Auto Enrollment:
Best Practices and Common Mistakes

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WHY AREN'T YOU SIGNED UP FOR THE 401K?
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I'D NEVER BE ABLE TO RUN THAT FAR.
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Automatic Enrollment

- Passive approach
  - You can defer or not: your choice
  - If you don't do anything, we'll defer x percent of your pay into the plan
  - If you want to defer more, or less, or $0, do this
  - Designed to combat lethargy and encourage savings

Not Everyone Is a Fan

- Imposes burden on those who handle payroll
  - Errors generally mean deferrals weren't taken out of pay and EPCRS correction is corrective QNEC
  - Major deterrent to automatic enrollment
  - But not much different than 6 month hardship suspension?
- May result in many small account balances
- Some think it's wrong to take advantage of inaction
- May create false sense of security that default rate is the "right" rate for the individual
- Employees who don't pay attention can be dissatisfied with reduction in paychecks

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Poll Question #1

From a policy perspective only, do you like automatic enrollment?

Yes

No

Neutral

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Poll Question #2

From a provider perspective only (TPA or recordkeeper), do you like automatic enrollment?

Yes

No

Neutral

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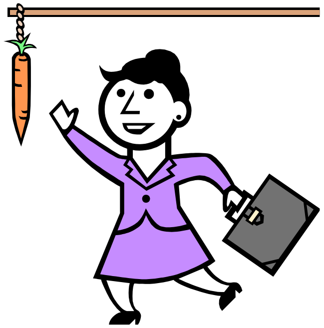
Current Landscape

PPA Provisions

- Solved three barriers to automatic enrollment
  - Fiduciary protection for investments (QDIA)
  - Preempts contrary state laws
  - Allows participant withdrawals
- Provides two incentives
  - Safe harbor design (no ADP test)
  - Six months to correct ADP/ACP tests by distribution



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PPA Created Three Types of Arrangements

- Automatic Contribution Arrangement (PPA ACA)
  - Now irrelevant (discussed in next slide)
- Eligible Automatic Contribution Arrangement (EACA)
- Qualified Automatic Contribution Arrangement (QACA)

PPA Automatic Contribution Arrangement

- Provides ERISA preemption of state laws
- Applies to all three types of PPA automatic contribution arrangements
- QDIA regulations expanded preemption to all automatic contribution arrangements (even those not referenced in PPA)
  - This is why PPA ACA is no longer relevant

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Types of Automatic Contribution Arrangements

- Three types of automatic contribution arrangements
  - EACA
  - QACA
  - Everything else!

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Qualified Automatic Contribution Arrangements (QACAs)

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QACAs

- A type of safe harbor 401(k) plan
- Offers two benefits:
  - Slightly lower matching contribution
    - Three percent nonelective is the same
  - Ability to include two-year cliff vesting

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Main Elements of QACA

- Minimum uniform automatic deferral percentage
  - Automatic deferrals can't exceed ten percent of compensation
  - Applies to nondiscriminatory definition of compensation
- Mandatory employer contribution
  - Distribution restrictions
  - Fully vested after two years of service
- Notice
- Otherwise follow classic SH rules

Request Denied

- Many commentators wanted to exclude from automatic deferrals employees who:
  - Had entered plan prior to QACA effective date who did not have deferrals
- IRS answer: NO
  - You can only exclude those with an AFFIRMATIVE election
    - Could include election to defer $0
  - If you don't know whether no election or election to defer $0, tough luck

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Expiration of Elections (Re-Enrollment)

- A plan can provide for the expiration of affirmative elections
  - For example, all elections expire on June 1, 2016
    - Or only those that are below the default percentage
- Participant must either make a new election or else would be subject to automatic deferrals
- Allows for "reset button" approach

Minimum Automatic Deferrals

Period	Minimum rate
Initial period	3%
Second year (first plan year after initial period)	4%
Third year	5%
Fourth year and thereafter	6%

- "Initial period" begins when first QACA default deferrals made and ends on last day of following plan year
- Maximum of ten percent

Schedule Is a Minimum

- Can always be higher than the minimum to avoid issues with escalation
- When QACAs were new, many plans set the default deferral percentage at six percent
  - Avoids the need to have escalation

