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Getting Auto-Enrollment Implementation Right

Implementing automatic enrollment without thinking through plan design can result in compliance and administrative issues.

"When a retirement plan sponsor tells me they want to implement automatic enrollment, I always ask them why," says Scott M. Dufek, a partner with Dufek & Co. Certified Public Accountants in Chicago, which provides auditing services for retirement plans.

Dufek notes that he often gets blank looks when he asks that question, or the plan sponsor attended an event and heard that it was a good thing to do. "Some plan sponsors jump into it without thinking it through, and they often do not meet their goals or create administrative headaches," he says.

"Each plan sponsor has independent reasons to auto-enroll or not," adds Dennis Sain, senior vice president of Retirement Services at The Newport Group, who is based in Chicago. He gives the example of a client with only 60% participation in its 401(k) plan, for which Newport has suggested automatic enrollment. The client offers a very rich plan, with 100% match of employee deferrals up to 6%, as well as a profit sharing contribution that all eligible employees receive. The company balked at the additional cost auto-enrolling employees would create. It didn't have problems with nondiscrimination testing and felt the richness of its plan was accomplishing the goal of attracting physicians to its group, so it decided against auto-enrollment.

However, a plan sponsor more concerned about the relatively low participation rate, or that was having problems with nondiscrimination testing may have decided to implement automatic enrollment. Dufek says if a client is concerned about increasing its costs by auto-enrolling employees, he sometimes suggests the company amend its match formula at the same time. For example, a company matching 50% of up to 6% of employee deferrals may decide to instead match 25% of up to 12% of deferrals. This could also accomplish the goal of encouraging employees to save more.

When plan sponsors have a goal of increasing participation or helping more employees save for retirement, they may consider implementing auto-enrollment for all employees, including existing employees, and not just new hires. The plan sponsor's goal can determine how conservative or aggressive they are going to be with automatic enrollment, says Sain. An example of a conservative approach, according to Sain, is a client that implemented automatic enrollment to all participants at only a 2% default deferral, without also implementing automatic deferral increases. An aggressive approach was implemented by another client that automatically enrolled all participants at a 6% default deferral and also implemented a 2% per year automatic deferral increase up to 10%.

According to Dufek, a lot of times, companies do have nondiscrimination testing issues and want to implement automatic enrollment so highly compensated employees can defer what they want and not have deferrals returned due to failed nondiscrimination tests. However, if a plan sponsor sets the auto-enrollment deferral rate too low, the average deferral rate may still be too low to help highly compensated employees contribute more. Dufek says companies wanting to solve this issue should auto-enroll at higher deferral rates.

Immediate eligibility for defined contribution retirement plans is increasingly being used as plan sponsors try to improve employees' retirement outcomes. However, this can be an issue if implementing automatic enrollment. "If there is no service requirement, plan sponsors can end up missing someone, or more likely, auto-enrollment is inconsistent; some employees may be enrolled with their first paycheck, some with the second, some with the third," notes Dufek.

He recommends plan sponsors change to a service requirement of 60 days and provide for an entry date as of the first of the month coinciding with or following the service requirement. "This gives time for paperwork to be processed and for participants to opt out. It also establishes only one payroll period per month for new enrollments, instead of each pay period," Dufek says. He adds that this mitigates compliance issues, and it can also solve the issue of having small plan balances for employees who opted out of auto-enrollment after payroll started deferrals, which can add more costs for plan sponsors.

According to Sain, a 30-day service requirement offers enough time for payroll and the plan provider to be notified of the enrollment. He notes that the plan can be amended to allow for a distribution of small plan balances caused by employees opting out of auto-enrollment. The Employee Retirement Income Security Act (ERISA) allows plan sponsors to provide participants with a period of up to 90 days to opt out of automatic enrollment and receive a permissible distribution of those balances with no tax consequences. Sain admits this will add an additional layer of communication and administration for plan sponsors, but it can be helpful in ensuring auto-enrollment goes smoothly.

Some plan sponsors adopt automatic deferral increases along with automatic enrollment, and some provide that the deferral increase is made on a participant's plan anniversary date, Dufek notes. "I can't think of an instance where this didn't cause problems," he says. He always recommends the increase be effective every January 1 or every January 1 and July 1. "To have to monitor this each payroll date is an administrative nightmare."

Dufek concludes: "As auditors we see a lot of failures due to automatic enrollment, either breaking the law or operational failures, so plan sponsors should put language in their plan document that is easy to follow and not burdensome to live with."

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