UTZ MILLER & EICKMAN LLC
ATTORNEYS AT LAW

SEPTEMBER 18, 2009 VOLUME 5, NUMBER 8

"Plans are neither required to include automatic enrollment, nor are they required to use the model language . . . . But for plan administrators that have recently implemented automatic enrollment or are thinking about doing so soon, the new guidance is particularly helpful."

AUTOMATIC ENROLLMENT: PLAN AMENDMENTS AND AUTOMATIC INCREASES

By
Matthew J. Eickman
Utz, Miller & Eickman, LLC
meickman@utzmiller.com

Earlier this week, we described the new Section 402(f) explanation safe harbor language issued by the IRS in connection with President Obama's Retirement and Savings Initiative. The IRS also issued some helpful guidance related to automatic enrollment, including model plan language in Notice 2009-65 and automatic increase interpretative guidance in Revenue Ruling 2009-30. Plans are neither required to include automatic enrollment, nor are they required to use the model language even if they do automatically enroll their employees. But for plan administrators that have recently implemented automatic enrollment or are thinking about doing so soon, the new guidance is particularly helpful. We will not reproduce the model language in this newsletter, but we will address the plan amendment deadline upcoming for many plans, the general content of the model amendments, and some flexibility available to plans that automatically increase default contributions.

Automatic Enrollment

A plan may include various types of automatic enrollment. Section 401(k) regulations allow a plan to include a plain-vanilla automatic contribution arrangement (an "ACA"), under which a default contribution percentage applies to a participant in the absence of an affirmative election. This approach typically results in higher participation rates and may make it easier to pass the ADP and ACP tests, though it does not provide ADP and ACP safe harbor treatment. The Pension Protection Act of 2006 ("PPA") created two specific types of ACAs that afford certain advantages: (i) the *qualified* automatic contribution arrangement (the "QACA"); and (ii) the *eligible* automatic contribution arrangement (the "EACA"). A QACA results in safe harbor treatment for the ADP and ACP tests. An EACA may allow employees to withdraw default contributions within 90 days of the first default contribution being made and may provide the plan an extra 3 1/2 months to distribute excess contributions and thereby avoid the 10 percent excise tax on the employer. Of course, in order to receive those advantages, a plan must meet specific requirements.

Model Language

Notice 2009-65 includes sample plan language for an ACA and EACA (but not the nondiscrimination safe harbor QACA) that, if followed, would meet those requirements. A plan is not required to adopt the language verbatim, and the Notice suggests that a plan be adapted as appropriate. This adaptation will be particularly necessary if the plan does not use an adoption agreement because the IRS model language is written for a plan that does. But in any event, the

"Regardless of whether a plan uses the model language, the plan must be timely amended if it is to include an ACA or EACA (or a QACA, for that matter)."

model language will allow for a more efficient plan amendment process and greater confidence in the adopted language. And if it is added to a pre-approved plan, the amendment will not impact the plan's status as a master and prototype or volume submitter plan, or its reliance on an opinion, advisory, or determination letter.

Amendment and Notice Deadline. Regardless of whether a plan uses the model language, the plan must be timely amended if it is to include an ACA or EACA (or a QACA, for that matter). The deadline is the later of: (i) end of the plan year in which the amendment is effective; or (ii) if applicable, the PPA amendment deadline, which, for non-governmental plans, is the last day of the first plan year beginning on or after January 1, 2009. Practically, for a calendar year non-governmental plan that has already implemented an ACA, EACA, or QACA, this results in a December 31, 2009 deadline. Note that, in addition to planning ahead for timely plan amendments, a plan administrator must give timely notice before the amendment becomes effective. Thus, a plan administrator wishing to add a type of automatic enrollment as of January 1, 2010, must give notice in 2009 – most likely no later than December 1, 2009.

Model ACA Language. The model ACA language prescribes for an initial default contribution percentage in the absence of an election. It allows for annual, automatic escalation of the default percentage, which may occur as the first pay period of a plan year or as of some other specified date of each plan year. Under the model language, the plan administrator may elect whether the ACA will cover *all* participants, only all participants without affirmative elections, or only participants without affirmative elections who become participants on or after a particular effective date. Finally, the model language requires that notice be provided 30 to 90 days before the beginning of a plan year to each covered employee. That notice must include specific information, such as the amount of the default election, the right to elect not to make a contribution, and how a default contribution will be invested. Regulations do not specifically impose the 30-to-90 day advance notice window, but this is an example of an opportunity to rely on model language for comfort.

