



401(k) Automatic Enrollment Arrangements under the Pension Protection Act of 2006

Q1: What is a qualified automatic enrollment feature?

A: A qualified automatic enrollment feature is a plan design strategy that can apply to 401(k), 403(b) or governmental 457(b) plans, whereby elective contributions are automatically made to the plan at a specified rate unless the employee elects not to make contributions or to make contributions at a different rate. A qualified automatic enrollment feature must meet certain requirements with respect to

- automatic deferrals,
- matching or nonelective contributions, and
- employee notification.

A 401(k) or 403(b) plan that contains a qualified automatic enrollment feature is treated as satisfying nondiscrimination requirements related to the actual deferral percentage (ADP) and the actual contribution percentage (ACP) tests for deferral and matching contributions respectively. In addition, a plan consisting solely of contributions made pursuant to a qualified automatic enrollment feature is not subject to top-heavy rules.

Employees who meet the plan's eligibility requirements are eligible to start contributing to the plan. The employer will notify these eligible employees and provide them with enrollment information. If the eligible employee does not respond, the employer will automatically start withholding a specific percentage of compensation from their salary, and will deposit the dollars into the plan on their behalf. These contributions will continue until the employee notifies the employer to increase, decrease, or cease the contributions all together.

Q2: Why would an employer want to add a qualified automatic enrollment feature?

A: The advantages to the employer are

- automatic passage of ADP and ACP tests;
- automatic satisfaction of top-heavy rules;
- increased plan participation;
- the period for distributing ADP/ACP testing excesses without incurring a 10 percent penalty is extended to six months after the plan year end (rather than the standard 2 ½ months).

Q3: Is there a window of time that a participant can remove automatic deferrals without penalty?

A: Yes, a 90-day period is available for participants to withdraw their contributions penalty free when contributed under the automatic enrollment feature. A distribution of such an amount is generally treated as a payment of compensation, rather than as a contribution to and then a distribution from the plan.

Q4: What types of plans can offer an automatic enrollment feature?

A: 401(k), 403(b) and governmental 457(b) plans may utilize automatic enrollment.

Q5: When can plans start using this new qualified automatic enrollment feature?

A: The qualified automatic enrollment feature as outlined in the Pension Protection Act of 2006 (PPA-06) can apply to plan years beginning after December 31, 2007.

Q6: Can state laws prohibit automatic enrollment?

A: No, passage of this bill pre-empts state law restrictions for automatic enrollment as long as certain participant notification requirements are met. The pre-emption of conflicting state regulations is effective on August 17, 2006.

Q7: If the employer adopts an automatic enrollment feature, do the rules apply to current employees?

A: No, a plan does not have to apply the automatic enrollment feature to an employee who was eligible to participate in the plan or had an election in place for employee deferral contributions on or before the amendment adopting the automatic enrollment feature.

Q8: What are the requirements of a qualified automatic enrollment feature to secure a safe harbor from ADP, ACP and top heavy requirements?

A: In order for an automatic enrollment feature to qualify for the safe harbor, the plan must provide for

- graduated automatic deferrals,
- a specified employer match or nonelective contribution,
- an accelerated vesting of employer contributions, and
- participant notification.

Q9: Is there an employee notice requirement?

A: Yes, employers must give eligible employees a notice prior the beginning of the plan year that explains the automatic enrollment feature in easily understood language. The eligible employee must be given a reasonable period of time after receipt of the notice and before the first elective contribution is to be made to make an election with respect to contributions and investments

Q10: What are the employee requirements for a qualified automatic deferral feature?

A: An employee's automatic deferral contributions cannot exceed 10 percent, and must be at least three percent during the initial plan year, increasing to four percent during the second plan year, increasing to five percent during the third plan year, and increasing to six percent during any subsequent plan years.

Q11: What are the employer contribution requirements for a qualified automatic deferral feature?

A: The plan must provide one of the following to each nonhighly compensated employee:

- A matching contribution equal to 100 percent of deferrals up to one percent of compensation, plus a matching contribution equal to 50 percent of deferrals that exceed one percent but that do not exceed six percent of compensation;

OR

- A nonelective contribution equal to three percent of compensation (regardless of whether the participant makes contributions to the plan).

A plan that provides for matching contributions is deemed to satisfy ACP testing if

- matching contributions do not exceed six percent of compensation,
- the rate of matching contribution does not increase as the rate of an employee's elective deferrals increases, and
- the rate of match for a highly compensated employee is no greater than the rate of match with respect to the same rate of deferral of a nonhighly compensated employee.

Q12: Does this new provision eliminate the need for existing safe harbor 401(k) plans that do not use an automatic enrollment feature?

A: No, this is an additional option available to employers.

Q13: Are there vesting requirements with respect to employer contributions made pursuant to a qualified automatic enrollment feature?

A: Yes, employer contributions must be 100 percent vested after no more than two years of service. This vesting rule is different than the one that applies to 401(k) safe harbor plans, where employer safe harbor contributions must be 100 percent vested.

Q14: If a plan does not follow the safe harbor guidelines for a qualified automatic enrollment feature, is it precluded from offering automatic enrollment?

A: No, a plan may still offer automatic enrollment if the employer meets participant notification requirements and allows participants to change their elections. A nonsafe harbor automatic enrollment arrangement does not require employer contributions nor does it require accelerated vesting. However, the plan will be subject to ADP, ACP and top-heavy testing requirements