

# retirement

## plan news

JULY/AUGUST 2009

### Final Automatic Enrollment Regulations: QACA

The Pension Protection Act of 2006 (PPA) created two types of automatic contribution arrangements (ACAs): the qualified ACA (QACA) and the eligible ACA (EACA). Earlier this year, the U.S. Treasury Department issued the long-awaited final regulations for both.

The lead article discusses final regulations governing QACAs, which are effective January 1, 2008. Final EACA regulations are discussed on page three. Note: The final regulations do not affect automatic contribution arrangements that are not intended to be a QACA or an EACA.

When a plan has an automatic contribution arrangement, employees are treated as having enrolled in the plan and elected to contribute an amount specified by the plan *unless* they make an affirmative election to defer a different amount or opt out. A QACA is basically a safe harbor plan that has an automatic enrollment arrangement and other QACA features.

**Minimum Contribution Percentage Requirements.** The QACA has an escalator feature that gradually increases the minimum default contribution percentage. The minimum for the first year is 3% of compensation. It increases 1% each year until reaching 6%. Therefore, the minimum contribution percentage for an automatically enrolled employee is generally based on the number of years the employee has been making default contributions to the QACA.

An employee who severs service and is rehired after a full plan year has transpired may be treated as a new employee for purposes of automatic enrollment and

the minimum contribution percentage requirement. The status of the employee's QACA contribution percentage at termination is not a factor.

**Example:** Employer has a calendar-year plan. If an employee terminates in 2009 and is rehired in 2011, the plan is permitted to automatically enroll the rehired employee at the initial period minimum percentage (e.g., 3%), even if the employee's automatic contribution rate had been escalated to a higher percentage before severance.

**Deferral Election May Have Expiration Provision.** Automatic enrollment rules do not apply when an affirmative election is in effect. However, as introduced in the final regulations, a plan may provide that an affirmative salary deferral election may expire. In such case, employees who wish to continue to defer would have to complete new salary deferral forms. Once the affirmative election expires, if an employee does not complete a new affirmative



election, he or she will be automatically enrolled at the plan's minimum default contribution percentage.

**Example:** Employer has a QACA beginning in 2009. The plan provides that all affirmative elections in effect on December 31, 2010, will expire on that date. If the QACA continues into 2011, eligible employees who do not make a

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new affirmative election will be automatically enrolled under the QACA at the plan's minimum default contribution percentage.

**Hardship Suspension.** If an employee who has made an affirmative election takes a hardship withdrawal, elective contributions are suspended for six (or 12) months. If the plan has an election expiration provision, and the timing is such that the employee's election expires during the suspension period, unless the employee files a new election, he or she will be automatically enrolled in the QACA when the suspension ends.

**Definition of Compensation.** For plan years beginning on or after January 1, 2010, the definition of compensation for purposes of determining default contributions is the safe harbor definition of compensation, and may be for the full plan year or for the period of time an employee is a participant (as defined in the plan).

**Uniformity Requirement.** The default contribution percentage must be applied uniformly, although the percentage may vary based on the number of years an eligible employee has participated in the QACA. However, the rate of deferral in effect immediately prior to the effective date of the default percentage under the QACA is not reduced.

**Example:** An employee has elected to defer 6% of compensation prior to the QACA. Once the QACA is effective, the employee may not have the deferral amount reduced to a lesser percentage (such as 3%) when automatically enrolled in the QACA.

The final regs allow a QACA to increase the default deferral percentage in the middle of the plan year to coincide with salary increases or performance evaluations, provided that salary increases occur at the same time for all covered employees. Otherwise, the uniformity requirements are violated.

**Notice Requirements.** Generally, the timing rules for the annual automatic enrollment notice are the same as those for the safe harbor notice: 30 to 90 days before the beginning of each plan year. For a new employee or new plan, the notice may be provided up to the employee's eligibility date or the plan's effective date, respectively.

If newly hired employees are immediately eligible, the notice must be provided sufficiently early to provide a reasonable amount of time between when the notice is received and when the first default contribution will be made to ensure that employees have an opportunity to make an affirmative election. An employer is

required to provide the notice to the employee prior to the pay date for the payroll period that includes the date the employee becomes eligible.

**First Effective Date of Default Election.** The default election must be effective *no earlier than* a reasonable period of time after an employee receives the notice (to provide time for an affirmative election to be made) and *no later than* the earlier of:

- The pay date for the second payroll period that begins after the date the notice is provided or
- The first pay date that occurs at least 30 days after the notice is provided.

Barring any delay of the first default contribution, QACA safe harbor contributions (i.e., nonelective contributions, which are based on a full year's compensation, and matching contributions, which vary based on compensation) must be based on the safe harbor compensation earned since the participant was first eligible under the plan.

**Additional Points.** Participants who have affirmative elections in effect immediately before a QACA is added may be excluded from automatic enrollment. The regulations *do not* permit the exclusion of existing employees who, at the time the QACA starts, had never filed an affirmative election.

The final regulations reiterate that all eligible employees must receive safe harbor matching contributions or nonelective contributions (whichever is applicable). The special treatment for employees who have an affirmative election in effect has no bearing on whether safe harbor matching contributions or nonelective contributions are required on behalf of those employees. Safe harbor contributions are not eligible for hardship distribution. ❖



# Final Automatic Enrollment Regulations: EACA

One concern about automatic enrollment is that employees may not understand that some action is required on their part to opt out of the arrangement and, hence, may wish to withdraw contributions that were automatically made on their behalf. To address this concern, PPA created the eligible automatic contribution arrangement (EACA).