QACA Initial Period Example

- Calendar year plan
- Employee's first automatic deferral is January 15, 2014
- Initial period is January 15, 2014 to December 31, 2015: three percent
- January 1, 2016: four percent
- Can increase mid-year, but must be at least minimum shown for entire plan year
  - Plan could have increased to four percent prior to January 1, 2016
  - Plan could not increase to four percent after January 1, 2016

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QACAs – Final Regulation Clarifications

- EE moves up schedule
  - Whether EE is still employed
  - Whether EE elects to defer
  - Whether EE is participant
  - Even if hardship suspension

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Rehires

- Optional plan provision
- If participant has no QACA automatic deferrals for a full plan year, the plan may start EE over again at three percent
  - Not limited to rehires but that's when it would most often arise
  - It's a full plan year, not 12 months

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Minimum Automatic Deferral Examples

- In each case
  - Calendar year QACA
  - Uses minimum automatic deferral percentage
  - Payday on 15th and end of month
  - Quarterly entry dates
  - Unless otherwise stated, no deferral election filed

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Minimum Automatic Deferral Examples

- Ann
  - Hired 10/15/13; entered 1/1/14; first QACA $ 1/15/14
  - Initial period ends 12/31/15: three percent
  - Four percent in 2016
- Bob
  - Hired 9/15/14; entered 10/1/14; first QACA $ 10/15/14
  - Same initial period and schedule as Ann
  - Does not matter that Bob entered plan later in 2014 than Ann

Example: In and Out

- Paul entered plan in 2010
- Laid off 7/10/13 (at five percent); rehired 9/1/14
- 2014 (and thereafter) = six percent
- Laid off 3/15/15; rehired 10/1/17
    - If use one-year rule: 2017 is new initial period at three percent
    - If do not use one-year rule: 2017 stays at six percent

Example: Late Starter

- Doug entered plan on 7/1/10 and elects to defer five percent of pay
- Plan provides all elections expire on 12/31/15
- Doug doesn't file new election
- Initial period: 1/15/16 to 12/31/17: three percent
- 2017: four percent

Hardship Options

- Plan can "suspend" existing election
  - Similar to automatic enrollment even if plan doesn't contain automatic enrollment provisions
- Plan can treat it as expiration of election
  - So automatic enrollment after six months
- Plan can treat as affirmative election of $0

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Hardship

- Cathy entered plan 7/1/13
- First QACA $ 7/15/13
- Took a hardship 10/1/15; can't defer until 4/1/16
- Her deferral rate based on QACA schedule was four percent

Poll Question #3

Cathy was at four percent in 2015 and the plan suspended deferrals for six months. What is her automatic contribution rate on 4/1/16?

- Three percent
- Four percent
- Five percent

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Ways to Handle a Hardship

- Treat the six-month period as a "suspension"
  - Plan must start deferrals back immediately after six months
- Treat as a discontinuance (i.e., expiration of election)
  - Deferrals didn't stop for a full PY so person moves to next tier
  - Those who had an affirmative election now become automatically enrolled unless a new election is made
- Make the hardship request include an affirmative election of $0
  - Nothing happens after six months

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Uniformity Requirement

- Same automatic deferral rules and percentages must apply to all plan participants
  - Existing and new
    - Unless affirmative election in place
  - HCE and NHCE
- Percentage must be uniform for all participants except plan can:
  - Vary based on time since initial period start
  - Keep higher deferral rates in effect before QACA
  - Apply 402(g) and 415 limits
  - Apply safe harbor hardship suspension rules

Portions of Years

- Time interval exception to uniformity: "The percentage varies based on the number of years (or portions of years) since the beginning of the initial period for an eligible employee"
- Preamble: "Portions of years" allow mid-year increase in percentage
  - Coincide with salary increases or performance reviews
  - <u>Must satisfy minimum percentage at beginning and end of year</u>
  - Must be uniform for all employees

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Employees Subject to QACA

- All employees who do not have an affirmative election
  - Affirmative election of $0 OK
  - Problem if employer doesn't know why someone is not in plan
- Can use otherwise excludible EE rule
  - One year/age 21; union EEs
  - Cannot exclude HCEs (can exclude HCEs from contribution – but not automatic enrollment)

