retirement
plan news

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Automatic Enrollment 2008

Automatic contribution arrangements (ACAs) have been in existence for a number of years. The Pension Protection Act of 2006 (PPA) created two new automatic enrollment arrangements — the eligible automatic contribution arrangement (EACA) and the qualified automatic contribution arrangement (QACA) — for plan years beginning on or after January 1, 2008.

The IRS issued proposed regulations for QACAs and EACAs in November 2007. Unlike some other recently released guidance, those regs may be used for now, even before the final regulations are issued. The IRS has said that if the final regulations are more restrictive than the proposed regulations, the specific restrictions will not be applied retroactively.

What Are the Advantages of Automatic Enrollment? The automatic enrollment feature, also known as default enrollment, is attractive for many reasons. For one thing, automatic enrollment capitalizes on underlying participant inertia. Traditionally, in a cash or deferred arrangement (CODA), if an employee who is eligible to join a plan does not complete the necessary paperwork to have a portion of his or her salary deferred — which is very often the case — the default is that cash is paid to the employee (and no deferral is made). With automatic enrollment, if an eligible employee does not respond (i.e., does not elect to opt out of the plan), the default is that a set amount is deferred to the plan.

As a general policy, automatic enrollment encourages greater retirement savings. Employees (especially younger ones) who otherwise might not participate in a retirement plan will do so by default. Employees who participate early in their careers can benefit from the long-term growth that can only occur when earnings on contributions are allowed to compound for 30 or 40 years or more.

Plan sponsors benefit as well. Automatic enrollment helps plans pass the actual deferral percentage (ADP) and actual contribution percentage (ACP) tests.

What Is a QACA? The QACA is basically a traditional safe harbor 401(k) plan with an automatic enrollment feature plus some new safe harbor features courtesy of PPA. Other than changes made by PPA, traditional safe harbor 401(k) provisions apply to the QACA. For example, a 12-month plan year is normally required. (The exceptions that apply to the 12-month plan year requirement for traditional 401(k) safe harbor plans also apply to QACAs.) In addition, as with existing safe harbor arrangements, there may be no allocation requirements for the safe harbor contribution (i.e., no last-day rule or hours-of-service requirement).

PPA added these safe harbor features just for QACAs:

- A new formula for safe harbor matching contributions: a 100% match on the first 1% of compensation deferred and a 50% match on deferrals between 1% and 6%. Note that sponsors may choose to make an enhanced match, or they may make a flexible or guaranteed 3% nonelective safe harbor contribution.
- A two-year-cliff vesting schedule on QACA safe harbor contributions.

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- A minimum deferral percentage starting at no less than 3% and increasing to no less than 6% (with a maximum of 10%).

Deferral Percentage Escalator. For participants automatically enrolled in a QACA, the minimum deferral percentage for the first year of participation is 3%. Note that this rate remains in effect from the day the participant is automatically enrolled until the end of the following plan year.

Example: A calendar-year QACA plan has a one-month eligibility requirement and a monthly entry date. A participant who is hired on February 11, 2008, will satisfy eligibility on March 10, 2008, and enter the plan on April 1, 2008. The employee is provided with an automatic enrollment notice, a qualified default investment arrangement (QDIA) notice (if applicable), and a salary deferral agreement. If the employee does not respond, he or she is automatically enrolled on April 1, 2008, at a deferral rate of 3%. The 3% rate continues through the end of the following plan year (i.e., December 31, 2009). On January 1, 2010, the deferral percentage escalator increases the minimum deferral rate to 4%. On January 1, 2011, the minimum deferral rate is increased to 5%, and on January 1, 2012, it is increased to 6%. (These percentages are minimums and may be higher.)

Keep in mind that since the QACA is first available in 2008, the minimum 3% deferral rate applies to all participants who are automatically enrolled on January 1, 2008. Thus, if an employee had been eligible to become a participant in 2006, the deferral rate would still be set at 3%, not at a higher rate based on the length of service prior to the QACA.

