Mandatory Automatic Enrollment

Presenter Information

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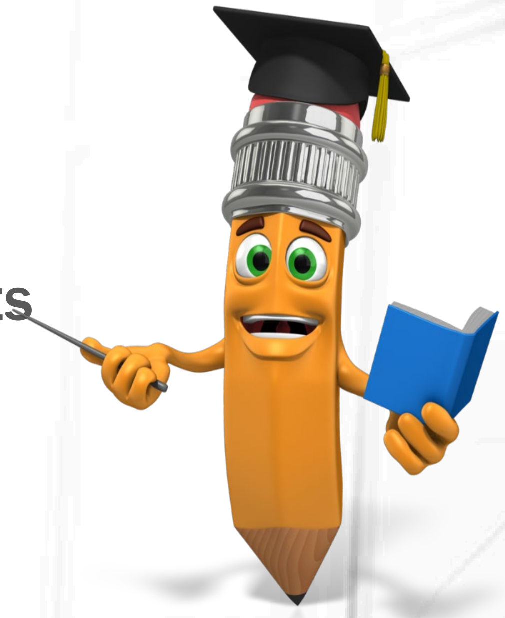
What we'll cover

- Mandatory Automatic Enrollment
- MEPs and PEPs
- 403(b) and Starter Plans
- Eligible Automatic Contribution Arrangements
- Correction of Automatic Enrollment Failures
- Qualified Automatic Contribution Arrangements



SECURE 2.0 Timeline

- December 29, 2022: President signed SECURE 2.0
- November 25, 2023: IRS issued proposed LTPT EE regulations
- December 20, 2023: IRS issued Notice 2024-02
  - Q&As on 12 issues in SECURE 2.0 (Grab Bag Guidance)
- December 20, 2023: IRS released Notice 2024-03
  - Cumulative List of Changes • Provisions in Cycle 4 DC documents

Mandatory Automatic Enrollment

Mandatory Automatic Enrollment

- SECURE §101
  - New 401(k) and deferral 403(b) plans required to have an eligible automatic enrollment arrangement (**EACA**)
  - Default deferral percentage
    - First year: 3% to 10%
    - Auto increase of 1%/year thereafter: capped at 10 – 15%
  - QDIA unless participant makes investment election
  - Must allow permissible withdrawals (up to 90 days after first auto deferral)

Exemptions

- SIMPLE 401(k)
- Plans established before 12/29/2022 (Grandfathered Plans)
- Governmental and church plans
- Plans sponsored by employer that normally employs fewer than 11 employees
  - Exemption expires 1 year after close of first tax year after employer exceeds the limit
- New business: exempt during first 3 years of existence of the business or a predecessor business

What is a Grandfathered Plan?

- A defined contribution plan with a 401(k) feature established before 12/29/2022 is considered a “pre-enactment qualified CODA” or “pre-enactment section 403(b) plan”

Example

- Example provided in Notice 2024-02
  - New Plan is effective January 1, 2023
  - Plan document is signed October 1, 2022
    - Before Enactment of SECURE 2.0
  - Considered as a Grandfathered Plan for mandatory auto enrollment provision
- For 401(k) plans, what counts is when deferral provisions are formally included in the plan document
  - Employer adopts profit sharing plan January 1, 2022
  - Amends plan to add 401(k) feature January 1, 2023
  - Not a Grandfathered Plan – mandatory automatic enrollment applies

Grandfathered Plans

- Grandfathering is dependent on the date of adoption preceding SECURE 2.0, rather than the effective date
  - If an employer signed a brand new plan with a 401(k) provision prior to the enactment of SECURE 2.0, but with an effective date after, the plan will be considered to be grandfathered
  - Example. Employer X adopted a 401(k) plan on 12/15/22, with an effective date of 1/1/23
    - The plan is a grandfathered plan
  - Example. Employer X maintained a profit sharing plan
    - X amended on 12/15/22 to add a 401(k) feature with an effective date of 1/1/23
    - The plan is considered to be a grandfathered plan

Grandfathered Plan (cont.)

