

Retirement

Insight

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AUTOMATIC ENROLLMENT



Automatic Enrollment and Your 401(k) Plan

The concept of automatic enrollment is becoming more and more appealing to Plan Sponsors. Automatic enrollment is essentially the opposite of conventional enrollment where employees do not make any contributions to their company's 401(k) plan until they submit instructions.

Automatic enrollment allows the employer to automatically enroll employees into the 401(k) plan at specified contribution levels and investment percentages immediately upon hire or upon meeting eligibility requirements. Typically, the rate of deferral is 3% to 4% and some plans increase these amounts annually. This is referred to as auto-increase.

With all employees contributing (at least upon their initial eligibility), the plan will likely produce more favorable nondiscrimination test results. Meanwhile, employees may come to appreciate that salary deferrals are an easy way to save for retirement, without having significant effects on take home pay. Plan Sponsors must give notice within a reasonable time before each plan year to each employee to whom the automatic enrollment arrangement applies for such plan year. Typically, 30–90 days prior to the plan year is acceptable.



Automatic Enrollment

The Pension Protection Act of 2006 (PPA) has provided clarification for employers who wish to adopt the automatic enrollment provisions into their plans. The PPA provides basic stipulations for automatic enrollment as well as safe harbor provisions. These provisions will generally be for plan years beginning after December 31, 2007.

There are automatic enrollment provisions that can allow for vesting to be applied to safe harbor contributions.

Ask your consultant for more information.

A Sound Retirement Plan Starts With Superior Plan Design

The Pension Studio provides employers with retirement plan design, administration, and ongoing employee communication. The Pension Studio was formed by professionals with an average of fifteen years of experience in the retirement planning and technology fields. This unique combination ensures leading-edge technology and features. Our ongoing commitment to technology allows employers of all sizes the advantages that larger plans have without losing the personalized services we value.

Advantages to Auto-Enrollment

General Stipulations



1. An employee notice is required. This notice should discuss the employee's right to opt out of the plan and how to change his/her current deferral amounts. It should also state the default investment should the participant not give investment direction. This is referred to as the QDIA (Qualified Default Investment Alternative).

2. For up to 90 days, an employee can withdraw the contributions and related earnings due to automatic enrollment. These will be penalty free, but income tax will be owed on the money.

3. Plans that offer automatic enrollment are granted an extension of the corrective distribution period. For plans subject to ADP/ACP testing, corrective distributions can be made up to six months after the end of the plan year without any penalties. (Note: Current law only allows 2 1/2 months for corrective distribution to be penalty free).

4. ERISA will pre-exempt state withholding laws, provided the annual notice requirements and DOL guidelines are met.

1. For the plan: improved nondiscrimination test results. Since participation rates are higher, the ADP test results are typically better, thus allowing the highly compensated employees to defer more money into the plan.

2. For the employee: immediate savings on hire or meeting eligibility requirements. Inertia dominates human actions. Thus, by making enrollment easier, many employees will simply join and remain in the plan.

3. For the employee: immediate appreciation of the convenience of payroll deductions. The federal government learned this years ago when designing our tax system. If money is taken out before people see it, they do not miss it as much. Pay yourself first!

4. For the employee: a much greater chance of retiring with a higher percentage of replacement income. Please see the chart on the following page for the impact of automatic enrollment combined with an automatic increase in retirement savings.





Combining automated services can magnify impact on replacement income

	Participant 1	Participant 2	Participant 3
Auto-enroll default	3%	3%	3%
Auto-increase	None	1% per year up to 10%	2% per year up to 15%
Match	\$.50 on the first 6%	\$.50 on the first 6%	\$.50 on the first 6%
Assumed rate of return (which could change depending on your default investment)	3%	8%	8%
Account value at age 65	\$176,000	\$1,370,000	\$1,890,000
Replacement income	7%	58%	79%

Source: T. Rowe Price

This chart is for illustrative purposes only and does not represent a particular investment.

Assumptions: The starting age for each participant is 25, with a salary of \$30,000. Salary is adjusted annually to anticipate a 3% inflation rate. Participant 1 remains in a money market account; participants 2 and 3 utilize the plan's QDIA.

When automated services are used in combination, they can have a cumulative effect. For example, the ending account value and replacement income of participant 2 is about eight times greater than that of participant 1. By letting auto-increase go to 15%, participant 3 has a replacement income of 79%, which is in the range financial planners advise.