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Three Choices for QACA Employer Contributions

1. 3% nonelective contribution
   - Same as classic SH
   - Can be greater

2. Basic QACA match	
% of comp	Match rate
Up to 1%	100%
1% to 6%	50%

3. Enhanced QACA match
   - At least as good as basic QACA at all levels of deferrals
   - Rate of match doesn't climb
   - No HCE has rate of match > any NHCE

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Differences: QACA Versus Classic Safe Harbor

Assume participant comp $40,000						
Deferral		3% Non-elective	QACA match		Basic SH match	
%	$	$	%	$	%	$
1.0%	$400	$1,200	1.0%	$400	1.0%	$400
2.0%	$800	$1,200	1.5%	$600	2.0%	$800
3.0%	$1,200	$1,200	2.0%	$800	3.0%	$1,200
4.0%	$1,600	$1,200	2.5%	$1,000	3.5%	$1,400
5.0%	$2,000	$1,200	3.0%	$1,200	4.0%	$1,600
6.0%	$2,400	$1,200	3.5%	$1,400	4.0%	$1,600

QACA Notice

- Content:
  - Everything in classic SH notice
  - Automatic deferral percentage
  - Right to elect different percentage or zero
  - How invested (e.g., default investment if participant directed)
- Timing:
  - Same as SH
  - EE must have sufficient time before automatic deferrals begin to elect deferral and investment

Effective Date of Automatic Deferral

- Regulations impose maximum period on how long plan can wait before beginning automatic deferrals
- Automatic deferrals must start by earlier of:
  - The pay date for the second payroll period that begins after SH notice given, or
  - The first pay date that occurs at least 30 days after the SH notice is provided

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Delay of Automatic Deferrals

- Earlier of:
  - The pay date for the second payroll period that begins after SH notice given, or
  - The first pay date that occurs at least 30 days after the SH notice is provided
- Example 1:
  - Payday on 15th and last day of month
  - Participant enters and receives notice 7/1/16
  - Eligible to defer from 7/15/16 paycheck
  - Automatic deferrals must start by 8/15/16 paycheck

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Compensation

- General rule: plans have flexibility in determining deferral compensation
  - 1.401(a)(4)-4(e)(3) - rate of elective deferrals permitted must be nondiscriminatory and a rate is based on compensation regardless of whether it satisfies 414(s)
- ADP Safe Harbor plan can limit deferral compensation to a "reasonable" definition of compensation (no compensation ratio test)
  - QACA Regulations provide that compensation for purposes of determining default contributions means safe harbor compensation as defined in §1.401(k)-3(b)(2)
    - 414(s) except cannot exclude comp over $ limit

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Eligible Automatic Contribution Arrangements (EACAs)

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Basic EACA Requirements

- Automatic contribution arrangement
- Applicable employer plan
- Uniform automatic deferral percentage
- Notice
- May or may not follow QDIA rules

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EACA Benefits

- Two benefits
  - Six months to distribute excess contributions and excess aggregate contributions (ADP/ACP) without ten percent penalty
    - Extension of 2 ½ month period
  - Option to allow withdrawals of automatic contributions
- These are optional - not all employers care to use the above

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Who Must Be in EACA?

- Doesn't have to include everyone eligible to defer (but see below)
  - Plan can define (e.g., Division A or only new employees)
- If not in EACA don't have to receive notice
- If not in EACA no permissible withdrawals
- If all participants (HCE and NHCE) are not in the EACA, then six-month rule is not available
  - So, only EACA benefit would be permissible withdrawal

Participants Who Defer

- Plan document must specify whether employees who file affirmative election are still in the EACA
  - If EXCLUDE affirmative election employees:
    - Don't have to give them notices
    - Cannot use the six-month delayed corrective distribution rule