- However, if an employer maintained a profit sharing plan before the enactment of SECURE 2.0 and added the 401(k) feature after the enactment, the plan is not grandfathered
  - Example. Employer X established a profit sharing plan in 2019
    - X amended the plan in 2023 to add a 401(k) feature
    - The plan is NOT grandfathered

Example

- Company X establishes a 401(k) plan on January 1, 2023
  - X has 10 employees for 2023, 2024 and 2025
  - Although X plan is not grandfathered, it is not subject to mandatory automatic enrollment in 2025 because it qualified under the small plan exemption
  - On 2/15/26, X adds two employees
  - On 1/1/28, X's plan must apply automatic enrollment to its plan

Example

- Jim establishes a new company (X) with 20 employees on 2/1/25
  - On 3/1/25, X establishes a new 401(k) plan
  - The plan is not subject to mandatory automatic enrollment until 3/1/28

MEPs and PEPs

Participating Employers

- An employer that was a participating employer in a MEP or MEP that included a 401(k) provision before SECURE 2.0 will be considered a grandfathered plan
- However, the participating employer does not qualify as a grandfathered plan because the MEP or PEP offered a 401(k) provision before SECURE 2.0
  - The participating employer does not receive credit because the MEP or PEP offered the 401(k) feature before SECURE 2.0
  - A participating employer only receives credit its participation agreement was in place before the Enactement Date

Example

- **Example 1**. Employer X became a participating employer in the MEP in 2018
  - The MEP has a 401(k) feature and X adopted the feature in 2018
  - X is a grandfathered plan
- **Example 2**. Assume instead, X only adopted the profit sharing feature in the MEP in 2018
  - X adopted the 401(k) feature in 2023, X's plan is not grandfathered

Spin-off Plans

- Single Employer Plans
  - Original plan is a Grandfathered Plan
    - Then, the spin-off plan will be treated as Grandfathered Plan
  - Original plan is NOT a Grandfathered (signed after 12/29/22)
    - Then, the spin-off plan won't be a Grandfathered Plan
- Multiple Employer Plans
  - Participating employer's portion of plan is treated as Grandfathered and is spun off into a new separate plan
    - Then the new plan is a Grandfathered Plan

MEP/PEP: Spin-Off Plans

- The critical date is the date the Participating Employer originally adopted the PEP/MEP and elected a 401(k) feature and not the effective date of the PEP/MEP
  - **Example:**
    - Participating Employer adopted MEP 5/1/2023
    - MEP was originally effective 1/1/2019
    - The plan is not a Grandfathered Plan for the Participating Employer
      - Doesn’t impact the other MEP/PEP employers
    - When the Participating Employer spins-off into another plan, the spun-off plan won’t be a Grandfathered because of its adoption date

Plan Mergers

- Merger of two single employer Grandfathered Plans
  - Resulting plan is a Grandfathered Plan
- Merger of single employer Grandfathered Plan into Grandfathered Plan with more than one employer (e.g. MEP)
  - Resulting plan is a Grandfathered Plan for that employer

Plan Mergers

- Plan X is not a Grandfathered Plan
  - Merges into Plan Y that is a Grandfathered Plan
  - Resulting plan is NOT Grandfathered, <u>unless</u>:
    - Merger is in connection with merger/acquisition under coverage transition rule of Code §410(b)(6)(C)
    - Grandfathered Plan Y is the surviving plan, AND
    - Merger occurs by end of coverage transition rule period (i.e., Last day of following plan year)

Example

- Company X established a 401(k) plan in 2019 (grandfathered plan)
- Company Y established a 401(k) plan in 2023 (not a grandfathered plan)
- On June 15, 2024, X acquires Y (become part of controlled group)
  - Coverage transition rule triggered
  - As part of the transaction, X merges Y's plan into X's
  - The resulting plan is a grandfathered plan and is not subject to mandatory enrollment in 2025

Example

- Company X and Y are part of a controlled group since 2015
  - X established a 401(k) plan in 2016 (Y employees not included)
  - Y established a 401(k) plan in 2023 (X employees not included)
- XY decide to merge the plan on June 15, 2024 to save costs
  - The resulting plan is NOT a grandfathered plan and is subject to mandatory enrollment in 2025

