THE ERISA INDUSTRY COMMITTEE

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Advocating the Benefit and Compensation Interests of America's Major Employers

Summary of H.R. 1508: The 401(k) Automatic Enrollment Act of 2005

Sec. 2: A qualified 401(k) plan may contain an automatic enrollment provision with the following features:

(1) the employee can opt out at any time and receive cash *[Sec. 2. (a), IRC §401(k)(13)(B), as amended]*

(2) the automatic deferral contribution cannot be invested in qualifying employer securities (§4975(e)(8)) or qualifying employer real property (§407(d)(4)), unless affirmatively elected by the employee *[Sec. 2. (a), IRS §401(k)(13)(D), as amended]*

(3) the contributions begin on the earlier the first day of the plan year beginning after the date on which the employee satisfied plan participation requirements, or six months after the date on which he satisfied the requirements. *[Sec. 2. (a), IRC §401(k)(13)(E), as amended]*

(4) The plan administrator gives participants notice of their rights under the automatic enrollment arrangement, to include the following information:

a. An explanation of the employee's right under the arrangement to elect not to have elective contributions made on their behalf, or to have them made at a different percentage or rate;
b. The employee must have a reasonable amount of time after receipt of the notice and before the first elective contribution is made to make an alternative election;
c. An explanation of the employer matching contributions or other contributions available under the arrangement; and,
d. An explanation of how the contributions will be invested in the absence of an election by the employee.

[Sec. 2. (a), IRC §401(k)(13)(F), as amended]

(5) An employee may opt out of the automatic enrollment election retroactively to the beginning of the plan year and take an "unwind distribution", as long as the employee is ineligible to make elective contributions for the rest of the plan year. The option is only available to a participant once.

a. Unwind distributions are includable in gross income, but not subject to the §72(t) penalty.

b. Unwind distributions cannot be made to highly compensated employees (§414(q))
c. The account balance of a participant taking an unwind distribution cannot exceed the greater of $400 or the amount of automatic deferrals made during the first four payroll periods after referrals began.
d. Matching contributions on amounts taken as part of an unwind distribution are forfeited.
e. Contributions attributable to unwind distributions are not taken into account for nondiscrimination testing.

[Sec. 2. (a),IRC §401(k)(13)(G), as amended]

(6) The automatic enrollment arrangement may permit eligible employees to elect to have the contribution amount automatically increased based on such factors as increases in compensation, passage of time, or increases in years of service or participation. The arrangement may also provide for such increases to occur automatically (without participant direction) unless the employee elects otherwise. The employee must have the option to stop such increases with regard to future contributions. *[Sec. 2. (a), IRC§401(k)(13)(H), as amended]*

(7) Treasury is authorized to prescribe regulations that provide for simplified methods of reporting and implementation. *[Sec. 2. (a), IRC §401(k)(13)(I), as amended]*

(8) An automatic enrollment arrangement may be included in a SIMPLE, 403(b), or 457 plan. *[Sec. 2(b), IRC §408(p)(2)(A), as amended; IRC §408(p)(10), as amended; Sec. 2(c), IRC §403(b)(14), as amended; Sec. 2(d), IRC §457(e)(19), as amended]*

(9) In the case of a plan electing to meet the safe harbor matching requirements under 401(k)(12)(B), the plan must have an automatic enrollment feature and the employer must make matching contributions of 50% of the elective contributions of the employee (up to 6%) on behalf of each employee who is not an HCE. Employee affirmative elections must be in effect for three (3) years unless the plan provides for a shorter period or the employee makes a new election or has elected an automatic increase. At least 85% of eligible employees must have participated in the arrangement during the previous plan year. The default contribution must equal the minimum contribution percentage, and may be subject to periodic automatic increases.
[Sec. 2(e), IRC §401(k)(12)(B)(i), as amended, §401(k)(12)(G), as amended].
a. The minimum contribution percentage for these purposes is 3% for the first year of participation (the employer may opt for a higher percentage); for subsequent years of participation, it is the amount contributed during the first year increased by either 1 percent or 2 percent. The minimum contribution percentage cannot exceed 9% for any plan year.

Furthermore, for any plan year after the first year of participation, the minimum contribution percentage cannot exceed the previous year's minimum contribution percentage plus the percentage increase in the employee's compensation. *[Sec. 2(e), IRC §401(k)(12)(G)(ii) et. seq., as amended]*

The effective date of the amendments to this section is 12/31/2005; for automatic enrollment plans that provide for investment in employer securities by default, the effective date is 12/31/2006. For safe harbor plans, the effective date is 12/31/ 2007. *[Sec. 2(f)].*

Sec. 3. Section 514 is amended to provide that ERISA preempts any State law that precludes automatic enrollment arrangements or mandatory direct transfers to individual retirement plans.

Sec. 4. ERISA Section 404(c)(3) is amended to limit the fiduciary responsibilities for a plan fiduciary with respect to a mandatory direct transfer to an individual retirement plan under Section 401(a)(31)(B).