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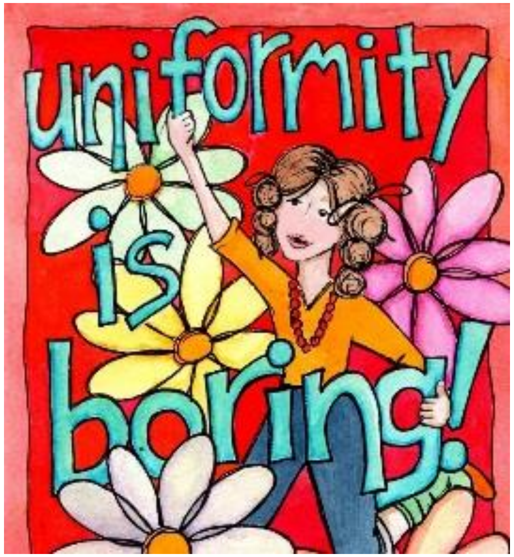
Uniformity

- Default deferral must be uniform percentage of compensation
- QACA uniformity exceptions apply:
  - Difference based on time of participation (e.g., escalation)
  - Participant deferring more before EACA in effect
  - Enforce Code limits
  - No deferrals for six months after hardship



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Uniformity

- Uniformity requirement based on “plan” for 410(b) coverage purposes
  - All EACAs in single “plan” must be uniform
  - Union and non-union separate “plans” for coverage
- Example: plan provides for automatic contributions of three percent for hourly employees and four percent for salaried employees
    - This is not an EACA
    - Could handle with separate plans but would not be able to use permissive aggregation

EACA Notice Content

- Everything in classic safe harbor notice (other than safe harbor contributions)
- Level of default deferrals
- Right to elect different percentage or $0
- How contributions made under the arrangement will be invested if EE doesn't specify
- Permissible withdrawal rights and procedures (if any)
- Accurate, comprehensive, understandable

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Notice Requirements

- Must go to all participants in EACA
- Timing
  - Same as safe harbor notice
  - Reasonable time to opt out
- Since notice required before start of year, generally can't add EACA mid-year to existing 401(k) plan
  - Can still start new 401(k) plan mid-year
  - Informally IRS has said okay to add mid-year if only applies to new participants
- What about mid-year amendments to a EACA plan?

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Permissible Withdrawals

- Optional provision
- Any employee in EACA can withdraw default deferrals
  - Plan distributes all default deferrals to effective date of request adjusted for earnings
- Latest effective date of election is earlier of:
  - Payday for the second payroll period that begins after the election date; or
  - First payday that is at least 30 days after election date

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Permissible Withdrawal Timing Rules

- Withdrawal election deadline: 90 days after first default deferral
  - First default deferral is the date the deferral would have otherwise been included in income
- Plan can set shorter period, but must be at least 30 days
  - Crucial if plan is not using the six-month rule

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Withdrawal Rules

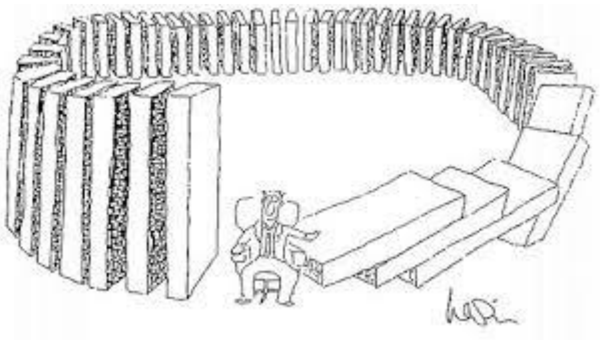
- Can treat EE with no automatic deferrals for a full plan year as new participant with new 90-day period
- Cannot restrict withdrawal right based on future affirmative election
  - Participant could elect withdrawal and at same time make an affirmative deferral election

Withdrawal Rules

- Distribution must be made in accordance with timing of other plan distributions
- Can charge same fees as other distributions
  - Or less
  - Same issues we struggle with when there are very small balances
- No spousal consent needed for withdrawal

Withdrawal Consequences

- Tax rules
  - Pay tax in year of distribution (unless Roth)
- Plan forfeits related match
  - But if match not made yet, do not need to contribute
  - Differs from ACP test correction method
- Don’t take into account for purposes of
  - 402(g) limit
  - ADP/ACP test



Need for Six-Month Rule

- Calendar year 401(k) plan allows immediate entry
- EACA with 90-day permissible withdrawal provision
- Jack enters 12/16/15; first deferral 12/31/15
- Jack's permissible withdrawal deadline is 3/31/16
  - 16 days after normal 3/15 correct deadline
  - Jack's withdrawal affects ADP test
- If EACA doesn't include all plan participants, can't use six-month rule
  - Consider lowering withdrawal right to 60 days
  - Consider having no withdrawal rights

