Get the ball rolling
Automatic Enrollment FAQs

MassMutual ERISA Advisory Services℠
What is automatic enrollment?

Automatic enrollment is when an eligible participant under a 401(k) or 403(b) plan is “automatically” set to begin salary deferrals at a predetermined rate unless the participant makes an affirmative election to the contrary. This affirmative election to the contrary can be a different deferral percentage or the option not to contribute at all.

2007 Percentage of 401(k) Plans with Automatic Enrollment by Plan Size

Source: Profit Sharing/401(k) Council of America 2007 Plan Experience Survey
Why offer automatic enrollment?

Automatic enrollment helps solve one of the major issues with saving for retirement: participants’ inertia. Generally, participants are inclined to take no action to change their current situation. Automatic enrollment helps solve for such inertia by making enrollment into a retirement plan the standard but requiring action to opt out of the plan.

In addition to help solve for this inertia, automatic enrollment can be viewed as a way to increase plan participation, especially for non-highly compensated employees (NHCEs). If plan participation increased for NHCEs, this would generally have a positive impact on Actual Deferral Percentage (ADP) and Actual Contribution Percentage (ACP) testing which may allow HCEs (those that earn greater than $110,000 in the prior year [2009 as indexed] and/or or more than 5% owners) to defer more into the 401(k) plan.

Why have some Sponsors reacted slowly to implementing automatic enrollment?

There are many reasons why a Sponsor has not yet offered automatic enrollment for their retirement program. Some of these barriers have recently been eliminated by the Pension Protection Act of 2006 (“PPA”). The following outlines some of the barriers as well as action taken by Congress to address such barriers:

1 | **State wage payment laws** – Prior to the enactment of PPA, some states maintain state payroll deduction laws that prohibited the employer from deducting amounts from employees’ wages without their written consent. As a result, some Sponsors were awaiting clarification on how automatic enrollment could work in conjunction with such state law. Although some viewed that the Department of Labor (DOL) has always taken the position that federal automatic enrollment laws preempted these state payroll deduction laws, PPA was clear that automatic enrollment laws did, indeed, preempt such state laws.

2 | **Lack of fiduciary protection** – Under the typical automatic enrollment scenario, employees are enrolled at a predetermined rate unless the employee chooses a different percentage or elects not to contribute. What happens to the money under an automatic enrollment situation if the participant never did elect an investment option? Under current scenarios, the Sponsor is responsible for choosing the investment option for such automatic enrollment contribution. Under prior law, if the participant did not make an affirmative election as to the investment of the automatic deferrals, Sponsors would not receive any ERISA §404(c) protection for such default investment.

   With PPA, if the Sponsors choose a Qualified Default Investment Alternative (QDIA) as their default investment for these automatic deferrals and meets the administrative requirements for such QDIA, then the Sponsor would receive fiduciary protection as it relates to the investments in such QDIA.

3 | **Small balances** – Under prior law, when a participant was automatically enrolled into a plan, amounts became plan assets as soon as such amounts were withheld from the paycheck. For many reasons, participants would complain to their human resources department about such automatic deferrals and request that these amounts be given back to them since they never requested such contributions. Although legally binding, these deferrals may not be distributed to participants until a distributable event has occurred, e.g., attainment of age 59.5 years, death, disability, hardship, plan termination or separation of service.

   Understanding that this was problematic for Sponsors and participants, PPA enacted the 90-day unwind provision to help solve this issue. If the automatic enrollment provision met the eligible automatic contribution arrangement (EACA) criteria, the plan would be permitted, if requested...
by the participant, to return the deferrals plus interest to plan participants within 90 days of the first automatic contribution. The following applies for returned deferrals:

- Not included in ADP testing
- Not subject to the 10% early distribution tax
- The distribution is taxed in the year of distribution
- The distribution is reported on the Form 1099-R
- Any related matching contributions must be forfeited and not included in the ACP test

MassMutual can help analyze the impact of the automatic enrollment feature on matching contributions and can suggest match formulas that would help control costs which may also benefit plan year-end testing results.

**What default percentage should a Sponsor choose?**

There is no IRS or DOL prescribed limit that a Sponsor has to follow. This is purely a plan design decision. Thus, the Sponsor has the ability to choose any default deferral percentage provided such limit does not violate any other plan limits or regulator limits (e.g., $16,500 deferral limit [2009]).

**Employer matching contribution costs**

Automatic enrollment may increase plan participation which may result in the increase of the matching contribution costs for the employer. This increased cost should be analyzed to determine if such cost outweighs the benefits of automatic enrollment, e.g., increase plan participation, participants saving for retirement, and enhanced testing results. The Sponsor may want to redesign the match formula to help offset such cost to entice participants to defer more but not have a significant cost increase due to the automatic enrollment feature. For example, if a plan has a 100% of the first 3% match formula, the Sponsor may want to consider a 50% of the first 6% match formula. Participants deferring at least 6% would receive the entire 3% match (and would help increase the average deferral percentage for NHCEs for testing purposes) but would also help cut the match cost for those participants who are automatically deferred into the plan (e.g., from 3% to 1.5% assuming a 3% automatic deferral rate).

Average participation rate increase was 16%

Source: Deloitte Consulting LLP, 2008 401(k) Benchmarking Survey (Based on 436 responses from employers nationwide)
What is an Automatic Contribution Arrangement (ACA)?

There are two types of ACAs: ERISA based ACA and non-statutory traditional ACA.

This is a baseline automatic contribution arrangement. Under the ERISA based ACA definition, if the following conditions are satisfied, civil penalties under ERISA §502(c)(4) may be avoided:

1. Plan allows the participant to defer a different percentage or opt out of participating in the retirement plan;
2. Plan follows the QDIA requirements; and
3. Annual notice requirement must be satisfied.

The non-statutory traditional ACA would generally follow the same parameters as the ERISA ACA except for the QDIA requirements would not be required.

There are two types of ACAs: EACAs and QACAs.

What is an Eligible Automatic Contribution Arrangement (EACA)?

An EACA is a type of ACA. However, if the following conditions are satisfied, EACAs are provided certain benefiting provisions as provided by PPA.

1. Uniformity – The default deferral percentage must be applied on a uniform basis to all employees eligible to defer into the plan.
2. Notice requirement – A notice must be provided to each eligible employee with a notice that specifies:
   a. The amount that will be withheld from pay absent an affirmative election;
   b. The right to defer at a different percentage or to opt out of deferring to the plan;
   c. How the contributions will be invested if the participant did not make an election; and
   d. If provided, the rights of the employees to make a withdrawal during the 90-day unwind period.

The notice must be provided to all eligible employees annually with a reasonable period of time before the beginning of the plan year. To coincide with the QDIA requirements, such notice would need to be made between 90 and 30 days prior to the beginning of the plan year. For newly eligible participants, the notice may be provided from 90 days prior to entry up until their entry date. However, if it is not practicable for the notice to be provided on or before the date specified, the notice can be provided as soon as administratively feasible but no later than prior to the pay date for the payroll period that includes the date the employee becomes eligible.

3. Who should be covered – EACAs may only cover newly eligible participants; however, if they don’t cover existing participants, the special 6-month testing provision does not apply.

4. Plan year – The EACA must be in effect for an entire plan year to be a valid EACA. Because of the notice requirements, EACAs may not be implemented mid-plan year unless as a result of only covering newly eligible participants.

If the plan satisfies the EACA design provisions, the Sponsor may take advantage of the following options:

1. The ability to offer to participants the 90-day unwind provision.
2. 6-month ADP refund extension – Under current rules, employers that want to distribute excess contributions from a failed ADP test must distribute such excesses to HCEs by 2½ months after the close of the plan year to avoid the 10% employer penalty tax. If the plan satisfies the EACA provisions and covers all participants, such 2½ month period is extended to 6 months after the close of the plan year to avoid such 10% penalty tax.

Plans that utilize the EACA design are not required to offer QDIAs as their default investment option. However, if the Sponsor wants fiduciary protection on the default investment option, a QDIA must be the default investment option.
What is a Qualified Automatic Contribution Arrangement (QACA)?

QACA is a new automatic enrollment safe harbor plan design where, if the requirements are met, ADP/ACP testing are deemed to be satisfied for the plan year. Similar to the traditional safe harbor plan design where the Sponsor receives a free pass from ADP/ACP testing, this new safe harbor design provides for a lower required safe harbor matching contribution formula and a more flexible vesting schedule for the employer. The following are requirements of the QACA plan design:

1 | **Who must be covered** – The plan must require automatic enrollment for both newly eligible participants and participants who are currently not participated in the plan because they did not make a prior deferral election (the initial automatic deferral percentage shall be 3%).

2 | **Automatic Deferral Increases (ADI)** – The minimum deferral percentage increases by 1% for each plan year thereafter until it reaches 6%. This is known as automatic deferral increases (ADI). While a plan can utilize a higher initial default deferral election to limit or eliminate the deferral escalator, such default deferral percentage cannot exceed 10%. Such increase may be timed during the plan year based upon a participant’s pay increase.

3 | **Safe Harbor Employer Contribution** – Sponsors have two types of safe harbor contribution formulas to choose from: 1) safe harbor matching contribution or 2) safe harbor non-elective contribution. The safe harbor matching contribution formula of 100% on the first 1% of compensation deferred, then 50% on the next 5% of compensation deferred. This would equate to a 3.5% match as compared to the traditional safe harbor match of 4%. The safe harbor non-elective contribution would be 3% of compensation for each eligible participant regardless if they made salary deferrals to the plan.

4 | **Vesting** – The safe harbor contributions would be subject to a 2-year cliff vesting schedule (or schedule that vest at least as rapidly as the 2-year cliff schedule). This means that a participant would be 0% vested on the safe harbor contribution with their first year of service but that would increase to 100% vesting once they completed their second year of service.

5 | **Notice requirement** – Participants are required to receive annual notice at least 30 days but no more than 90 days prior to the beginning of the plan year about the provisions of this design. In addition, newly eligible employees must receive the notice no later than the day an employee is first eligible and no earlier than 90 days before the employee first becomes eligible. Similar rules that are provided under EACAs apply to QACAs.

6 | **Withdrawal restrictions** – The safe harbor contributions are subject to the same withdrawal restrictions as salary deferral (e.g., attainment of age 59.5 years for active participants). However, such safe harbor contributions cannot be distributed on account of hardship.

Plans that utilize the QACA design are not required to offer QDIAs as their default investment option. However, if the Sponsor wants fiduciary protection on the default investment option, a QDIA must be the default investment option.

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**Percentage of Automatic Enrollment Plans that Automatically Increase Default Deferrals**

<table>
<thead>
<tr>
<th></th>
<th>Combination Plans</th>
<th>401(k) Plans</th>
<th>All Plans</th>
</tr>
</thead>
<tbody>
<tr>
<td>Automatic Escalation</td>
<td>55.4%</td>
<td>47.8%</td>
<td>50.3%</td>
</tr>
<tr>
<td>Voluntary Escalation</td>
<td>29.7%</td>
<td>34.3%</td>
<td>32.8%</td>
</tr>
<tr>
<td>No Automatic Escalation</td>
<td>14.9%</td>
<td>17.9%</td>
<td>16.9%</td>
</tr>
</tbody>
</table>

Source: 2007 PSCA's 51st Annual Survey of Profit Sharing and 401(k) Plans
Can a deferral escalator be utilized on plans that are not QACA?

Yes. Automatic enrollment plans can utilize the deferral escalator provision even if they don’t want to satisfy the safe harbor conditions of a QACA. In addition, the Sponsor can choose how high the deferral escalator can go as it would be a plan design choice. Adding this feature is a good way to help increase the average deferral percentage of the participants which could help with the non-discrimination requirements that ultimately may allow HCEs to salary defer more into the retirement plan as well as helping participants save for retirement.

What is a SHEACA (Traditional Safe Harbor Eligible Automatic Contribution Arrangement)?

Although this is not industry standard terminology, it does show how Sponsors can be creative with their plan design as it relates to automatic enrollment. This design takes advantage of the EACA provisions (and the benefits that go along with such provision) and combines it with traditional safe harbor provisions to avoid ADP/ACP testing. This allows a plan to implement both EACA and safe harbor without having to require certain QACA provisions like deferral escalators, minimum 3% default deferral percentage, maximum 10% default deferral percentage, etc. The only difference is that the traditional safe harbor provisions would need to be satisfied which includes 100% immediate vesting on safe harbor contributions and the safe harbor match must be at least 100% of the first 3% deferred plus 50% on the next 2% deferred.

What is a QDIA Investment Option?

Some plans provide for a default investment option if a participant fails to make an investment election during enrollment. Generally, this is seen in automatic enrollment plans where participants are enrolled at a pre-determined deferral rate unless the participant elects not to participate. However, this protection is not limited only to automatic enrollment plans. In addition, a plan is not required to be an ERISA §404(c) plan to receive this protection.

Even if impacted, participants do not make an affirmative investment election, fiduciaries may still receive protection with respect to such investment if the following are met:

a. Default investment option must satisfy the definition of a “Qualified Default Investment Alternative” (QDIA).

b. Participants must have an opportunity to direct the investments in his or her account but did not direct the investment of the assets.

c. An initial and annual notice to participants is required notifying them about their rights with respect to such default investment.

d. Any material provided to the plan relating to participant’s investment in a QDIA is provided to the participant.

e. Participants must have an opportunity, consistent with the terms of the Plan (but not less frequently than once within a three-month period), to transfer assets to any other investment alternative under the plan without financial penalty.

Fiduciaries are still responsible for prudently evaluating and monitoring the investments under the plan, including the QDIA. In the case of QDIAs, the Sponsor must also ensure that the level of risk associated with a QDIA is appropriate for participants of the plan as a whole in the case of balanced QDIAs or for individual participants in the case of target-date QDIAs. However, the regulations do not require fiduciaries to evaluate which type of QDIA is the most prudent for their Plan.
With respect to the definition of a QDIA, the final regulations generally include the following three long-term based QDIAs:

1) Life-cycle or targeted retirement date investment options,
2) Balanced investment options, or
3) Managed accounts.

Generally, stable value and other capital preservation investment options do not satisfy the definition of a QDIA on a stand alone basis; however, there are some exceptions.

Stable value and other capital preservation type investments may play an important role as a component of a diversified portfolio that constitutes a QDIA.

A plan may designate certain stable value or other capital preservation investment options as a QDIA for a 120-day period following a participant’s first elective contribution.

Prior to the expiration of the 120-day period, if the participant had not performed a transfer out of such QDIA, the fiduciary must redirect the investment to another QDIA.

Please note that this option is not available on MassMutual’s recordkeeping system.

Stable value products and similar investment options will be treated as a QDIA solely for purposes of investment in such products made prior to the effective date of this regulation (December 24, 2007) provided participant notice and other requirements of the regulations are met.

For purposes of the initial notification requirement, the regulations provide that notice must be provided:

(a) At least 30 days in advance of the participant’s eligibility date, or at least 30 days in advance of any first investment in a QDIA, or
(b) On or before the eligibility date provided the participant has the opportunity to request a withdrawal within the first 90 days after the initial default contribution without penalty as allowed for eligible automatic contribution arrangements under the Pension Protection Act.

Annual notice must be provided at least 30 days prior to the beginning of each plan year. In addition, the regulations provide that such notice may not be part of the plan’s summary plan description (SPD) or summary of material modification (SMM) but may be part of a plan’s automatic enrollment notice, if applicable.

The regulations preclude the imposition of any restrictions, fees or expenses (other than investment management and similar types of fees and expenses) during the first 90 days of a defaulted investment in a QDIA. Afterwards, such investment in the QDIA may be subject to the same restrictions, fees or expenses applicable to participants that had made an affirmative election to invest in such QDIA. This provision would prevent the imposition of any surrender charges, liquidation or exchange fee, redemption fee or market value adjustment within such 90-day period.
## Automatic Enrollment Notice Chart

