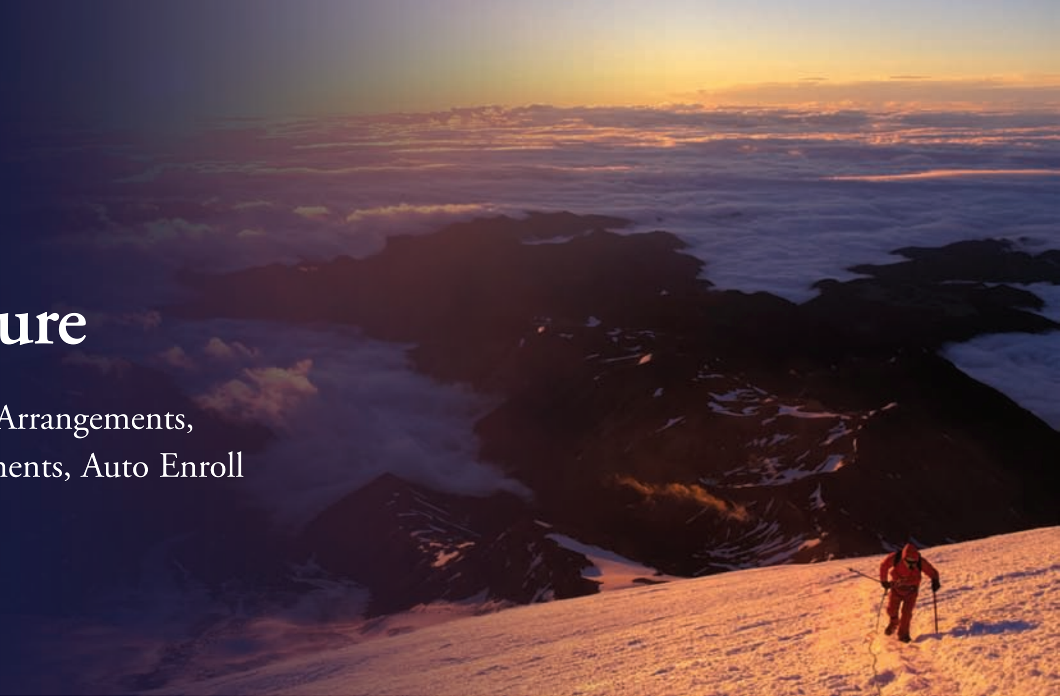

Automatic Enrollment Feature

Also known as: Negative Election Arrangements, Automatic Contribution Arrangements, Auto Enroll

Adding automatic enrollment features to a qualified retirement plan became much more attractive with the tax law changes that occurred in 2008. The government enacted these new regulations in hopes to increase the retirement plan accounts of individuals who have access to workplace plans. As with all government regulations, there are some positive and negative results. The following is a brief outline of the different types of automatic enrollment programs:

Automatic Contribution Arrangement (ACA):

- Considered "old style"
- Can be established at any time during the year
- Employer establishes a minimum automatic deferral amount (such as 3%)
- Can apply new feature to all employees whether or not they have a deferral election on file
- Employees do not have the option to have their account "refunded" unless they qualify for a distribution from the plan

Eligible Automatic Contribution Arrangement (EACA):

- Must be established prior to the beginning of a plan year
- Employees that do not have a salary deferral election on file must be enrolled
- No minimum or maximum automatic deferral amount (3% is the most common)
- Automatic annual increases are allowed if written in the plan document
- Annual notice is required
- Employees may request a refund of their salary deferrals if done within 90 days from the first deferral
- Employer generally must establish a default investment fund
- Employer has an extended discrimination testing period (6 months instead of $2\frac{1}{2}$ months)

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Qualified Automatic Contribution Arrangement (QACA) – Safe Harbor Plan:

- Must be established prior to the beginning of a plan year
- Employees that do not have a salary deferral election on file must be enrolled
- Minimum automatic contribution amount is 3%, can be as high as 10%
- Automatic annual increases are required, with the exception of an initial automatic contribution of 6%
- Annual notice is required
- Employees may request a refund of their salary deferrals if done within 90 days from the first deferral
- Employer generally must establish a default investment fund
- An employer contribution is REQUIRED (generally a 3-1/2% matching contribution or a 3% non-elective)
- Employer contributions can have a 2 year vesting schedule (1st year 0%, 2nd year 100%)
- Except from most discrimination tests

PROS: What are the advantages to having an automatic enrollment plan?

