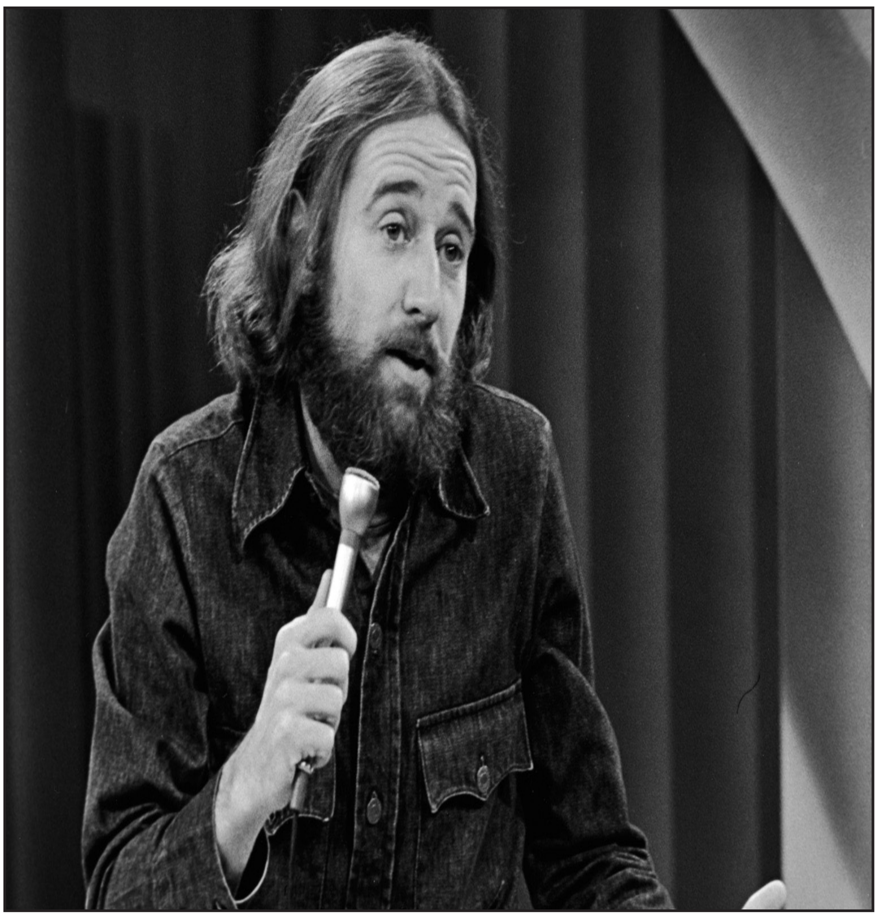
Why 401(k) Plan Providers Should Push Automatic Enrollment

By Ary Rosenbaum, Esq.

We have a retirement crisis in this country thanks to a Social Security program that has too many retirees to pay to, and the death of the pension plan in the private sector. The fact is that while 401(k) plans are an effective savings vehicle for retirement, they're only effective when employees actively participate by deferring their income. For many reasons, employees don't participate and this is problematic for the plan sponsor because it may impact compliance testing in a negative way and if their 401(k) plans don't achieve critical mass, then they won't get the better pricing reserved for larger plans. So automatic enrollment for a 401(k) plan that automatically enrolls employees who don't affirmatively opt-out of deferring is an effective tool to get employees to save as well as improving the compliance aspects of a 401(k) plan. As a plan provider, you need to take advantage of opportunities and I believe automatic enrollment is something you should advocate for.



The bumpy beginning for Automatic Enrollment

When I first heard about Automatic Enrollment in 1999, it was actually called Negative Election and I thought it was something out of the Soviet Union because it didn't seem fair or democratic. Negative Election came out of an Internal Revenue Service approval of a scheme by a fast food restaurant to enroll plan participants in a 401(k) plan and take out deferrals from their pay if they didn't submit a form declining active participation (thus the negative election). I didn't like it because I saw it as a cheap gimmick to pass the actual deferral percentage (ADP) test. Why I really hated it was because since negative election gave fiduciaries no relief in a participant directed 401(k) plan, plan sponsors just defaulted those negative election deferrals to a money market or a stable value fund. By parking the money there, it did little for participants because money market and stable value don't do well for long term retirement savings. The intent of negative election was clear; it was just a cheap gimmick to artificially boost the deferral rate of non-highly compensated employees to pass the ADP test. There was absolute zero interest in using negative election as a method to boost the retirement savings of employees especially when a participant was limited to about 3% of pay as a negative election deferral. Further guidance that allowed a deferral from a negative election up to the deferral limit of the plan did nothing to increase interest. With no help from the Internal Revenue Code or Department of Labor (DOL) on fiduciary relief, parking participant money in money market and stable value did very little in making this feature a popular one for 401(k) plans.

