



A Publication of  **BOULT • CUMMINGS  
CONNERS • BERRY<sup>LLC</sup>**

## **Pension Protection Act of 2006: Automatic Enrollment**

By [B. David Joffe](#)



In the Pension Protection Act of 2006, Congress added a new optional provision to the Internal Revenue Code to encourage increased participation in retirement plans through “automatic enrollment.” Automatic enrollment allows an employer to enroll its employees and make salary reductions without having employees complete the enrollment process. While the new provision may be good news for employers who want to increase participation and also pass the required nondiscrimination testing, there are some strings attached.

Under the new provision, a plan that contains a “qualified automatic enrollment feature” is treated as meeting the nondiscrimination tests for deferrals and matching contributions. In addition, a plan consisting solely of contributions made under a qualified automatic enrollment feature will not be subject to the top-heavy rules. However, it is important to note that the new provision is optional. Employers are still permitted to have automatic enrollment without satisfying the new rules, provided they otherwise meet IRS guidelines; in such case, the plan will be subject to the nondiscrimination tests and top-heavy rules. For plans that easily pass the nondiscrimination tests and that are not top-heavy, there may not be any advantage to the new provision.

### **Qualified Automatic Enrollment Feature**

A qualified automatic enrollment feature must meet certain requirements with respect to automatic deferral, matching or nonelective contributions, and notice to employees. It must provide that, unless an employee elects otherwise, the employee is treated as making an election equal to a stated percentage of compensation not greater than 10% and at least 3% for the first year, 4% for the second year, 5% for the third year, and 6% for fourth year and thereafter. Eligible employees mean all employees eligible to participate in the arrangement other than employees already eligible to participate with an election in effect (either to participate at a certain amount or not to participate).

### **Contribution Requirement**

An automatic enrollment feature satisfies the contribution requirement if the employer either makes the specified matching contribution or nonelective contribution. The nonelective contribution must be at least 3% of an employee's compensation on behalf of each nonhighly compensated employee. A plan generally satisfies the matching contribution requirement if the employer makes a matching contribution on behalf of each nonhighly compensated employee that is equal to 100% of the employee's elective deferrals that do not exceed 1% of compensation and 50% of the employee's elective deferrals that exceed 1% but do not exceed 6%. The matching contribution must be fully vested if the employee has completed at least two years of service.

### **Notice Requirement**

Under the notice requirement, each employee eligible to participate in the arrangement must receive notice

of the arrangement that is sufficiently accurate and comprehensive to apprise the employee of their rights and obligations and is written in a manner calculated to be understood by the average employee to whom the arrangement applies. It must explain the employee's right under the arrangement to elect not to have elective contributions made or to elect to have contributions made in a different amount and how contributions made will be invested in the absence of any investment election. The employee must be given a reasonable period of time after receipt of the notice and before the first election contribution is to be made to make an election with respect to contributions and investments. If the notice requirement is not satisfied, a maximum penalty under the Employee Retirement Income Security Act (ERISA) of \$1,100 per day could apply.

### **Other Rules**

The Act allows for an optional 90-day distribution window if participants want to withdraw contributions made under an “eligible automatic enrollment arrangement.” The amounts are taxable in the year of distribution and not subject to the 10% early withdrawal penalty. In addition, if a plan performs nondiscrimination testing rather than relying on a safe harbor, corrective distributions of excess contributions due to a failed nondiscrimination test are taxable in the year of distribution, and the employer has six months to correct excess distributions under such an arrangement without penalty.

### **Preemption and Default Funds**

The Act preempts any State law (such as a payroll law) that would directly or indirectly prohibit or restrict the inclusion in the plan of an “automatic contribution arrangement” that provides for permitted default investments. The Secretary of Labor is authorized to issue regulations on automatic enrollment and is also directed (by February 17, 2006) to provide fiduciary relief for permitted default investments. Until regulations are issued, it is not clear how the arrangement should be structured to comply with the Act.

### **Effective Date**

The new provision is effective for years beginning after December 31, 2007. However, the preemption of conflicting State regulations is effective as of August 17, 2006. Therefore, plans with automatic enrollment features should be reviewed now to potentially take advantage of ERISA preemption.

If you have any questions regarding automatic enrollment, please contact one of the attorneys on the Boulton Cummings [Employee Benefits and Executive Compensation](#) Team listed below:

Andrew Elbon  
615.252.2378  
[aelbon@boultoncummins.com](mailto:aelbon@boultoncummins.com)

B. David Joffe  
615.252.2368  
[djoffe@boultoncummins.com](mailto:djoffe@boultoncummins.com)

Gordon Earle Nichols  
615.252.2387  
[gnichols@boultoncummins.com](mailto:gnichols@boultoncummins.com)

John M. Scannapieco  
615.252.2352  
[jscannapieco@boultoncummins.com](mailto:jscannapieco@boultoncummins.com)

Boulton Cummings eNews is published solely for the interest of clients and friends of [Boulton, Cummings, Connors & Berry, PLC](#) and should in no way be relied upon or construed as legal advice. If you need specific information on legal issues or want to address specific factual situations please seek the opinion of legal counsel.

Boulton Cummings eNews is designed to update our clients on legal issues that may impact their business. If this information is not relevant to your position, please forward to the appropriate person in your organization. If this topic is not pertinent to your company, please provide topic suggestions as to the types of legal updates and topics that are relevant to your business. Please email [cbillingslea@boultoncummins.com](mailto:cbillingslea@boultoncummins.com) your feedback or suggestions.

2008 Boulton, Cummings, Connors & Berry, PLC. All rights reserved



**Roundabout Plaza, 1600 Division Street, Suite 700 Nashville, TN 37203**  
**615.244.2582 [www.boultcummings.com](http://www.boultcummings.com)**

This email was sent to [email]. To ensure that you continue receiving our emails, please add us to your address book or safe list.

[manage](#) your preferences | [opt out](#) using TrueRemove™  
Got this as a forward? [Sign up](#) to receive our future emails.

