

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 proposed regulations on November 8, 2007, covering these two types of arrangements, which are outlined below.

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” must be invested in a “qualified default investment alternative”, and 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 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). **We strongly encourage you to review the 90 day return option 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

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.

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
- 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 must be chosen, for which you will need to consult with your Financial Advisor
- 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 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.