



Just the FAQs for Plan Sponsors

12 Questions Retirement Plan Sponsors Should Ask about Adding An Automatic Enrollment Arrangement

1. What is an Automatic Enrollment Arrangement?

Traditionally, defined contribution retirement plans have required employees to affirmatively choose to save money in the plan through salary deferral. Today’s plans that adopt Automatic Enrollment are encouraging employees to save by making salary deferral the default, requiring them to opt-out or choose not to contribute to the plan.

2. What are the different types of Automatic Enrollment Arrangements?

Arrangement Type	Features – Must be stated in the Plan Document and timely communicated to employees
Basic Automatic Enrollment	<ul style="list-style-type: none"> • Employees will be auto enrolled unless they opt-out. • Specifies the percentage of an employee’s wages that will be automatically deducted. • Employees may choose not to withhold salary deferrals, or to elect a different percentage to be withheld.
Eligible Automatic Contribution Arrangement (EACA)	<ul style="list-style-type: none"> • Similar to the Basic Automatic Enrollment, but has specific notice requirements. • An EACA can allow automatically enrolled participants to withdraw their contributions within 30-90 days of the first contribution.
Qualified Automatic Contribution Arrangement (QACA)	<ul style="list-style-type: none"> • A type of Automatic Enrollment that provides a safe-harbor to avoid anti-discrimination testing (ACP, ADP and Top-Heavy). • Minimum employee automatic contribution of 3% in initial year, with annual increases to a minimum of 6% and a maximum of 10%. • Employer contributes either a 3% non-elective contribution, or matches 100% of the first 1% of compensation deferred and 50% of deferrals that exceed 1% of compensation, not to exceed 6% of compensation. • Employer contribution 100% vested in 2-years. • Specific employee notices are required.

3. When must an employer provide notice of the retirement plan's automatic contribution arrangement to an employee?

If the Plan uses an EACA or a QACA, the employer must notify all eligible employees between 30 and 90 days of the beginning of the plan year. For plans that auto enroll employees immediately upon being hired, an employer may give employees the notice on their hire date. If that is not practical, they can meet the notice requirements by:

- giving notice to the employee before the pay date for the pay period in which the employee becomes eligible; and
- allowing the employee to make deferrals from any compensation they received after becoming eligible.

4. How is the money invested when an employee is auto-enrolled?

For employees who do not make an affirmative investment selection from the Plan's investment menu (happens frequently in Plans with auto enrollment), the plan sponsor can direct their salary deferrals into a Qualified Default Investment Alternative (QDIA). Created by the Pension Protection Act of 2006, the QDIA carries some fiduciary protection from liability, for investments in one of the following:

- a) Target Retirement Date or Lifecycle Funds that change the investment mix among several asset classes based on the individual employee's age, projected retirement date or life expectancy.
- b) A product with an investment mix that takes into account the needs of the group of employees in the Plan as a whole. (e.g. a Balanced Fund made up of stocks, bonds and cash equivalents).
- c) A professionally-managed account made up from the Plan's investment menu and taking into account the individual employee's age or expected retirement date.
- d) A capital preservation fund (only allowed for the first 120 days of participation).

5. Can an employee opt-out of Auto Enrollment?

Yes. The basic automatic enrollment arrangement allows employees to opt-out of auto enrollment, but access to their account is determined by the Plan's distribution provisions. If the Plan contains an EACA an auto enrolled employee can opt-out and request return of their automatic salary deferrals no less than 30, and no more than 90 days after the first salary deferral. An EACA requires the plan sponsor to provide employees 30-90 days advanced notice explaining the arrangement and all the employee's rights.

6. What are the advantages of Automatic Enrollment for the plan sponsor?

- a) The employer is making an important life decision for employees about saving for retirement – a decision many fail to make on their own.
- b) Encourages employees to prepare for retirement, possibly reducing the costs associated with an aging workforce.
- c) Increases plan participation and favorable impact on anti-discrimination testing.
- d) For sponsors who wish to allow highly compensated employees to defer the maximum amounts, a QACA creates a safe-harbor avoiding anti-discrimination testing.
- e) Significant tax advantages for employers subject to corporate tax, including deduction of employer contributions.

7. What are the disadvantages of Automatic Enrollment for the plan sponsor?

- a) The increased cost of employer matching contributions, when the participation rate (number of employees deferring) increases.

- b) It is the responsibility of the plan sponsor to develop and effectively communicate the features of Automatic Enrollment.
- c) The cost of distributing required employee notices.
- d) Auto enrollment may increase record keeping fees (more employees requiring service by the record keeper).

8. What are the advantages of Automatic Enrollment for employees?

- a) Encourages employees to prepare for retirement, possibly reducing the costs associated with an aging workforce.
- b) The employee can take advantage of any employer matching dollars to grow their account faster.
- c) Tax deferral of amounts contributed, and earnings thereon, allow for faster account growth as compared to an investment without tax deferral.
- d) A well-selected QDIA may provide better long-term investment performance than the employee's own investment selection(s).

9. What are the disadvantages of Automatic Enrollment for employees?

A disadvantage is the possible misconception that the initial auto enrollment salary deferral rate set by the employer will be adequate to meet retirement savings needs. This disadvantage is addressed by adding an Automatic Contribution Escalation provision.

10. What is Automatic Contribution Escalation?

Automatic Contribution Escalation may be combined with Automatic Enrollment to provide a powerful tool to help employees grow their retirement account balance. Auto escalation is most effective when set up on an opt-out, versus an opt-in basis. Example of auto enrollment plus auto escalation: Employee is auto enrolled upon their eligibility date for the employer contribution at 3% of compensation. The employee's salary deferral rate is increased by 1% yearly until a 10% deferral rate is achieved. A plan can have Automatic Contribution Escalation as an alternative to a QACA. Unlike a QACA, no employer contribution is required and there is no safe-harbor from anti-discrimination testing.

11. Have Automatic Enrollment and Automatic Escalation been well-received?

In 2015 Transamerica Retirement Solutions published a retirement Industry Report, with responses from 4,573 employers across a wide variety of industries and representing all plan sizes – micro to mega Plans. Transamerica reported that 40.0% of plan sponsors surveyed indicated they had some form of auto enrollment. Of those plan sponsors, 90.5% auto enrolled new hires only. 45.0% of sponsors with auto enrollment indicated they have auto enrolled any eligible employees not contributing, or contributing below the default rate. The most commonly applied initial automatic deferral rate was 3.0%, cited by 43.0% of Plans with auto enrollment. 25.5% of sponsors with auto enrollment also have an automatic escalation feature. Of the plan sponsors with auto escalation, 87.0% increase the deferral rate in 1% increments annually. Separately, HANYS Benefit Services has found that clients who have adopted auto enrollment have seen that 85%-95% of employees who are auto enrolled do not opt-out, making auto enrollment a powerful tool for increasing the Plan participation rate.

12. How does a plan sponsor establish Automatic Enrollment and Automatic Escalation in their retirement plan?

A plan amendment is required to add auto enrollment or auto escalation to a plan. A QACA must be implemented at the beginning of the Plan Year.

Contact your SBS Retirement Plan Advisor for more about the advantages of automatic enrollment and automatic escalation.

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