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June 2009
National Edition
Volume 3 Issue 3

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Ask Kidder.

Why is there growing interest in Automatic Enrollment Plans? What does Congress and the IRS have to say?

Growing numbers of plan sponsors are amending their 401(k) plans to automatically enroll participants without requiring employee consent. Instead of sign-ups or enrollments, the sponsor simply provides notice to employees, explaining the dollar amount or percent of pay to be withheld as a salary deferral. By doing nothing (making no other election), employees agree to have salary deferrals withheld from their paychecks. Although they can choose a different amount (including zero), studies reveal that automatic enrollment significantly increases the percentage of employees contributing salary deferrals.

This type of default deferral enrollment (a.k.a. negative election) has been around for many years, but was not widely utilized, due to a lack of regulatory guidance and conflicts with state laws. The Pension Protection Act of 2006 eliminated the conflicts and encouraged sponsors of salary deferral plans to adopt automatic enrollment provisions, including additional fiduciary protections under Section 404(c).

In February, the IRS issued final regulations for automatic enrollment plans, giving sponsors of 401(k), 403(b), and governmental 457(b) plans the guidance required to make informed decisions regarding automatic enrollment. Most automatic enrollment plans will fit into one of two variations: EACA or QACA.

EACA, or Eligible Automatic Contribution Arrangement, provides automatic enrollment of salary deferrals at a uniform percentage of compensation. This requires an advance notice before the first deferral starts and an annual notice thereafter. A plan with EACA provisions is granted six months after the end of the plan year (instead of just 2½ months) to refund excess contributions to correct a failed ADP or ACP test and avoid the 10% excise tax.

QACA, or Qualified Automatic Contribution Arrangement, is a new safe harbor plan that avoids ADP/ACP testing. It permits a two-year vesting schedule for safe harbor contributions instead of immediate vesting. Advance notice is required before the first deferral starts and annually thereafter. Under QACA provisions, the starting automatic enrollment deferral percent must be at least 3% of compensation (but never more than 10%). This minimum stays at 3% until the end of the next plan year, then increases by 1% each year thereafter until reaching 6%. For simplicity, most employers adopting a QACA safe harbor plan have set their initial deferral default rate at 6% to avoid tracking these increases.

Will Automatic Enrollment be required for retirement plans?

While Congress may require automatic enrollment at some time in the future, no current action is anticipated. However, a recent White House proposal seeks to require automatic enrollment for businesses that have no existing retirement plan.

According to President Obama's proposal, which was released in May as part of his fiscal year 2010 budget, employers doing business for at least two years with ten or more employees would be required to offer a payroll-deduction automatic IRA option with a default salary deferral rate equal to 3% of compensation, beginning in January, 2012. This requirement would not apply to employers sponsoring qualified retirement plans that do not exclude a class or group of employees.

The budget also appeared to propose that all employer-sponsored 401(k), 403(b), and 457(b) plans be required to automatically enroll employees. As recently as May 7, the White House insisted that the budget proposal would include this automatic enrollment requirement. However, on May 11, the Office of Management and Budget released their details, with no automatic enrollment requirement for these retirement plans. We have no explanation, but don't be surprised if this issue reappears in one or more bills introduced in Congress.

While no one can predict what the end result will be, it is clear that changes are coming in the retirement industry. You can rely on Kidder to be prepared and to keep you up-to-date.

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What does it mean to wear the fiduciary hat? What is the role of the Fiduciary and Investment Committee?

Most owners of small and medium sized businesses (and many Executive Directors and Board members of not-for-profit organizations) are not fully aware of the scope of their responsibilities to any qualified plan they sponsor. They hear the words ERISA, fiduciary, trustee, and plan sponsor thrown about, but usually rely on others to guide them through the maze of legal and administrative requirements. But their reliance on outside advice does not relieve them of their responsibilities to the plan – even when the advice is incomplete or misunderstood. This is particularly true on the Investment Committee, which has been expanded in many organizations to be called the Fiduciary and Investment Committee.

The purpose of the Fiduciary and Investment Committee is to oversee the total plan operation. Its responsibilities may be spread over separate subcommittees or groups.

In very small firms, there is often no official committee. Instead the owner of the company and, perhaps, a key person or two are authorized to work with the investment professional, a TPA (like Kidder) and the investment platform provider.

In larger organizations, the committee(s) may be more formal. Designated committee members may include the CEO/President, the head of Human Resources, the CFO and other Department heads. There may even be representation from the Board of Directors.

Whether informal or formal, the responsibilities are the same.

- To monitor the operation of the plan and make specific decisions for the plan.
- To conduct regular and consistent due diligence to determine if the plan is meeting its objectives.
- To review investment results and make changes when needed and based on the investment policy.
- To review plan design and documents and make changes when necessary and required.
- To review vendors and fees and make changes if needed.
- To utilize outside experts to assist in fulfilling their responsibilities.

Some plan sponsors believe that the vendors that they select assume all responsibility for the plan. While it is true that an outside party may serve as *trustee* or *investment fiduciary*, or give a *fiduciary warranty*, the scope of its responsibilities is generally very limited. **The plan sponsor, owners and key individuals involved with the plan never give up all fiduciary responsibility.** Responsibility may be shared to a certain degree, but since the plan sponsor can select and change vendors, and make many discretionary decisions for the plan, they are still fully on the hook. Understanding where the buck starts and stops is critical when you put on any fiduciary hat.

Satisfying fiduciary responsibilities revolves around due diligence. A sound due diligence process is not about having the best investments or the lowest costs. It is about having prudent processes and procedures for making plan decisions, consistently applying them, and documenting the process and results. It is about making well considered and informed decisions for your specific plan and for the benefit and interest of the participants. It is not about being an expert in every area, but about having the foresight and knowledge to use experts when needed. Decisions relating to plan documents and design; plan administration, operation and compliance; internal organization processes; investment selection and review; participant education; and overall fiduciary governance are key areas where both formal and informal committees must provide satisfactory results.

A final thought: as mentioned above, reliance on outside experts is often a key to understanding and fulfilling fiduciary responsibilities. Understanding who is truly an outside expert is just as important.