- The increase in plan participation may results in better annual discrimination testing results for the owners and highly compensated employees (ADP test). This would increase the allowable percentage this group can contribution to the plan.
- Employer is perceived as helping the employees save for retirement.
- Employee benefit.
- Lower paid employees may benefit from the IRS Saver's Credit.
- Most large 401(k) investment providers offer assistance with this type of feature.
- Employees may have the opportunity to opt out within their first 90 days of participation and receive a full refund of their account. (EACA and QACA option)

CONS: What are the disadvantages to having an automatic enrollment plan?

- Greater fiduciary liability for the employer.
- Additional work to make sure accounts are setup properly for newly eligible employees
- May create a lot of small account balances.
- Increased administration costs.
- Annual notice requirement.
- Required employer contribution under the QACA arrangement.
- Employer needs very good practices and procedures to ensure the program is administered correctly. Errors in omitting employees could result in an employer contribution to the correct the error.

Frequently asked Questions:

Q: Does the plan need to be amended to add this feature?

A: *Yes, a plan amendment is required. The amendment will put in place the rules of the automatic enrollment feature. The employer must determine the initial group that will be affected by the new feature and the minimum automatic contribution percentage. For instance, will the feature apply to employees that have not made any election to the plan and new hires only, or will the provision be expanded to employees that have made an election but it is below the minimum automatic enrollment percentage? Does the employer want an annual increase to the automatic enrollment percentage? Will a refund option be available? These are just a few of the options to consider.*

Q: Will the plan automatically pass the discrimination testing?

A: *This depends on which automatic enrollment feature you decide to add to the plan. It is possible that any one of them will improve the annual plan testing. However, only the Qualified Automatic Contribution Arrangement will ensure the plan passes this test. This type of automatic enrollment feature requires the employer to make a contribution to the plan.*

Q: What is the amount the employer needs to contribute to a QACA plan?

A: *The employer can decide between a matching contribution or a non-elective contribution. The matching contribution can be structure in various ways. However, the two most common matching formulas are as follows:*

- *Dollar-for-dollar match on the first 1% contributed by an employee, plus 50% on the next 5% contributed by an employee or,*
- *Dollar-for-dollar on the first 3 1/2% contributed by an employee. (Aka – enhanced match)*
- *The non-elective contribution is 3% of compensation for all eligible employees. This is not based on an employee's 401(k) contribution to the plan.*

Q: Can the plan have a vesting schedule on the QACA employer contribution?

A: *Yes. A two year vesting schedule is allowed. This means an employee is not entitled to the employer contribution until they have completed two years of vesting service. The first year 0% vested, the second year 100% vested.*

Q: Can I add the QACA feature to my plan anytime?

A: *Unfortunately, this feature must be added prior to the beginning of the plan year. An employee must receive a notice explaining the program generally at least 30 days prior to the beginning of the plan year and every year thereafter.*

Q: What is the automatic deferral amount for a QACA plan?

A: *The minimum initial amount is 3%. The plan must have an annual escalation formula after an employee's second year in the plan. The percentage is escalated 1% per year up to 6% (may continue to 10% if written in the plan). The employer may decide not to use the escalation method and just start with a minimum 6% deferral percentage.*

Q: Do I have to make an employer contribution to the plan?

A: *No. An employer contribution is only required by the QACA plan. The ACA or EACA type of plans do not require and employer contribution. However, this also means that the plan will not automatically pass discrimination testing (ADP test) under these arrangements.*

Q: Are there any problems with including the feature in my plan and opting not to use it?

A: *Yes. This would be in violation of the terms of your plan and would jeopardize the tax qualified status of the entire plan. All qualified plans must operate according to the terms of the plan document. When an employer does not follow the terms of the plan document, it typically results in additional contributions to the employees and potentially penalties and interest.*

Q: Can we apply the automatic enrollment feature to just a certain group of employees?

A: *Generally, no. This feature has to be applied uniformly.*

Q: Can I start the EACA feature in the middle of the year?

A: *No. This type of automatic enrollment has to start at the beginning of the year. However, the ACA feature can be started anytime.*

Q: What is the difference between the ACA and EACA method?

A: *A couple of the biggest differences are the extended testing period that is allowed with a EACA plan and the 90 day refund feature. The discrimination testing (ADP) period is extended to 6 months as opposed to the normal 2 1/2 months under a non-automatic enrollment plan.*

NOTES: