Can Automatically Enrolled Participants Who Forgot to Opt Out Withdraw Their Deferrals?

Facts

We are thinking of adding automatic enrollment to our 401(k) plan. One of our concerns, however, is that we might end up with a bunch of tiny account balances for participants who forget to opt out until they see their first paycheck with automatic deferrals taken out.

Question

We understand that this money is meant to be retirement savings and that there are restrictions on participants taking withdrawals. Is there anything we do to prevent these small balances from accumulating in our plan?

Answer

The Eligible Automatic Contribution Arrangement (EACA) might be just the ticket, notwithstanding yet another goofy acronym. Why do we say that? Because the EACA is the only type of automatic enrollment provision that can allow participants who forget to opt out to withdraw those automatic deferrals if they catch it quickly. Let's take a look at the so-called permissible withdrawal feature as well as several other provisions that are unique to EACAs.

Permissible Withdrawals

If you implement an EACA, you are allowed, but not required, to offer permissible withdrawals. If a participant does not timely opt-out of the automatic enrollment prior to the date the first deferrals are automatically withheld, he or she has up to 90 days to request a distribution of those automatically withheld amounts (adjusted for applicable gains or losses). It's that simple, but there are a few caveats to keep in mind:

- All or nothing A participant cannot take a partial permissible withdrawal. He or she must take all automatic deferrals or none.
- Fees A plan can charge its normal distribution fee to process a permissible withdrawal.
- *Automatic deferrals only*. Participants are only allowed to take permissible withdrawals of amounts that were automatically withheld. Any deferrals made pursuant to a participant election cannot with be withdrawn under this provision.
- No penalty x 2 Permissible withdrawals are not subject to the 10% early withdrawal penalty. In addition, participants cannot be otherwise penalized for utilizing this feature. That means it would not be allowed to make a participant sit out of the plan for some period of time before re-enrolling following a permissible withdrawal.
- No match If the participant received a matching contribution based on the automatic deferrals that are subsequently withdrawn, the match is forfeited and not paid out to the participant.

Extended ADP Testing Deadline

When a 401(k) plan fails its ADP test and corrects by making refunds to highly compensated employees, those refunds must be made within 2 ½ months after the close of the year (March 15th for calendar year plans) in order to avoid a 10% excise tax. EACAs that satisfy the uniformity requirement (see below) get an extension of that deadline to June 30th (six months following the close of the year). We haven't heard from any clients who have implemented an EACA just for this reason, but it can be a nice added bonus, especially if your plan regularly fails the test and you have difficulty correcting by March 15th.

Uniformity Requirement

As a general rule, an EACA requires that all participants who have not made an affirmative election to be treated the same. That means they are all automatically enrolled at the same default rate. This includes all existing participants as well as those who become eligible going forward.

This can present a bit of a challenge at initial implementation. The reason is that many companies with non-auto enrollment plans do not require participants to sign a deferral election form if they don't want to contribute. Rather, those participants simply don't sign up.

With an EACA, however, it is critical to know the difference. If a participant formally elected not to defer, that is an affirmative election, which means that participant would not be automatically enrolled when the EACA is rolled out. But any participants who simply didn't sign up would need to be automatically enrolled. It's not a deal-breaker, just something to be aware of if you do not have records to make this determination.

Any EACA that does not satisfy the uniformity requirement does not get to take advantage of the extended testing deadline. If that feature is not important to you, then you are home free.

Same Old, Same Old

Apart from the above characteristics, EACAs generally work the same as any other variation on automatic enrollment.

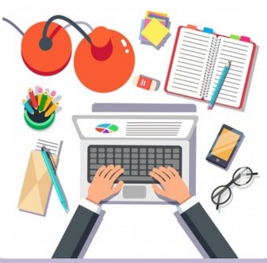
- **Default Deferral Rate** The plan document must specify the default deferral rate, which should generally be high enough to establish meaningful savings, but not so high that it scares folks away from participating in the Plan.
- **Automatic Escalation** In addition to automatically enrolling, the plan can (but is not required to) include a provision to automatically increase deferral rates at set intervals.
- **Notice** You must provide a notice to participants 30-90 days before they are initially subject to the automatic enrollment feature, and before the start of each year thereafter. The notice describes the basics of what automatic enrollment is, communicates the default deferral rate and instructs participants how to change their elections or opt out.

- Plan Amendment A formal plan amendment is required to add an EACA feature. The amendment must generally be adopted before the start of the year, but there are some exceptions that would allow for mid-year implementation.

We know this is a long answer to a short question, but we wouldn't want to point you to an EACA without some additional details. When it comes to automatic enrollment, understanding your motivations for considering it are key to landing on the version that is better suited to your situation. Give us a call, and we are glad to help you walk through the pros and cons of each.

Related Resources

- DWC Knowledge Center: Retirement Plan Design Resources



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