<table>
<thead>
<tr>
<th>Participant Notice</th>
<th>QDIA</th>
<th>Traditional non-statutory ACA</th>
<th>Traditional statutory ACA</th>
<th>EACA</th>
<th>SHEACA</th>
<th>QACA</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Full Name</strong></td>
<td>Qualified Default Investment Alternative</td>
<td>Automatic Contribution Arrangement</td>
<td>Automatic Contribution Arrangement</td>
<td>Eligible Automatic Contribution Arrangement</td>
<td>Traditional Safe Harbor Eligible Automatic Contribution Arrangement</td>
<td>Qualified Automatic Contribution Arrangement</td>
</tr>
<tr>
<td><strong>Special Rules to Consider</strong></td>
<td>Do not need to be an ERISA §404(c) Plan to receive QDIA protection.</td>
<td>Not required to follow QDIA regulations.</td>
<td>Must follow QDIA default investment option. This is only available for deferral plans subject to ERISA.</td>
<td>Only EACA plans can utilize the 90 day unwind provision and the 6 month ADP testing period to avoid the employer 10% penalty.</td>
<td>Only EACA plans can utilize the PPA’s 90 day unwind provision.</td>
<td>QACA plans are not required to follow the QDIA regulations. However, if they want the 90 day unwind provision, then they need to be an EACA Plan which requires the plan to follow the QDIA regulations.</td>
</tr>
<tr>
<td><strong>When to Use It</strong></td>
<td>Non-automatic enrollment plans that want fiduciary protection with respect to default investment option(s)</td>
<td>Automatic enrollment plans that do not follow the QDIA regulations.</td>
<td>Automatic enrollment plans that do follow the QDIA regulations.</td>
<td>Automatic enrollment plans that may/may not want fiduciary protection with respect to default investment option(s)</td>
<td>Traditional safe harbor plan with automatic enrollment that may/may not want fiduciary protection with respect to default investment option(s)</td>
<td>New PPA safe harbor plan that may/may not want fiduciary protection with respect to default investment option(s)</td>
</tr>
<tr>
<td><strong>When to Distribute</strong></td>
<td>Annually at least 30 days prior to the beginning of the plan year.</td>
<td>Within a reasonable period of time before the beginning of the plan year.</td>
<td>Within a reasonable period of time before the beginning of the plan year, at least 30 days before start of plan year.</td>
<td>Annually at least 30 days prior to the beginning of the plan year.</td>
<td>Annually at least 30 days prior to the beginning of the plan year.</td>
<td>Annually at least 30 days prior to the beginning of the plan year.</td>
</tr>
<tr>
<td>Participant Notice</td>
<td>QDIA</td>
<td>Traditional non-statutory ACA</td>
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<tr>
<td><strong>To New Participants</strong></td>
<td>At least 30 days prior to the first contribution going into a default investment option or if plan offers 90 day unwind, as if the participants become eligible.</td>
<td>Within a reasonable period of time before the first automatic enrollment contribution.</td>
<td>Within a reasonable period of time before the first automatic enrollment contribution.</td>
<td>If following QDIA rules, at least 30 days prior to the first contribution going into a default investment option or entry date if plan has immediate eligibility and offers 90 day return of erroneous contribution provision.</td>
<td>If following QDIA rules, at least 30 days prior to the first contribution going into a default investment option or entry date if plan has immediate eligibility and offers 90 day return of erroneous contribution provision. Must also follow safe harbor notice rules.</td>
<td>Notice must be given by date of eligibility. If QDIA, follow QDIA timing rule.</td>
</tr>
<tr>
<td><strong>Who Must be Covered</strong></td>
<td>All participants that are defaulted into the QDIA or could be defaulted into a QDIA.</td>
<td>Sponsor may limit arrangement to only new hires or could auto enroll existing employees who are not deferring or are deferring below the auto enrollment rate.</td>
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<td>May cover only newly eligible participants but if a plan wants 6-month testing exception, EACA must cover all existing participants.</td>
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<td>Must include new and existing employees who have not made an affirmative election to participate or not participant in the plan before the implementation of QACA.</td>
</tr>
<tr>
<td><strong>Distribution Options</strong></td>
<td>Provide in writing or electronically in accordance with IRS or DOL electronic delivery requirements.</td>
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</tr>
<tr>
<td><strong>What is the penalty for failure to distribute participant notice</strong></td>
<td>No penalty, however no QDIA protection until notice requirements have been met.</td>
<td>Presumably, $1,100 per day (civil penalty under ERISA Section 502(c)(4))</td>
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MassMutual. We’ll help you get there.℠