Note: Employer QACA safe harbor contributions are made for all employees who are eligible to defer, not just those who are automatically enrolled.

What Is an EACA? An eligible automatic contribution arrangement must meet the following requirements:

- A participant may elect to defer compensation to the plan.
- The participant is treated as having elected to have elective deferrals made in an amount equal to the plan's stated uniform percentage of compensation until he or she specifically elects not to make contributions or specifically elects to have a different percentage deferred.
- In the absence of an investment election by the participant, contributions are invested in a qualified default investment arrangement (QDIA).
- An automatic enrollment notice and a QDIA notice must be provided to all participants in a timely manner.

90-day Withdrawal Election. A participant who is automatically enrolled may withdraw contributions made under an EACA within 90 days of the first pay date on which deferrals were made under the EACA. The withdrawal option could apply to employees previously eligible under the CODA who are first automatically enrolled under the EACA (even if an automatic contribution arrangement existed in the plan prior to the EACA).

Note: PPA created the EACA for plan years beginning on or after January 1, 2008. Therefore, an automatic contribution arrangement cannot become an EACA before January 1, 2008, and the 90-day withdrawal election can only apply to elective contributions made after January 1, 2008.

A Comparison. The deferral percentage escalator that is necessary in a QACA is not necessary in an EACA. The EACA also does not require a safe harbor contribution, although a traditional safe harbor may be added to an EACA.

By definition, a QACA is not an EACA. In reality, however, most plans will opt to have a QACA that also satisfies the EACA requirements. A QACA that is also an EACA *may* include the 90-day withdrawal rule, but *must* satisfy QDIA requirements.

Automatic contribution arrangements that existed prior to 2008 (or started in 2008) are not required to incorporate QACA or EACA features. However, an automatic enrollment notice will be required, and a traditional safe harbor and/or a QDIA may be incorporated. (If those features are being considered, the employer may well consider having the plan become a QACA, assuming the employer wants to get involved with the deferral escalator provisions.)

Coordinated Notices. Several notices required by PPA that relate to automatic contribution arrangements have similar content and timing requirements, including the QDIA, automatic enrollment, and safe harbor notices. The IRS and DOL have coordinated their efforts and jointly permit plan sponsors to provide a single notice containing the requirements of *all* the notices — as long as the timing requirements are satisfied. ❖

NEW AUTOMATIC ENROLLMENT ARRANGEMENTS

	EACA	QACA
Minimum deferral %	None	3%
Maximum deferral %	None	At least 6%, not to exceed 10%
Employer contribution (matching or nonelective)	Not required	Required
QDIA rules	Mandatory	Optional

Stretch IRA and Other Options for Spouse Beneficiaries

If a qualified plan participant dies after reaching his or her required beginning date (RBD) for taking required minimum distributions (RMDs), and the participant's surviving spouse is the sole primary beneficiary, then that spouse is faced with a question: Is it better to continue taking distributions from the decedent's plan or roll the funds over to the spouse's own IRA or possibly to the spouse's qualified plan? The decision can have long-term tax consequences for the surviving spouse and his or her beneficiaries.

Take Minimum Distributions from the Plan. A spouse beneficiary has the option of taking minimum distributions from the qualified plan over his or her single life expectancy. Even though the assets are being distributed from the participant's qualified plan, the surviving spouse may name his or her own beneficiary(ies). In such a case, when the surviving spouse dies, the longest distribution period available to the beneficiary(ies) is that spouse's life expectancy in the year of death. The maximum period is reduced by one year for each year the money remains in the plan.

Stretch Out Payments with an IRA Rollover. If, however, the surviving spouse rolls the assets into his or her own IRA and names his or her own beneficiary(ies) under the IRA, when that spouse dies, the IRA beneficiary(ies) would then be able to establish a life expectancy payout based on his or her own life expectancy. This effectively "stretches" the period of time over which payments may be made to a beneficiary.