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Mid-Year Amendments to EACAs/QACAs

- IRS Notice 2016-16 provides guidance on mid-year amendments to safe harbor plans
  - This would apply to QACAs because they are a type of SH plan
- What about EACAs?
  - They are subject to the same notice requirements as a QACA
  - Not clear if same rules on mid-year amendments apply
  - IRS asked for input in Notice 2005-16

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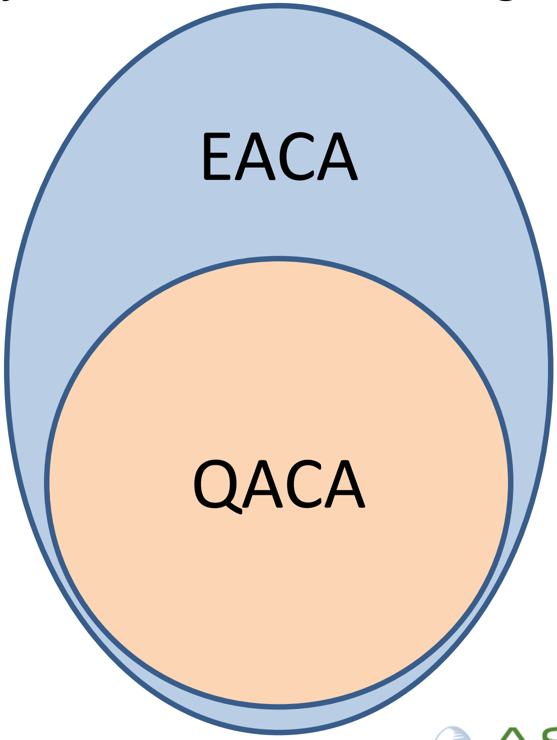
QACAs and EACAs

- All QACAs are EACAs
  - Don’t have to offer permissible withdrawals
  - Only care about six-month rule if subject to ACP test or using OEE rule
- All EACAs are not QACAs
  - Minimum automatic deferrals
  - Required employer contributions



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What if No EACA/QACA?

Automatic Escalation

- Escalation of deferrals is becoming more popular even if no other automatic contributions
- Applying only to those with affirmative elections (including election of zero percent)
  - Avoids small balances
  - Avoids problems with those who do not want to defer

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Automatic Escalation

- Procedural approach: have an escalation option on deferral election form
  - I elect to defer three percent and want it increased by onepercent (or even more) each year

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Expiration of Elections

- Some plans provide for expiration of all elections every year
- Some provide for expiration only if affirmative election is below a certain percentage (such as the default percentage)
- If no new election, then automatic deferrals are made

Best Practices

- Better communication
  - Consider no permissible withdrawals
- Provider push to payroll
- Pay attention to escalation dates
  - Consider first-year delay

Immediate Entry

- Be careful if plan provides immediate entry for deferral purposes
- Automatic deferrals may be taken out before person is set up in admin/recordkeeping system
- Consider adding a minor service requirement (e.g., 30 days)

The DOL Did What?

- Payroll deduction programs that have limited employer involvement are not ERISA plans
- The DOL issued a proposed regulation that would exempt a payroll deduction IRA program from ERISA if automatic enrollment is mandated by law
  - Reasoning is that participation is “completely” voluntary
  - Implies that if it’s not required by law, participation is not “completely” voluntary and ERISA applies
  - This is also an issue for 403(b) arrangements trying to fall within ERISA exemption of limited employer involvement

If (When) Things Go Wrong

- A temporary rule for correction of plans with automatic contributions
  - No corrective contribution for the missed deferrals (must sill make-up match) if fixed within 9 ½ months of the error
  - Absent this rule:
    - Have three months to correct without corrective contribution
    - If corrected within two years contribution is 25 percent of missed deferrals
- IRS will review in 2020 to see if this encourages more employers to implement automatic contribution arrangements

Poll Question #4

Do you think the special IRS correction rules will result in more employers adding automatic contribution arrangements to their plans?

Yes

No

Questions?

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