

Increasing Automatic Enrollment Contributions

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Since 1998, the IRS has recognized automatic enrollment as a method of increasing participation in 401(k) plans. Employers responded by providing the required communications to existing and newly-hired employees and implementing a typical automatic salary deferral contribution of 3%. In 2000, the IRS extended guidance to 403(b) plans that inspired tax-exempt employers to implement salary deferral contributions of 4%.

Now the IRS has formally recognized that more is better. In a General Information Letter, the IRS provided that a plan's automatic enrollment may now

- be for *any percentage of compensation* otherwise permitted under the plan;
- contain an automatic schedule under which the percentage *changes over time*; and
- automatically apply to compensation increases such as *pay raises and bonuses*.

In each case, the plan must clearly set forth the rules, and in notices to employees, employers must clearly explain how the rules operate and how an employee can opt out of the automatic contributions. Employers must still be aware of any state wage payment laws that require employee consent to deductions from wages.

Once the automatic deferrals are in the plan, the amounts must be invested. Typically, plan fiduciaries provide a "default" investment fund, such as a money market or fixed income investment fund. In this arena, the IRS defers to the Department of Labor's position. Note that the DOL takes the view that even in an ERISA Section 404(c) plan, which typically puts the investment burden on the participant, the automatic or default investment of any amounts will not be considered to have been made under the control of a participant or beneficiary. In other words, the plan fiduciary remains responsible for the investment of automatic deferral contributions under ERISA's fiduciary standards. The selection of the default investment fund must be treated as an ERISA investment management decision that is duly investigated and considered. This consideration should consider not only the preservation of the funds in the default investment fund, but also whether the fund is a reasonable choice in light of its return relative to other investments.

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