Sec. 5. Section 404 is amended to provide that a fiduciary is deemed to have properly discharged his duty of care if automatic enrollment or mandatory direct transfer contributions are invested in life cycle type investments that have reasonable fees and expenses. Appropriate investments are described as investments that consist of a balanced portfolio containing: (1) broad-based index funds or managed funds diversified to minimize risk of loss and (2) either stable value or fixed income investments which comprise at least 20 percent of the fair market value of the portfolio and are diversified to minimize loss (or are US bonds). Stable value investments are described as those with are designed to preserve principal and provide a reasonable rate of return, and may include investments designed to maintain a stable dollar value equal to the value of the original investment. Plans are free to have other investment options as permitted under the Code or ERISA. *[Sec. 5(a), ERISA §404(e), as amended]*

Treasury may issue regulations regarding compliance with this section. The amendments made by this section are effective for investments made after 1/1/2005. *[Sec. 5(b)].*

Sec. 6. The nondiscrimination testing safe harbor notice is amended to provide that annual notice must be given in the 6th or 7th month of the year, effective 12/31/2006. Notice is not required for nonelective contributions, effective 12/31/2005.

Sec. 7. Treasury and Labor are required to submit a report to Congress on their findings regarding the availability low-cost individual retirement plans.

Summary of PSCA Automatic Enrollment Legislative Proposal

Section 1**:** Cash or deferred arrangements will be treated as meeting the 401(k) average deferral percentage (ADP) nondiscrimination test if the arrangement constitutes an Automatic Contribution Trust (ACT). An ACT is an arrangement under which eligible employees are automatically enrolled at the applicable percentage of compensation (at least three percent) until the employee elects otherwise. Additionally, the deferral rate will increase by at least one percentage point on an annual basis until the percentage reaches at least ten percent, unless the employee elects otherwise. A plan may continue the automatic increases above the ten percent level. The first increase must be made not later than the first day of the second plan year beginning after the automatic election.

The automatic enrollment requirement applies only to "newly-eligible employees." It does not apply to employees eligible to participate in the plan or predecessor plan immediately prior to the adoption date of the ACT. It is not intended that the legislation would prohibit the application of the safe harbor if a plan also automatically enrolls existing nonparticipants.

ACTs require a matching contribution of 50% of the first five percent of compensation or a nonelective contribution of two percent of compensation for non-highly compensated employees. Matching and nonelective contributions are subject to the normal vesting requirements – three-year cliff or six-year graded for matching contributions; and five-year cliff or seven-year graded for nonelective contributions.

The existing requirements applicable to the current law 401(k) safe harbor regarding notices and alternative level matching formulas apply to ACTs. The existing ban on Social Security integration applies.

Employees must be notified of their right to elect to decline participation in the ACT and be provided a reasonable amount of time to reach a decision prior to the first automatic elective deferral. Additionally, an annual notice of an employee's rights and obligations under the ACT must be provided. The existing 401(k) safe harbor notice requirements regarding accuracy, comprehensiveness, and manner of writing apply. *[Sec. 1(a), IRC §401(k)(13), as amended]*

Cash or deferred arrangements with a matching contribution feature will be treated as meeting the 401(m) average contribution (ACP) nondiscrimination test if the arrangement constitutes an ACT. This exemption from the ACP test will also apply in the case of a 403(b) arrangement that constitute an ACT. *[Sec. 1.(b) IRC §401(12) et. seq., as amended]*

ACTs are excluded from the definition of top-heavy plans. *[Sec. 1(c), IRC §416(g)(4)(H), as amended]*

Instructs the Secretary of the Treasury to modify existing regulations 1.414(s)-1(d)(3) (alternative definitions of compensation that satisfy section 414(s)) and 1.401(a)(4)-3(b) (nondiscrimination safe harbors) to permit the use of base pay or rate of pay for purposes of satisfying the various nondiscrimination safe harbors where the amount of annual overtime compensation varies significantly. Instructs the Secretary of the Treasury to issue regulations that extend the payroll period rules applicable to the existing 401(k) safe harbor to ACTs. *[Sec.1(d)]*

Codifies in the statute existing guidance that 403(b) arrangements may adopt the current law nondiscrimination safe harbor created for 401(k) plans. *[Sec. 1(e), IRC §401(m), as amended]*

Under appropriate conditions, default investments (whether made to an ACT plan or a non-ACT plan) are treated as participant-directed investments under ERISA section 404(c). The Secretary of Labor shall issue regulations, within six months of enactment, providing guidance on appropriate default investments in automatic enrollment plans and defined contribution plans generally. The guidance will include a discussion of the appropriateness of default investments that include a mix of asset classes consistent with long-term capital appreciation. *[Sec. 1(f), ERISA §404(c), as amended]*

ERISA 514(b) is amended to specify that ERISA preempts any state laws that would directly or indirectly prohibit or restrict automatic contribution arrangements. The Secretary of Labor may set minimum standards that such arrangements would be required to satisfy in order for pre-emption to apply.*[Sec. 1(f), ERISA §514, as amended]*

Permits a participant to direct a plan to reverse an automatic enrollment deferral within three months for amounts less than $500. The "corrective distribution" shall be treated as if the plan never held the deferred amount and as compensation paid to the participant. *[Sec. 1(g)]*

These provisions are effective for plan years beginning after December 31, 2005, except that subsection (e) relating to 403(b) plans applies to years beginning after December 31, 1998. Final regulations under ERISA section 404(c), as provided under subsection (f) shall be issued within six months of enactment of this proposal. *[Sec. 1(h)]*