

THE PENSION PROTECTION ACT OF 2006

Automatic enrollment enhancements under the PPA

Automatic enrollment, referred to as negative election plans, is designed to automatically enroll employees in the plan at a contribution rate unless the employees opts-out or changes the rate.

Three terms relate to automatic enrollment:

1. Automatic contribution arrangement
2. Eligible Automatic Contribution Arrangement (EACA) preempts state wage garnishment laws
3. Qualified Automatic Contribution Arrangement (QACA) a safe-harbor plan design

Eligible Automatic Contribution Arrangement (EACA)

Treats an employee as having elected a percent of compensation to be deducted from pay, unless the employee opts out or elects an alternate percent.

Salary deferral contributions are invested in a default investment (QDIA) which satisfies Department of Labor (DOL) regulations.

Satisfy notice requirement.

Benefits of EACA:

Preemption of state wage garnishment laws

Provide fiduciaries with ERISA § 404(c) protection for default investment (QDIA)

Addition of a 90-day period during which employees may elect to opt-out and have contributions returned without incurring a 10% tax withdrawal penalty

Pre-emption of state wage garnishment laws. Many states have wage garnishment laws which prohibit employers from taking deductions out of an employee's pay absent an affirmative election by the employee. Prior to the enactment of the PPA, there was debate about whether state garnishment laws applied to employee benefit plans. The PPA resolved this controversy by amending ERISA § 514 which preempts any state law that would otherwise prevent the establishment of an Eligible Automatic Contribution Arrangement. [ERISA § 514(e)]

90-day opt-out feature under the EACA. The 90-day opt-out feature, allows an employee to opt-out of the Plan within 90-days after the first salary deferral contribution is deducted from the employee's compensation. If an employee opts-out after salary deferral contributions have been made, then any elective contributions made to the plan (adjusted for gains or losses) will be refunded to the employee.

The amount refunded is included in taxable income in the year distributed and will be reported on Form 1099-R. The amount refunded is not subject to a 10 percent tax penalty for an early withdrawal distribution. Any employer matching contributions will be forfeited.

Qualified Automatic Contribution Arrangement (QACA)

In addition to enhancing the benefits of an Eligible Automatic Contribution Arrangement, the PPA created a new plan design, the Qualified Automatic Contribution Arrangement (QACA), which offers "safe-harbor protection" from certain nondiscrimination testing.

The initial automatic enrollment percent must be between 3% and 10%.

The initial percent must increase to no less than 4% in the second year, 5% in the third 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 of 6%, the plan does not need to increase the rate each subsequent year.

All new employees, after the date the plan includes a QACA provision, must be included.

The minimum employer contribution is either a 3% nonelective contribution (profit sharing) or a minimum matching contribution of 3.5%.

Employer contributions must be 100% vested at the end of two (2) years of vesting service.

Satisfy notice requirement.

Benefits of QACA (safe harbor plan design):

Deemed to satisfy ADP and ACP tests

Not subject to top heavy rules

Notice Requirements for QACA

In addition to the information required by Code Sec. 401(k)(12) under traditional safe harbor plans, the notice must explain the employee's rights, under the qualified automatic contribution arrangement, to elect not to have elective contributions made on the employee's behalf or to elect to have such contributions made at a different percentage.

The regulations further require that the notice disclose the level of elective contribution that would be made on the employee's behalf, absent an affirmative election. In the event the arrangement allows employees to elect among two or more investment options, the notice must explain how contributions made under the arrangement will be invested absent an election by the employee.

Notice provided within a reasonable time before the initial deferral and annually

Notice must provide participants with a description of their rights

Notice must be able to be understood by the average employee

Explain employee rights not to have deferrals made or to change percent of the deferral

Explain how the employee deferrals will be invested absent employee instructions

Annual notice requirement for QACA. The application of the safe harbor is conditioned on each employee eligible to participate in the QACA receiving, within a reasonable period of time before each plan year, written notification of employee rights and obligations under the arrangement.

Existing employees and adoption of QACA: Employees already enrolled in the Adopting employer's Plan will not be subject to the initial minimum contribution rate and the employee's rate will not change since the employee has already made an affirmative deferral election.

For any employee who was eligible to join the Adopting employer's Plan prior to the QACA adoption, but who is not currently deferring, the employee will automatically be enrolled in the Plan, even if the employee previously opted not to join the Plan.

Measuring when to increase the deferral election under the QACA

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

The 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%.