MEP/PEP Mergers

- Note: the determination is based on the participating employer and not the MEP/PEP original effective date
  - **Example:** Company X's 401(k) plan was originally effective 1/1/2020
  - The plan merges into a MEP
  - The plan will be Grandfathered within the MEP
  - **Example**: Company Y's 401(k) plan was originally effective 1/1/2024
  - Even though the participating employers in the MEP are Grandfathered, Y's 401(k) plan won't be Grandfathered as a participating employer

403(b) and Starter Plans

403(b) Plans

- 403(b) plans are subject to all the same rules discussed with respect to 401(k) plans
  - Except, it doesn’t matter when the elective deferral feature was added
  - If the 403(b) plan was signed before 12/29/2022, it is a Grandfathered Plan, even if deferral feature is added later

Starter 401(k) Plans

- Starter 401(k) Plans (new in 2024) will be subject to the mandatory auto enrollment rules
  - Unless the plan sponsor qualifies for an exemption due to size or recent establishment of the employer

Eligible Automatic Contribution Arrangement

Eligible Automatic Contribution Arrangement (EACA)

- An EACA is a 401(k) arrangement which:
  - specifies that in the absence of the participant's affirmative election, a **default election** applies under which the plan treats a participant as having elected to have the employer make default deferrals on the participants behalf, which default election will cease to apply for periods for which the participant makes an affirmative election not to defer or to defer a different amount;
  - satisfies the **uniformity requirement**; and
  - satisfies the **notice requirement**

Uniformity Requirement

- An EACA must provide that the default elective contribution is a uniform percentage of compensation
- **Exceptions to uniformity.** The automatic deferral percentage does not fail to satisfy the uniformity requirement because:
  - the automatic deferral percentage varies based on the number of years (or portions of years) the employee has participated in the arrangement operated as a EACA;
  - the plan does not reduce the deferral percentage in effect immediately before the arrangement became a EACA (i.e., the plan may leave in effect an employee's deferral percentage in effect immediately before the effective date of the EACA which is higher than the automatic deferral percentage);
  - the plan limits the elective contribution percentage so as not to exceed the compensation limit, the 402(g) limit, or the 415 limit

Notice Requirement

- The plan satisfies the notice requirement only if it provides the EACA notice to each employee covered by the EACA
  - The notice must be in writing, but may be communicated electronically
  - The EACA notice must include and explain the following:
    - Automatic deferral percentage
    - Right to make alternative election
    - Investment options
    - Permissible withdrawal right

Notice requirement/timing

- The plan satisfies the notice timing requirement if it provides the EACA notice to each covered employee a reasonable time before the beginning of each plan year a reasonable time before the employee becomes a covered employee
- Identical to the safe harbor notice requirement, an EACA satisfies the “reasonable” notice requirement if it provides the notice to the covered employees at least 30 days and not more than 90 days before the beginning of each plan year

Permissible 90-day withdrawal

- An EACA may permit an employee to withdraw the employee's automatic deferrals, if the employee makes the election not later than 90 days after the date of the employee's first automatic deferrals
- The election applies to all of the employee's automatic deferrals made before the effective date of the election (and attributable earnings)
- For purposes of determining the latest election date, the date of the first default deferral is the date the employee otherwise would have included the compensation in gross income

Extended 6-month grace corrective distribution period

- For an EACA that distributes excess contributions or excess aggregate contributions (with attributable income), the 10% excise under does not apply to the employer if the plan distributes the excess amounts within 6 months, rather than within 2½ months under the rule that normally applies
- However, the 6-month correction period is available only if all HCEs and NHCEs eligible to defer are covered under the EACA for the entire plan year (or the portion of the plan year that the employees are eligible employees)

Automatic Increase of Default Deferral

- To avoid the auto increase requirement, can the plan start the default deferral at 10%?
  - Apparently, the answer is YES
  - Avoids the administrative hassle (as well as potential mistakes) of increasing the default deferral each year
  - May have unintended consequence of increasing the contribution cost

