time after receipt of the notice and before the first elective contribution is made under the arrangement to make [participant] elections ...”
- Must be delivered to “each eligible employee.”

EACA

- No minimum contributions or vesting
- Automatic enrollment in elective deferrals with a uniform percentage of compensation
- Notice to participants
- Must be a QDIA if subject to ERISA (H.R. 4195 retains rule)
- ADP/ACP correction period extended from 2-1/2 to six months
- Participants who are automatically enrolled in the plan may request a full refund of contributions and earnings within 90 days
- May use in conjunction with a QACA
- No need to offer to all employees – but likely a benefit, right or feature

EACA - Notice

- The EACA notice must contain all of the information in a regular safe harbor notice and the following:
 - (1) The level of elective contributions which will be made on the employee's behalf if the employee does not make an affirmative election;
 - (2) The employee's rights to elect not to have default elective contributions made to the plan on his or her behalf or to have a different percentage of compensation or amount of elective contributions made to the plan on his or her behalf;
 - (3) How contributions made under the arrangement will be invested in the absence of any investment election by the employee; and
 - (4) The employee's rights to make a permissible withdrawal, if applicable, and the procedures to elect such a withdrawal.

EACA – Notice (Cont)

- Provided no more than 90 and no less than 30 days before beginning of each plan year. If immediate eligibility, no more than 90 and no later than the eligibility date
- And must be provided sufficiently early to allow a reasonable period of time after receipt of the notice to make participant elections
- Must be delivered to “each eligible employee.” (401(k) or EACA eligible?)

EACA - Withdrawals

- Participant must request in 90 days
 - Measured from the date that compensation would have been included in income
- Refund includes earnings and losses (measured under rules “similar” to ADP refunds)
- Fees may be imposed to the extent imposed on other distributions
- Withdrawal taxed in the year of the distribution without penalty (Refunds of Roth Contributions not taxed)
- Reported on Form 1099-R, not eligible for rollover
- Matching contributions must be forfeited
- Not subject to 411(a)(11) or 417 consent rules
- Not included in ADP test

TACA

- Treas. Reg. section 1.401(k)-1(a)(3)(ii)
 - Automatic enrollment is treated as a cash or deferred election
- Revenue Ruling 2000-8
 - Must give notice
 - Participant must be given reasonable opportunity to elect.
- Preemption requires notice

QDIA

- Provides ERISA section 404(c) relief to fiduciaries that invest participant assets in certain types of default investment alternatives in the absence of participant investment direction
- Two principal requirements of a QDIA:
 - Participant notice
 - Plan fiduciaries select an appropriate default investment

QDIA Section 404(c) Relief

- Need not be a Section 404(c) Plan
- Applies to:
 - Automatic enrollment
 - Elimination of an investment alternative
 - Rollover from another plan
 - Any other failure of a participant to provide investment instruction
- Fiduciary must still exercise judgment in the selection and monitoring of the default investment

QDIA - Operational Requirements

- Provide participant notice
- Provide same investment information as required in a 404(c) plan
- Allow divestment at least every three months
 - No restrictions or fees if divest within 90 days
 - May impose fees and expenses charged for the operation of the investment (such as investment management fees, distribution and/or service fees, "12b–1" fees, and legal, accounting, transfer agent and similar administrative expenses)
- Offer broad range of investment alternatives

QDIA - Notice

- Must be provided at least 30 days prior to eligibility or investment in QDIA and 30 days prior to the beginning of each subsequent plan year.
- For plans that offer immediate participation, the notice may be provided up to the date of plan eligibility; but only if the plan is also an EACA.
- Preamble to the final regulations the DOL notes that "the fiduciary may obtain relief for later contributions with respect to which the 30-day advance notice requirement is satisfied."

QDIA – Notice Content

- (1) A description of the circumstances under which assets in the individual account of a participant or beneficiary may be invested on behalf of the participant or beneficiary in a qualified default investment alternative; and, if applicable, an explanation of the circumstances under which elective contributions will be made on behalf of a participant, the percentage of such contributions, and the right of the participant to elect not to have such contributions made on the participant's behalf (or to elect to have such contributions made at a different percentage);
- (2) An explanation of the right of participants and beneficiaries to direct the investment of assets in their individual accounts;
- (3) A description of the qualified default investment alternative, including a description of the investment objectives, risk and return characteristics (if applicable), and fees and expenses attendant to the investment alternative; (Fund sheet should be OK)
- (4) A description of the right of the participants and beneficiaries on whose behalf assets are invested in a qualified default investment alternative to direct the investment of those assets to any other investment alternative under the plan, including a description of any applicable restrictions, fees or expenses in connection with such transfer; and
- (5) An explanation of where the participants and beneficiaries can obtain investment information concerning the other investment alternatives available under the plan.

QDIA - Investment

- No employer securities
- Managed by:
 - An investment manager, trustee of the plan or plan sponsor who is a named fiduciary;
 - An investment company; or
 - Certain stable value funds
 - No longer than 120 days after the date of the participant's first elective contribution
 - Grandfathered as of December 24, 2007

QDIA – Investment (Cont)

- Consist of:
 - Target date or life cycle fund (may be professionally managed) based on participant's age, target retirement date (such as normal retirement age under the plan) or life expectancy
 - Balanced or life style fund with target level of risk appropriate for participants of the plan as a whole
 - Certain stable value funds
 - 120 days after the date of the participant's first elective contribution
 - Grandfathered as of December 24, 2007

Preemption - ERISA section 514(e)

- Covers automatic contribution arrangements
- Must be QDIA (but see regulations)
- Provide notice that is
 - Sufficiently accurate and comprehensive to apprise the participant of such rights and obligations, and
 - Written in a manner calculated to be understood by the average participant to whom the arrangement applies
- Notice must:
 - Explain the participant's right not to have elective contributions made on the participant's behalf (or to elect a different percentage),
 - Provide the participant has a reasonable period of time, after receipt of the notice to make such election, and
 - Explain how contributions will be invested in the absence of any investment election by the participant.

Preemption - Regulations

- State law preempted for automatic contribution arrangement that meets the requirements of QDIA
- “Nothing ... precludes a pension plan from including an automatic contribution arrangement that does not meet the conditions of [a QDIA]” (Contradicts ERISA section 514(e)(2)(C))
- Section 502(c)(4). “The Secretary may assess a civil penalty of not more than \$1,000 a day for each violation by any person of, section 302(b)(7)(F)(vi) , or section 514(e)(3).” [Failure to give notice.]

Notices

- IRS published a model notice (QACA, EACA and TACA. QDIA and Preemption)
- A Summary of Material Modifications (SMM) is not required until after the end of the plan year in which the automatic enrollment feature is put into effect
- It is likely that the participant notice would suffice as an SMM
- Ftwilliam.com will provide SMMs and updated Summary Plan Descriptions later next year

Plan Amendments

- Section 1107 of PPA. Amendments not required until the last day of the first plan year beginning on or after January 1, 2009
- Proposed IRS regulations state that plan provisions that satisfy the QACA or the EACA rules must be adopted before the first day of the plan year and remain in effect for an entire 12-month plan year
- However, informal conversations with the IRS confirm that Section 1107 applies to both QACAs and EACAs
- Do amendment to eliminate traditional safe harbor plan if converting to a QACA or an EACA
- Do board action to be safe in other situations
- DOL clarified in the QDIA regulations that a plan amendment is not required to implement a QDIA