Example: Harry has been a participant in a qualified retirement plan and has been receiving minimum distributions since age 70½. Harry passes on at the age of 85. His surviving spouse Sally, age 84, decides to take distributions from his qualified plan and names her son Scott as her beneficiary. Sally dies two years later at age 86. Scott, age 50 at the time of his mother's death, must continue to take payments over a period no greater than his mother's remaining life expectancy (7.1 years).

If Sally had decided to roll the money over into her own IRA and name Scott as her IRA beneficiary instead of taking distributions from Harry's qualified plan, when his mother died at age 86, Scott would have been able to use his own life expectancy (34.2 years) to determine the payout period going forward. Finally, if Harry had not met Sally, we wouldn't be having all this fun.

Note: Remember that the required minimum distribution for the year of death may not be rolled over by the spouse.

Other Rollover Options. If the surviving spouse is a participant in a qualified plan, he or she may roll the deceased spouse's qualified plan assets into an IRA (as illustrated above) or into his or her own qualified plan (if the plan accepts rollovers). In such a case, the rollover would be treated as part of the spouse's own assets.

Participant Dies Before Reaching His or Her RBD. The stretch IRA option is also available if the participant dies before RMDs have begun. But the surviving spouse has other options as well. One rarely used option is for the spouse to wait to begin taking distributions until the participant would have attained age 70½.

Another option, if available in the plan document, is for the spouse to take distributions under the five-year rule. With this option, the spouse (or other beneficiary) could receive a distribution of the entire account balance by the close of the calendar year that includes the fifth anniversary of the participant's death. (The money would be taxable at the time of distribution unless rolled over.)

To be eligible for payments based on the surviving spouse's life expectancy, the initial payment must be made by the end of the calendar year following the year of death. If the life expectancy rule is not satisfied, the five-year rule applies. For ease of administration, many plans only allow beneficiary distributions under the five-year rule. Distributions for long periods after a participant's death are often seen as undesirable. ❖

recent developments

PBGC Addresses PPA Changes to DB Plans. Technical Update 07-3 from the Pension Benefit Guaranty Corporation (PBGC), issued December 2007, provides guidance on lump-sum calculation issues for terminating single-employer plans (in standard terminations and certain distress terminations). The Pension Protection Act of 2006 (PPA) made changes to the interest rate and mortality assumptions used to determine minimum lump-sum values. If a plan terminates before the effective date of the PPA changes, the pre-PPA assumptions apply when determining lump-sum payments made both before and after the effective date.

Further guidance on PPA provides that, generally beginning in 2008, single-employer defined benefit plans that are between 60% and 80% funded may not pay lump sums or other accelerated distribution forms of payment with values in excess of (1) 50% of the amount that would be paid absent the restriction or, if smaller, (2) the present value of PBGC's maximum guarantee computed under PBGC guidance.

The PBGC has posted a table on its website (*www.pbgc.gov/practitioners/law-regulations-informal-guidance/content/tu16287.html*) showing the present value of its maximum guarantee for 2008. It has also issued Technical Update 07-4 to provide information about how the table was developed and how it should be used.

2008 PBGC Premiums. The PBGC announced that the flat-rate premium for plan years beginning in 2008 is $33 per participant for single-employer plans (up from $31) and $9 per participant for multi-employer plans (up from $8).

Supreme Court To Decide 401(k) Case. The Supreme Court heard a case, *LaRue v. DeWolff*, involving an employer "making up" an employee's investment losses that occurred due to administrative error. The employee directed the employer to change his investment options and the direction wasn't followed. The market then went into a downturn before either party noticed that the change had not been made. Typically, an ERISA suit seeks "recovery on behalf of the plan." In this case, the employee is seeking to make his individual account whole. The employer's position is that this is not what was meant by recovery on behalf of the plan. A Supreme Court decision in this matter is significant. A ruling is expected by midyear. ❖

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