



Automatic 401(k) Plans

What Your Employees Need to Know

If you are getting ready to set up an automatic 401(k) plan, you have the Pension Protection Act of 2006 (PPA), the final regulations published by the Internal Revenue Service on February 24, 2009, and our resources to guide you. This specific resource covers the notification rules that the PPA established and the final regulations clarified for automatic 401(k) plans.

Employers Take Note

Employers must give each eligible employee written notice of their rights and obligations under the automatic 401(k) arrangement and explain their right to opt-out of the plan or change the default contribution amount.¹³ The notice has to identify how the default contributions will be invested if the employee doesn't make an explicit choice. For a Qualified Automatic Contribution Arrangement (QACA) designs, the notice must also include information about the type of employer contribution non-elective or matching, and related vesting. For Eligible Automatic Contribution Arrangement (EACA) designs, the notice must describe the conditions for allowing the penalty free withdrawal within the first 90 days after the default contribution was withheld from the employee's paycheck.

Employers generally need to provide initial notice to an employee at least 30 days before the employee first becomes eligible or at least 30 days before the first investment in a qualified default investment. Notice must also be given annually thereafter within a reasonable period of time of at least 30 days (and no more than 90 days) before the beginning of the plan year. For employees that become eligible on dates that prevent meeting the above timeframes, an employer is required to provide the notice prior to the pay date the employee is otherwise eligible to elect a deferral contribution and sufficiently early enough for the employee to affirmatively elect a deferral amount or change the percentage of deferral prior to the default contribution.

Under the regulations, participants must be given sufficient time to act affirmatively. Therefore, plan sponsors have to notify participants within a reasonable period before contributions go into the default investment, and again before the start of each plan year.

¹³ Plan Sponsors can be liable for civil penalties for failure to provide the notice in a timely fashion. Refer to ERISA section 502(c)(4), 514(e)(3).



Automatic 401(k) plan sponsors have been afforded a measure of fiduciary relief related to their selection of default investments. Among the conditions the eligible employer must meet is a notice to employees related specifically to the default investment. It needs to explain or describe:

- The circumstances under which elective contributions will automatically be made, the percentage of pay and the participant's right to opt-out or choose to contribute at a different percentage;
- the participant's right to direct the investment of assets in his or her account;
- the circumstances under which a participant's contributions will be invested in the default investment;
- the investment itself, including investment objectives, risk and return characteristics and fees and expenses;
- how a participant can move investments out of the default investment, including any applicable restrictions, fees or expenses that apply in connection with such a transfer; and,
- where participants can get investment information about the plan's other investment options.

The notice must be a separate written communication—not simply part of or by reference to the plan's Summary Plan Description or Summary of Material Modifications. It also needs to be easy to read and understand. For a sample notice that the IRS has provided, see page 22.

Join the Trend

The popularity of automatic features in 401(k) plans continues to grow. The PPA and final regulations gives plan sponsors plenty of reasons to move forward. The Department of Labor projects that automatic 401(k) plans may cover 50 to 65 percent of the 401(k)-eligible population in the future.¹⁴ These employees will be put on a better path to a financially secure retirement. Will your employees be among them?

¹⁴ See page 60470 in *Federal Register* Volume 72, No. 205. October 24, 2007.