Correction of Automatic Enrollment Failures

Safe Harbor Correction for a 401(k) plan with an Automatic Contribution Feature

- EPCRS provides a safe harbor correction method for a 401(k) plan that includes an automatic contribution arrangement
- Under the safe harbor, the employer does **not** have to make a corrective contribution for an elective deferral failure (failure to implement and improper exclusion) in a 401(k) plan with an automatic contribution arrangement provided the following conditions are satisfied:

1. **Correct elective deferrals** begin by the first payroll date on or after the earlier of:
   a) 9½ months after the end of the plan year in which the failure first occurred; or
   b) The last day of the month after the month the affected employee first notified the employer of the failure.
2. The employer provides a **notice** of the failure to the affected participants not later than 45 days after the date on which the correct deferrals begin. And
3. If the eligible employee would have been entitled to additional **matching contributions** on the missed deferrals, the employer makes a corrective allocation equal to the matching contributions that would have been allocated on the missed deferrals. These contributions must be made within the two year timeframe for correcting significant operational failures.

Safe Harbor Correction – Automatic Enrollment

- EPCRS (Rev. Proc. 2021-30, Appendix A)
  - Special correction for automatic enrollment/escalation is now incorporated into Code §414(cc)
    - Includes affirmative elections made by participant in lieu of automatic enrollment
  - Same basic correction principles apply
  - Correction window is the earlier of:
    - 9½ months following the end of the plan year in which the failure occurred; OR
    - The last day of the month following the date on which the participant brings the failure to the plan sponsor's attention (This would include the employer identifying the failure and bringing to the participant's attention)
  - Correction:
    - 0% QNEC
    - However, the employer must make corrective contribution for the missed match + earnings

Correction Method

- Corrective QNEC contribution:
  - 0% if corrected timely and a 45-day notice is provided to the affected participants
    - Now, 0% QNEC applies even for terminated employees (401k fix-it guide stated this correction didn't apply to terminated employees)
      - Language in 45 day notice would need to be modified to remove reference to correcting future deferrals
    - Corrective matching contributions (plus earnings) must still be funded for all affected participants
      - Deadline to fund corrective contribution is reasonable time after correct deferrals begin
      - 6 months is reasonable

Correction Method – Non Safe Harbor

- What if the employer fails to comply with the automatic enrollment safe harbor correction method?
  - Fails to effect correct deferrals w/i correction window
  - Fails to provide 45 day notice timely
  - Fails to make corrective contribution for the missed matching contributions
- Consequence: employer is subject to non-safe harbor correction method
  - 50% QNEC for missed deferrals (plus earnings)
  - Corrective contribution for matching contributions (plus earnings)

Correction Method

- Pre-SECURE 2.0
  - The plan could use the safe harbor correction method except the employer may not use the correction method for terminated employees
    - Plan needed to use the 50% QNEC
    - See 401k fix-it guide
- SECURE 2.0 §350
  - Extended the safe harbor correction method
  - Terminated employees are now subject to the safe harbor correction method

Matching Contributions

- When correcting an automatic enrollment failure, the employer must make a contribution equal to the missed matching contribution
  - Coded 414(cc) requires that the employer must generally deposit the missed matching contributions within 6 months after the date after the correct automatic enrollment begins for the affected participants
  - **Grace period.** If the automatic enrollment failure occurred before 2024, the employer has until the end of the third plan year following the year in which the failure occurred to deposit the missed matching contributions

Example

- Company X maintains a QACA with the matching contribution formula (100% on the 1% of deferrals and 50% match on deferrals between 1% and 6%)
  - Ann becomes eligible for the plan on January 1, 2024
    - Ann makes neither an affirmative election nor a contrary election
    - Ann's compensation is $5,000/month
  - X fails to implement the 3% automatic elective deferral for Ann until January 1, 2025
  - X will <u>not</u> need to make a corrective contribution for the 2024 missed deferrals
  - However, X will need to make a corrective contribution of $1,200 for the matching contributions on the missed deferrals (2% [100% x 1% + 50% on the next 2% of deferrals] x $60,000)
  - X also will need to provide Ann with a notice within 45 days of January 1, 2025 (the date correct deferrals commence)

