APRIL 29, 2008

Automatic 401(k) Enrollment: Benefits For Both Employers And Employees

Based on current articles in both the popular and business press, it should come as no surprise that Americans are currently not saving adequately to fund their retirement. Legislators have become increasingly concerned, and, with the Pension Protection Act of 2006 (PPA), they took action. Although many employers historically have had automatic enrollment, one of the PPA's provisions encourages employers to enroll their employees automatically in an employer-sponsored 401(k) plan without employees' written authorization.

The new legislation also provides an Employee Retirement Income Security Act (ERISA) preemption to state laws that often prohibit employers from taking paycheck deductions without the employee's written permission, as long as the employer maintains an ERISA-qualified plan and provides notice to employees. The state preemption was previously a barrier to implementing automatic enrollment.

The automatic enrollment feature is rapidly growing in popularity. Employers are adopting it for two main reasons:

1. Employers are committed to raising 401(k) participation levels. Research shows that one of the biggest barriers to participation is inertia: Employees mean to enroll, but just don't get around to it. Employers help employees overcome this inertia by automatically enrolling them in the plan.

2. The plan is failing its annual non-discrimination testing. By adding an automatic enrollment feature to the plan, the testing results are often dramatically improved because more non-highly-compensated employees participate in the plan.

Action Steps To Implement Automatic Enrollment

- Review the IRS's regulations on qualified automatic contribution arrangements (QACA) and eligible automatic contribution arrangements (EACA), and the Labor Department's regulations on qualified default investment alternatives (QDIA).

- Determine if automatic enrollment or the "safe harbor" automatic enrollment makes sense for your plan by contacting your Client Service Manager.

- If your plan allows for Roth contributions, determine what type of contribution you will be withholding on behalf of the employee.

- Select a QDIA for automatic enrollment contributions by discussing the QDIA rules with your investment advisor and selecting an option that meets the requirements.

- Determine the process for handling annual automatic enrollment increases.

- Determine when a plan amendment is necessary to change your plan.

- Provide notices (Automatic Enrollment Notice; Qualified Default Investment Notice, generally provided by your investment advisor) to your employees at least 30 days before enrollment and then annually thereafter.

- Enroll employees automatically at a uniform percentage of at least 3% of pay.

- Deposit and invest automatic enrollment contributions in the qualified default investment.

- Make changes to election levels when the next annual change is due.

This article was contributed by Judy Simons, CPC, QPA, QKA, Vice President and Senior Consultant, Compliance Services for TRI-AD. AHI is pleased to announce that its May 15 webinar on Automatic 401(k) Enrollment will be presented by Ms. Simons. She will discuss EACAs, QACAs, QDIAs, and answer your specific questions.

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