Automatic Enrollment

Pension Protection Act of 2006

Automatic enrollment

Plans with automatic enrollment (referred to as “negative election”) may also include:

1. Eligible Automatic Contribution Arrangement (EACA)
2. Qualified Automatic Contribution Arrangement (QACA)

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“It is worth noting that many QACAs will also want to comply with the rules for Eligible Automatic Contributions Arrangements; e.g. default investing, in order to take advantage of state-law preemption and Section 404(c) protection for the default investment election.”

Eligible Automatic Contribution Arrangement

Employee can opt-out within 30 days

90-day opt-out deferral option

If the Plan includes a 90-day opt-out option, an employee can opt-out within 90 days after the date of the paycheck in which the first deferral contribution was deducted.

If the employee opts-out in the specified time frame, the employee will receive cash - plus or minus any earnings. Any matching contribution will be forfeited. Benefit: Employee may request a distribution up to 90 days after the first deferral deduction, regardless of whether the employee is otherwise eligible to take a distribution from the plan and regardless of age which would impose a tax penalty on the distribution if the employee is less that age 59½.

Eligible Automatic Contribution Arrangement:

1. Treats an employee as having elected a percent of compensation to be deducted from pay unless the employee
   a. Opts out within 30 days
   b. Employee elects an alternate percent
2. Contributions must be placed into a qualified default investment alternative (QDIA), which complies with the DOL regulations issued under ERISA Section 404(c)(5), in the absence of investment elections made by participants. Plan sponsor is responsible for sending employees a notice at least 30 days prior to the automatic enrollment date.

Notice Requirements:

1. Notice provided within a reasonable time before the initial deferral and annually
2. Notice must provide participants with a description of their rights
3. Notice must be able to be understood by the average employee
4. Explain the employee’s rights not to have deferrals made or to change the percent of the deferral
5. Explain how the employee’s deferrals will be invested “absent” employee instructions

Benefits of eligible automatic enrollment arrangement:

1. Preemption of state wage garnishment laws
2. Extend time for making corrective distributions
3. Addition of 90-day period which employees may elect to have contributions returned
4. Provide fiduciaries with ERISA § 404(c) protection for default investment

Qualified Automatic Contribution Arrangement and Safe-Harbor

In addition to enhancing the benefits of an eligible automatic contribution arrangement, the PPA created a new plan design, Qualified Automatic Contribution Arrangement (QACQ), which offers protection from certain nondiscrimination testing.

If a plan includes a "qualified automatic contribution arrangement" (QACA), the plan must meet certain plan design requirements in order to comply with safe-harbor rules.

QACA Plan Design Requirements:

1. Initial automatic deferral percent cannot be less than 3% and not greater than 10%.
2. Initial percent must be increased to no less than 4% in the 2nd year following the plan year in which deferrals are first made, 5% in the 3rd year, and 6% in any subsequent year. A plan may provide for a contribution rate up to 10%.

   If a plan starts with a deferral rate of 6%, the plan does **not** need to increase the rate each subsequent year.
3. All new employees must be included after the date the plan adopts a QACA provision.
4. If an employee is already enrolled in the plan, at a contribution rate greater than 0%, then the deferral rate for the employee will not change and the employee will not be subject to the automatic contribution rate increase since the employee has already made an affirmative deferral election to contribute xx%.
5. If an employee is determined to be eligible/not/deferring as a result of satisfying the service requirements and the plan entry date has passed, the employee will automatically be enrolled in the plan at the initial contribution rate, even if the employee had previously elected to enroll in the plan. After being automatically enrolled the employee has the option to opt-out of the plan.
6. The minimum employer contribution is <u>either</u> a 3% non-elective contribution <u>or</u> an employer matching contribution of not less than 3.5%.
7. The employer matching contribution must be a minimum of 100% of employee first 1% deferred and 50% of employee next 5% percent deferred for a minimum total match of 3.5% of compensation.

   A plan may match more than 1% of employee first percent deferred; e.g. match 100% of employee first 2%. In this case, the plan would not be required to match 50% of the employee next 5%. Instead, the employer could match 50% of employee next 3%.
8. Employer contributions must be 100% vested at the end of two (2) years of service.
9. If highly compensated employees are excluded, the employer is not required to make minimum contributions to highly compensated employees or automatically escalate their contribution rate.
10. Notice must be provided to employees, in advance of the first deferral, advising them of their right to (a) opt-out (b) change the contribution rate and (c) inform them how their deferrals will be invested absent direction from them.

Benefits of a qualified automatic contribution arrangement (QACA):

1. Deemed to satisfy ADP and ACP tests (match must meet existing safe-harbor rules regarding level matching rates)
2. Are not subject to top heavy rules

QACA and Automatic Deferral Election Increase

The automatic deferral election increase will cease to apply to any employee that changes his or her contribution rate to an amount different than the stated percent under the QACA.

Initial automatic enrollment contribution rate must be between 3% and 10%.

> Employee's initial period is measured from the date the automatic withholding starts through the end of the first full plan year (PY).
>
> **Example**: Plan year is a calendar year ending 12/31. Employee is automatically enrolled in April 2008. Initial deferral rate is 3%. Initial period is the rest of 2008 and through the end of the first FULL plan year ending December 31, 2009.
>
> In this case, the employee's deferral rate increases to 4% starting in plan year 2010 and continues to increase 1% in the subsequent years until it reaches 6%. I.E., 2011 rate is 5% and 2012 deferral rate is 6% and the rate does not escalate after reaching 6%.

QACA and existing and/or highly compensated employees

Plan sponsors may exclude existing employees and/or highly compensated employees from automatic enrollment under a QACA.

If the plan includes all existing employees, then any employee who was eligible to join the plan prior to the QACA feature and, who did not enroll in the plan, will automatically be enrolled even if the employee had previously elected not to join the plan.

QACA and Vesting

Employer matching and non-elective contributions are 100% vested after 2 years of service under a 2 year cliff vesting schedule.

Even if an employee changes his deferral rate (higher or lower), after entering the plan, the employer contribution will be 100% vested after 2 years of service.

QACA Contribution Source Profit Sharing and Match

Vesting Type	1 Yr	2 Yr	3 Yr	4 Yr	5 Yr	6 Yr	7 Yr
Two Year Cliff	0%	100%	100%	100%	100%	100%	100%

However, if the QACA is not applied to existing employees, those employees will continue to follow the prior vesting schedule for the employer non-elective and/or matching contributions.