Example

- Assume the same facts as in the previous example except:
  - Ann becomes eligible for the plan on January 1, 2024
    - Ann makes an affirmative deferral election of 5%
    - Ann's compensation is $5,000/month
  - X fails to implement the 5% deferral election for Ann until January 1, 2025
  - X will <u>not</u> need to make a corrective contribution for the 2024 missed deferrals
  - However, X will need to make a corrective contribution of $1,800 for the matching contributions on the missed deferrals (3% [100% x 1% + 50% on the next 4% of deferrals] x $60,000)
  - X also will need to provide Ann with a notice within 45 days of January 1, 2025 (the date correct deferrals commence)

New rules may apply to earlier failures

- New rules apply to failures for which the correction window ends after December 31, 2023
  - Example:
    - Calendar year QACA plan
    - 3 employees became eligible on January 1, 2023 and did not make a deferral election
      - Plan failed to automatically enroll (3%) the new participants
    - Correction window ends October 15, 2024
      - New rules apply, even though failure was pre-2024
    - Employer identified the failure on January 20, 2024
      - 2 participants: employer automatically enrolled at 4% (included 1% escalation) on February 15, 2024
        - Employer made 0% QNEC contribution for elective deferral failure
        - Employer made corrective contribution for the match (subject to 2 year vesting schedule)
      - 1 participant terminated on January 10, 2024
        - Employer made 0% QNEC contribution for elective deferral failure (even though terminated)
        - Employer made corrective contribution for the match (subject to 2 year vesting schedule)

Example

- Assume the automatic enrollment failure occurred in and was identified in 2023
  - The new corrected method is not available for terminated employees
  - The grace period applies for depositing the match
    - 12/31/26

Calculation of Earnings for 401(k) plans with Automatic Contribution Features

- For 401(k) plans with automatic contribution features that correct elective deferral failures using the safe harbor method of correction
- The employer may calculate the earnings on the corrective contributions by using the plan's <u>default investment alternative</u> if the participant has not made an investment election under the plan
  - However, if the default investment alternative has a loss, the employer may not reduce the required corrective contribution

Notice Requirement for Corrections of 401(k) Plans With Automatic Contribution Arrangements

- To satisfy the notice requirement under the safe harbor for 401(k) plans with automatic contribution arrangements, the notice must include the following information:

1. General information regarding the failure, such as the percentage of eligible compensation that should have been deferred and the approximate date that the compensation should have begun to be deferred.

2. A statement that the appropriate amounts have begun to be deducted from compensation and contributed to the plan.

3. A statement that corrective allocations relating to missed matching contributions have been made (or will be made). Information relating to the date and the amount of corrective allocations need not be provided.

4. An explanation that the affected participant may increase his/her deferrals in order to make up for the missed deferral opportunity, subject to the 402(g) limits.

5. The name of the plan and plan contact information.

Qualified Automatic Contribution Arrangements (QACA)

2025: Safe Harbor 401(k) Plans

- 2025
  - For employers (unless the employer qualifies under an exception) who want to establish a new **safe harbor 401(k) plan**, they should consider a **QACA** because the plan will be subject to the mandatory automatic enrollment requirement
- Grandfathered 401(k) plans (pre 12/29/22) may be converted into a safe harbor 401(k) plan and <u>not</u> be subject to the mandatory automatic enrollment requirement

QACA requirements

- 401(k) (or 403(b))
- Uniform default deferral – minimum %
- Minimum employer contributions
  - Can be subject to 2 year vesting schedule
  - Use standard vesting YOS definitions/rules
- Otherwise very similar to classic safe harbor 401(k)

Automatic deferral

- Automatic deferral not > 15%
- Minimums at right
  - Easiest schedule: 6% from start
- If participant does nothing, gets auto deferral
- Participant can choose:
  - Auto deferral
  - Some other deferral percentage
  - No deferral at all

Min%	P's plan years in QACA
3%	Year of 1st auto deferral and 2nd year
4%	3rd year
5%	4th year
6%	After 4th year

QACA uniformity requirement

- QACA default deferrals must be uniform except:
  - Percentage can differ based on years of participation in QACA
  - Deferrals in effect prior to QACA not reduced
  - Deferrals limited under 401(a)(17), 402(g), 415
  - Defaults don't apply to participants who have made affirmative election:
    - To defer different amount
    - To defer 0
- Same as EACA rules