The EACA allows penalty free withdrawals of certain automatic contributions (when requirements are met). Unlike a QACA, an EACA is not a safe harbor plan, although a QACA may include the EACA withdrawal feature. Final EACA regulations are effective January 1, 2010, or later.

**“Covered” Employees.** Automatic enrollment under an EACA need not apply to all employees eligible to make a deferral election under the applicable plan, but only to those employees who are covered by the EACA. The plan document must specify who is covered under the EACA and state whether an employee who makes an affirmative election remains covered under the EACA.

The automatic enrollment notice is required only for those employees who are covered by the EACA. If a plan provides that an employee who makes an affirmative election is no longer a covered employee, then the notice is no longer required for that employee.

A PPA provision granting a six-month period for an ADP/ACP refund without penalty is not available unless all eligible employees are covered by the EACA for the entire plan year.

**Uniformity Requirement.** An EACA must provide that the default elective contribution is a uniform percentage of compensation. The escalator exception to the uniformity requirement for a QACA may be applied to an EACA.

**Implementation.** Mid-year implementation of an EACA for an existing 401(k) plan is not permitted. Thus, an EACA must be established before the beginning of the plan year and be effective for the entire plan year.

**Notice for Newly Eligible Employees.** The employer is required to provide newly eligible employees with an automatic enrollment notice prior to the pay date for the payroll period that includes the date the employee becomes eligible.

**Permissible Withdrawals.** The regulations provide a 90-day withdrawal election period, starting from the date the first



default deferral would otherwise have been included in gross income. If an employer is concerned about remaining within the 90-day period, the plan is permitted to limit the permissible withdrawal election period to less than 90 days, provided it is at least 30 days. The effective date of a permissible withdrawal election cannot be after the *earlier of*:

- The pay date for the second payroll period beginning after the election is made or
- The first pay date that occurs at least 30 days after the election is made.

Of course, a plan may permit an earlier effective date.

If an employee is automatically enrolled and subsequently makes an affirmative election within the 90-day election period, the employee’s permissible withdrawal rights may not be restricted based on his or her subsequent affirmative election.

A permissible withdrawal distribution is to be handled in the same manner as any other distribution under the plan. For example, the plan cannot charge a higher fee for a permissible withdrawal than it would charge for any other distributions of cash.

**Employer Matching Contributions.** If matching contributions have been made on deferrals being distributed as a permissible withdrawal, the matching amounts must be forfeited (after adjusting for gains or losses). The plan may provide that matching contributions will not be made with respect to a permissible withdrawal if the withdrawal is made prior to the date matching contributions are to be allocated.

**QDIA Requirement Eliminated.** The Worker, Retiree, and Employer Recovery Act of 2008 (WRERA) eliminated the PPA requirement that an EACA have a qualified default investment alternative (QDIA), although the plan may choose to have one. The automatic enrollment notice must still specify a default investment; it just does not have to be a QDIA. ❖

# recent developments

## ■ 403(b) Opinion Letter

**Announcement.** The IRS has released Announcement 2009-34, which lists proposed procedures for issuing 403(b) prototype opinion letters and provides sample plan language for use in drafting the prototype document. The IRS is seeking public comments on these drafts no later than June 1, 2009.

In an attempt to gauge the future volume of opinion letter applications, plan sponsors and mass submitters that intend to submit 403(b) opinion letter requests are being asked to inform the IRS of their intentions by June 1, 2009. Mass submitters are being asked to provide an estimate of the number of applications they will be submitting on behalf of prototype sponsors.

## ■ President Obama's FY 2010

**Budget.** In his fiscal year 2010 budget, President Obama proposed requiring employers who do not sponsor a retirement plan to automatically enroll their employees in a direct-deposit IRA program. Employees would automatically defer a portion of their salaries into an IRA. Businesses that are less than two years old with fewer than 10 employees would be exempt from this program.

The IRS currently provides a non-refundable saver's income-tax credit for certain low and moderate income individuals who contribute to IRAs and retirement plans. The credit ranges from 10% to 50% of the first \$2,000 of contributions. President Obama's proposal would make it a fully refundable credit of 50% of the first \$1,000 for all eligible savers.

## ■ Plan Loans: Truth in Lending

**Rule Change.** Effective July 1, 2010, certain plans that offer loans to participants will no longer be required to provide disclosures due to a new exemption in the Truth in Lending Act. Plans making 25 or more participant loans (or five or more loans secured by a dwelling) in the current or prior calendar year are currently required to provide participants with truth in lending disclosures.

Under the rule change, plans that restrict loans to a participant's vested account balance and comply with Code Section 72 will be exempt from the disclosure requirements. Plans that offer loans in excess of a participant's vested account balance, however, will not be exempt. ❖

The general information in this publication is not intended to be nor should it be treated as tax, legal, or accounting advice. Additional issues could exist that would affect the tax treatment of a specific transaction and, therefore, taxpayers should seek advice from an independent tax advisor based on their particular circumstances before acting on any information presented. This information is not intended to be nor can it be used by any taxpayer for the purpose of avoiding tax penalties.

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