

Update on 401(k) Automatic Enrollment

The Pension Protection Act (PPA) introduced key provisions designed to enhance automatic enrollment arrangements in 401(k) plans. In order to encourage employers to take advantage of automatic enrollment, two new automatic contribution arrangements became effective for plan years beginning after 12/31/2007:

- 1) Eligible Automatic Contribution Arrangements (EACA)
- 2) Qualified Automatic Contribution Arrangements (QACA)

The IRS released final regulations on February 23, 2009, covering these two types of arrangements.

For both types of arrangements, an Employer must select a uniform automatic contribution percentage that applies to all employees who do not make an election to contribute or to not contribute. The “default contributions” are not required to be invested in a “qualified default investment alternative”, keeping in mind that if a QDIA is not chosen, fiduciary protection is not available. Proper notices to employees must be provided (an initial notice and an annual notice are both required). The regulations state that in order to implement one of these arrangements, they must be implemented prior to the beginning of the Plan Year. In addition, either type of arrangement may implement a 90 day return of 401(k) deferrals (or per the final regs, may be a shorter period but not less than 30 days) for those default enrolled and who would like to “opt out” and have their deferrals refunded. Earnings are also distributed and if there was any corresponding employer match this would be forfeited if the employer match was funded with the deferrals per payroll. The final regs state that if the matching period is such that the employer match is not allocated per payroll (e.g. quarterly, annual) then it does not need to be made. **We strongly encourage you to review the deferral return option whether it be 90 days or less, with your Account Executive if you would like to implement.**

EACA – Eligible Automatic Contribution Arrangement

Potential benefits include:

- Increase of plan’s overall contribution rate
- Increased contribution rates help the plan pass nondiscrimination testing
- Employees who would not normally save for retirement are now encouraged to save for their future
- Increased plan value could result in lower overall plan fees
- Employer will have 6 months after the end of the plan year to perform non-discrimination tests and make any corrections – the final regs allow this feature only if the EACA applies to all employees. The final regs allow you to choose who you want the EACA to apply to (e.g. only future eligibles, certain classes of employees). If not everyone is covered, then the 6 month extension is not available.

QACA – Qualified Automatic Contribution Arrangement

Under this type of arrangement, the Employer is exempt from ADP, ACP and Top Heavy tests as long as one of the below required contributions is made:

- 1) **Matching** contribution of at least: 100% on the first 1% plus 50% of next 5%. (Example: if an employee defers 6% or more, his match will be 3.5% of pay)
OR
- 2) **Employer contribution** equal to 3% of pay is made to all eligible participants

Regardless of the employer contribution method selected, it must be 100% vested after the employee has completed 2 years of service

Additionally, to qualify for the exemption from ADP/ACP and Top Heavy, there are minimum automatic contribution percentages and annual contribution percentage increases as outlined below:

<u>Automatic deferral percentage</u>	<u>Plan Year of QACA Participation</u>
3%	1st plan year and 2nd plan year
4%	3rd plan year
5%	4th plan year
6%	5th and subsequent plan years

Please note that this provision will require additional administration on the part of the Employer.

Safe harbor automatic enrollment (QACA) must apply to ALL ELIGIBLE employees, unless they previously made an affirmative election to join or opt out. The plan sponsor will need to identify these employees. The final regs also allow the QACA to be set up such that a participant's affirmative election will expire each year and the participant will need to choose a new election. If no new election is made, the participant will be default enrolled.

Every plan and every employer is unique and this provision may not be feasible in all situations. Some items to keep in mind:

- A system needs to be in place to track those automatically enrolled and, if applicable, those that need to be automatically increased annually
- There are notice requirements including an initial notice, for those who are newly eligible throughout the year, and then annually to those automatically enrolled. Special guidelines were recently put into place for plans with immediate eligibility to assist employers in meeting the notice requirements.
- If the plan allows for Roth contributions, decide whether traditional pre-tax or Roth after-tax contributions will be withheld from auto enrollees' pay checks
- A qualified default investment may be chosen, per the final regs, for any QACA, for which you will need to consult with your Financial Advisor. Keeping in mind that, if a QDIA is not used, fiduciary protection may not be available.
- Amend your Plan Document and/or execute a Board resolution
- Cost of matching contributions could increase

- Administration time and expense of additional small balances could increase due to the creation of numerous small balances
- Beneficiary information should still be collected and maintained
- Increased number of balances for terminated employees not taking a distribution could require plan to have an audit
- If the 90 day return of deferrals (or a shorter period) is made available, be certain that investment provider is capable of handling the return of funds. Also need to verify what types of fees would apply to these return of funds (distribution, redemption fees)

If you would like to explore this option for your plan, please contact your plan's investment advisor, legal counsel, or your Paragon Account Executive.