3 choices for QACA employer contributions

1. 3% nonelective contribution

- Same as classic SH
- Can be greater

2. Basic QACA match	
% of comp	Match rate
Up to 1%	100%
1% to 6%	50%

3. Enhanced QACA match

- At least as good as basic QACA at all levels of deferrals
- Rate of match doesn’t climb
- No HCE has rate of match > any NHCE

QACA employer contribution requirements

- Must be subject to 401(k) withdrawal restrictions
- Must be fully vested after 2 YOS
  - Can employer switch from classic safe harbor to QACA and impose 2 year cliff vesting on existing participants?

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ACP safe harbor available

- Matching contribution not subject to ACP test if:
  - Comply with QACA safe harbor
    - Nonelective or match
  - All matching contributions:
    - Not consider deferrals over 6% of compensation
    - Rate of match doesn't climb
    - No HCE has rate of match at any level of deferrals greater than any NHCE at that level
      - Therefore no allocation conditions on any match
    - Discretionary match $ limited to 4% of compensation

Top heavy exemption available

- Plan must consist solely of:
  - Deferrals that aren't ADP-tested because of QACA
  - ER nonelective or match that satisfies QACA safe harbor
  - Matching contributions which are under ACP safe harbor
- Forfeitures must be used as SH contributions or to pay expenses

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Classic safe harbor rules carry over

- Can’t convert from ADP-tested 401(k) to QACA match midyear
  - You can convert to a QACA nonelective plan mid-year
- Can start new 401(k)/QACA with at least 3 months left on the year
- Can terminate plan or exit match midyear
- Don’t have to true up periodic match if employer contributes match at by end of next plan year quarter
- Otherwise excludable employee rule available
  - No ER contributions for EE’s with less than 1 YOS/ age 21
  - Do not have to contribute TH minimum to lower group EEs, but lose TH exemption

QACA/EACA combination

- Can add EACA to QACA to provide 90-day withdrawal
  - 6 months for ADP correction doesn't matter
- Things to do:
  1. Start with valid QACA
  2. Default investments under QDIA rules
  3. Plan spells out withdrawal procedures
  4. Notice includes QDIA/EACA withdrawals

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Differences: QACA vs SH Match

Assume participant comp $40,000						
Deferral		3% QNEC	QACA match		Basic SH match	
%	$	$	%	$	%	$
1.0%	$400	$1,200	1.0%	$400	1.0%	$400
2.0%	$800	$1,200	1.5%	$600	2.0%	$800
3.0%	$1,200	$1,200	2.0%	$800	3.0%	$1,200
4.0%	$1,600	$1,200	2.5%	$1,000	3.5%	$1,400
5.0%	$2,000	$1,200	3.0%	$1,200	4.0%	$1,600
6.0%	$2,400	$1,200	3.5%	$1,400	4.0%	$1,600

Questions

1. Seems to be some confusion on if a delay on 1st increase is allowed like it currently is under EACA so that those being auto enrolled late in year are not increased soon after on next 1/1. Just says 1st day of plan year after each completed year of participation - is requirement for increase after full year of participation or for any part of year counts and then increase next 1/1 even if only been days/weeks.

2. If an established 401(k) Plan (grandfathered) that has never had auto enroll, can they amend and add ACA with any percent they choose, no increases, no withdrawals within 90 days?

3. Some industry leaders seem to think new mandotory auto enroll has to be a sweep and pick up all eligibles on 1/1/25. However, SECURE just says must be an EACA and an EACA can apply only to new hires so do not see where it says has to be a sweep. Can it just apply to new hires 1/1/25 and following?

Questions

4. For a new QACA, can the match schedule be set at 100% of the first 4% of deferrals?
5. Does establishing a QACA eliminate the need to add the permissive withdrawal provision as set forth in SECURE 2.0? Or do we have to design as a QACA that is subject to the EACA requirements?
6. Can a plan sponsor choose not to have automatic increase/escalation under a QACA?
7. Can the new automatic enrollment feature be applied only to new participants as of 1/1/2025 and later, or do we have to automatically enroll all existing participants?

THANK YOU