Model EACA Language. The EACA model language includes much of the ACA model language, as well as additional provisions. For example, it requires that the automatic contributions be made on a uniform basis to all covered employees, subject to limited exceptions. It also provides covered employees the right to withdraw default contributions within 90 days after the first contribution is made. A plan administrator has the option whether to include that rule, allow a shorter withdrawal period, or exclude the provision altogether. The model language clarifies that any matching contributions associated with those withdrawn contributions will be forfeited. Finally, if the plan administrator elects to cover *all* plan participants, the plan has six months (not 2 1/2) after the end of a plan year to distribute excess contributions and thereby avoid the 10 percent excise tax on the employer.

Automatic Increases

In Revenue Ruling 2009-30, the IRS clarifies certain ways in which plans with an ACA, EACA, or QACA may automatically increase default contributions on an annual basis. It does so by blessing the automatic increase schemes in one hypothetical plan that includes an ACA and another plan that includes an EACA and a QACA. The descriptions below focus only on the automatic increase issues highlighted by the Revenue Ruling.

ACA. The hypothetical employer maintaining the plan with an ACA usually provides its employees an annual pay increase effective as of the first pay period beginning on or after his or her employment anniversary. Absent an affirmative election, the plan applies a default contribution percentage of four percent of

Utz, Miller & Eickman, LLC
7285 West 132nd St.
Suite 320
Overland Park, KS 66213

Phone: 913.685.0970
Fax: 913.685.1281

Matthew J. Eickman
meickman@utzmiller.com
Phone: 913.685.0749
Fax: 913.685.1281

Eric N. Miller
emiller@utzmiller.com
Phone: 913.685.8150
Fax: 913.685.1281

John L. Utz
jutz@utzmiller.com
Phone: 913.685.7978
Fax: 913.685.1281

www.utzmiller.com

compensation for the first plan year of participation. A participant's default contribution then increases each subsequent plan year as of the first pay period beginning on or after the participant's employment anniversary date. The increase is the greater of: (i) one percent; or (ii) 30 percent of the percentage increase in base pay for such pay period over the base pay for the immediately preceding pay period (rounded to the nearest whole percentage point).

The plan is permitted to automatically increase the default contributions as of a day other than the first day of a plan year. The Revenue Ruling also clarifies that, because the arrangement is a plain-vanilla ACA, the lack of uniformity in the percentage increases is permissible. If the plan included an EACA or QACA, such a scheme would not be permissible because the different percentages may differ for reasons other than the number of years since the initial default period (as referenced below).

QACA and EACA. A different hypothetical employer maintains a plan intended to reap the advantages of both a QACA and an EACA, which is permissible if a plan satisfies the prerequisites for each type of arrangement. The employer usually provides annual compensation increases for pay periods beginning on or after April 1 of each year. The plan provides that a default contribution-making participant will have his or her default contribution percentage increased by one percentage point with the first pay period that begins on or after April 1.

Regulations generally require that the default contribution percentage be uniform for all employees covered by a QACA or EACA. An exception to that general rule applies, however, when the default contribution percentage varies among employees simply because of the number of years since each employee first made default contributions. This hypothetical plan can take advantage of that exception and will be considered to include a QACA and EACA. Note the distinction between this example and the ACA example above, which might increase default contributions based upon the size of pay increases.

Closing

The plan amendment deadline is fast-approaching for calendar year plans that have already implemented an automatic enrollment arrangement. And even if a plan has already been amended to provide for the arrangement, additional changes to the plan or its notice procedures may be necessary. For example, a plan with a QACA must use a safe harbor definition of compensation beginning with the 2010 plan year, as required by regulations finalized in February. If you have questions regarding automatic enrollment, please do not hesitate to let us know.

"The plan amendment deadline is fast-approaching for calendar year plans that have already implemented an automatic enrollment arrangement."

Utz, Miller & Eickman, LLC
7285 West 132nd St.
Suite 320
Overland Park, KS 66213

Phone: 913.685.0970
Fax: 913.685.1281

Matthew J. Eickman
meickman@utzmiller.com
Phone: 913.685.0749
Fax: 913.685.1281

Eric N. Miller
emiller@utzmiller.com
Phone: 913.685.8150
Fax: 913.685.1281

John L. Utz
jutz@utzmiller.com
Phone: 913.685.7978
Fax: 913.685.1281

www.utzmiller.com