



## Automatic Enrollment

On August 17, 2006, the Pension Protection Act of 2006 was signed into law. This law makes many changes, but this Client Alert will concentrate on provisions related to Automatic Enrollment in 401(k) Plans.

**Background:** Automatic enrollment is intended to increase employee participation in retirement plans. It can be used when a new or existing employee does not return an Enrollment Form to start making contributions into a 401(k) Plan. If the plan document states that Automatic Enrollment is allowed, the employer can then enroll the employee at a specific contribution rate set in the plan without the employee's signature. Automatic Enrollment is allowed by ERISA and some companies have included these provisions in their plan, but there was uncertainty as to whether state withholding rules would allow the employer to deduct contributions from an employee's wages without the employee's approval.

Following are the new rules effective on the date noted.

### Effective August 17, 2006:

- Federal law allows automatic enrollment and preempts any state laws that would not allow automatic withholding from employee paychecks. This preemption is available only if the plan meets the notice requirements and the default investment rules below. Currently, any investments used as default investments must be prudent investments and do not have protection under ERISA section 404(c) for fiduciary liability.
- Notice requirements - Employees in plans with automatic enrollment must receive a notice explaining their right to opt out of the plan, their right to change their rate of contributions, the time periods for making elections and how contributions will be invested. This notice must be provided to participants within a reasonable time before each plan year.

### Effective for plan years beginning January 1, 2007 or after:

- Default Investments - Plans can rely on the automatic enrollment preemption and are treated as complying with ERISA section 404(c), which furnishes limited protection against fiduciary liability, if contributions for employees who do not make their own elections are deposited into a default fund called a "Qualified Default Investment Alternative" (QDIA) and certain notice requirements are met. A QDIA may be a (1) Life-cycle or targeted-retirement dated fund, (2) Balanced fund, or (3) Professionally Managed Account. The notice explaining the QDIA details must be provided to participants at least 30 days prior to the initial investment in the QDIA and at least 30 days prior to the beginning of each subsequent plan year. The regulations regarding these details have not been finalized yet.



## Automatic Enrollment Cont'd

### Effective for plan years beginning January 1, 2008 or after:

- An employee who is automatically enrolled may be given a 90 day window to opt out of the plan and receive a refund of the contributions which were automatically deposited. The refund must include investment earnings and will be taxed in the year it is refunded but will not be subject to the 10% penalty tax for withdrawal before the age of 59½. Currently, any amounts contributed due to automatic enrollment can not be refunded to the participant from the plan. Thus, prior to 2008, an individual would need to be terminated from employment or meet the plan's in-service distribution rules to withdraw any amounts contributed due to automatic enrollment.
- A plan using automatic enrollment may issue refunds to correct discrimination testing violations within six months after the end of the plan year in order to avoid the 10% excise tax. The normal rules require refunds within 2 ½ months to avoid the 10% excise tax.
- A new Safe Harbor option is available for plans with automatic enrollment. Plans which meet the following requirements will avoid discrimination testing:
  - Automatic enrollment must apply to all employees who have not made previous election to opt out of contributions.
  - The initial automatic enrollment of employee contributions must be at least 3% of wages with the percentage increasing 1% each year for three years.
  - The required employee contribution percentage can not exceed 10% of wages.
  - The required employer contribution must be either an employer nonelective contribution of 3% of wages to all eligible employees or an employer matching contribution of 100% on contributions up to 1% of wages plus 50% on contributions between 1% and 6% of wages.
  - Safe Harbor nonelective or matching contributions would be 100% vested after two years of service.
  - Certain notice requirements would also apply.

Plan documents have to be amended to add Automatic Enrollment features to the plan. Please contact Administrative Retirement Services, Inc. if you would like to discuss Automatic Enrollment rules further or you are considering adding Automatic Enrollment features to your plan.

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