Pension Protection Act of 2006 (PPA) makes it official

My favorite comedian of all time, George Carlin, had a great act on euphemisms. Carlin said one day and for no reason, toilet paper became bathroom tissue and false teeth became dental appliances. Well one day, negative election became automatic enrollment. However, we know when negative election became automatic enrollment. That was through the Pension Protection Act of 2006. This allowed automatic enrollment to finally be codified into the Internal Revenue Code as well as allowing contributions made through an automatic enrollment to be deposited into something called a Qualified Default Investment Alternative (QDIA). A QDIA is a default investment that would allow these automatic enrollment deferrals to be deposited in and give some fiduciary relief to plan sponsors that wasn't available until

this law change. Surely, a QDIA is a far better investment than a money market or stable value fund. That's true and don't call me Shirley. When negative election became automatic enrollment, it was more of a euphemism. It also came from a different perspective. Negative election was more of a method to help with the ADP test and automatic enrollment was more of a method to get more participants to defer within a 401(k) plan. Automatic enrollment became more plan sponsor-friendly with the QDIA, automatic annual increases in the automatic enrollment deferral rate for the participant, as well as a Qualified Automatic Contribution Arrangement (QACA). A QACA is a safe harbor 401(k) matching provision that is tied with automatic enrollment that allows for a less generous matching contribution and a vesting schedule after 2 years (regular safe harbor matching contributions are always 100% vested). So automatic enrollment became a provision that was going to become popular because while it still offered the benefit of better deferral rates for non-highly compensated employees like it did when it was negative election, it also offered enough benefit to participants and plan sponsor fiduciary relief to become a wanted plan provision.

The proof is in the pudding

Like rap music, it was only going to be a matter of time before automatic enrollment would become accepted. According to T. Rowe Price, 61% of 401(k) plans now have automatic enrollment while only 35% had it in 2006, the year it became law. Of course in stating the obvious, T. Rowe Price also showed that 401(k) plans with an automatic enrollment feature have a 40% increase of participation by participants in salary deferrals over those plans that don't offer automatic enrollment. That's obvious since under automatic enrollment, plan participants are involuntarily deferring under the 401(k) plan where they can't under a plan that doesn't have that feature. So if a majority of 401(k) plans now have automatic enrollment, why would you have your 401(k) plan sponsors be in the minority of plans that don't have it?

It can help your business as a plan provider

I see automatic enrollment as a benefit for plan sponsors, but I also see it as something you can use to help grow your business. When the PPA was implemented, I worked as an ERISA attorney for a producing third party administrator (TPA). A producing TPA is a TPA with its own affiliated investment advisory services, so they provide administration services and investment advisory services. So when I heard about how automatic enrollment was such a great improvement over negative election, I sent an e-mail to my bosses about it. I suggested that we embrace automatic enrollment because it would help increase our assets under management. I also said that with good investment education through the enrollment meetings we conducted, we could probably transform those that deferred through automatic enrollment to actively defer with increased contribution amounts. 10 years later, I'm still waiting to hear back from my bosses. The only person who was part of the brain trust that responded was our top salesperson Rich Laurita. I didn't have a brother, but Rich came close and we fought a lot. Rich was against automatic enrollment because he thought that automatic enrollment was a headache for our plan sponsor clients because participants found out they were automatically enrolled. Provisions within the PPA allowed participants to get a refund of their contributions within a specified period of time and I contended that with the passive nature of people, most employees wouldn't notice if they were automatically enrolled. The bottom line is that if you make money on assets as a 401(k) plan provider, automatic enrollment is a no-brainer.

It's a feather in your cap

How do you measure yourself as a retirement plan provider? Hopefully, it's not by height. If you have your plan sponsor clients add automatic enrollment which increases plan assets, deferral participation rates, and the overall health of the plan, it's a feather in your cap as a plan provider. Automatic enrollment is a tool that you can use to show your prowess as a plan provider. Adding automatic enrollment to a 401(k) plan can yield metrics on participation and average account balance that can show positive feedback to show your clients. Automatic enrollment is a tool and if you can make it an effective tool for your plan sponsor clients, it's just another method you show your competence as a plan provider. If you are all about showing positive results to your plan sponsor clients, automatic enrollment can be an effective way to get that message across.

THE ROSENBAUM LAW FIRM P.C.

The Rosenbaum Law Firm P.C.
734 Franklin Avenue, Suite 302
Garden City, New York 11530
(516) 594-1557

http://www.therosenbaumlawfirm.com
Follow us on Twitter @rosenbaumlaw