Mandatory Automatic Enrollment Guidance

RETIREMENT MANAGEMENT SERVICES, LLC
Plan Consulting • Administration • Design

RETIREMENT MANAGEMENT SERVICES, LLC
905 Lily Creek Road Louisville, KY 40243

1/30/2025

Proposed Treasury Regulations sections 1.414(w)-1 and 1.414A-1 were issued on Thursday, January 9, 2025 ("MANDATORY AUTOMATIC ENROLLMENT Regs"). These proposed regulations answer many of the questions that we have had concerning mandatory automatic enrollment that took effect January 1, 2025. Until the final regulations are in force, we have to use a good faith interpretation of the proposed regulations.

As we expected, the plans that are not required to add mandatory automatic enrollment are governmental, church, SIMPLE, grandfathered, small employer and new employer plans. Grandfathered plans are 401(k)/403(b) plans that the documents were signed prior to December 29, 2022 even if they were effective January 1, 2023.

Small companies that "normally employ" fewer than 11 employees are exempt from mandatory automatic enrollment. One twist we did not expect was in order to determine the number of employees we have to use the COBRA definition for "normally employs".

To determine whether the company normally employs 11 people, the following rules apply:

- A full-time employee counts as one person.
- A part-time employee is a fractional person based on the number of hours typically worked divided by the number of hours for a full-time employee (which cannot exceed 8 hours per day or 40 hours per week).
- The number of employees is then determined on either a daily basis or a per-payroll period basis. The basis used must be applied to all employees for the entire fiscal year of the employer.
- The company "normally employs" 11 people if there are at least 11 people during 50% of the fiscal year.
- If the employer participates in a MEP or PEP, this determination is made on an employer-by-employer basis.

The good news is that only common law employees count which means self-employed individuals, independent contractors and corporate directors are not included in the count. Mandatory automatic enrollment must be instituted by the first plan year beginning at least 12 months after the close of the employer's fiscal year in which the sponsor exceeds 10 employees. Once a plan has mandatory automatic enrollment it stays in the plan even if they go under 11 employees in the future.

New businesses are exempt from mandatory automatic enrollment. A "new business" for this purpose is a business (including a predecessor employer) that, as of the beginning of the plan year, has been in existence for fewer than three years. Mandatory automatic enrollment has to be added the first of the 4th year of existence. We have found it to be easier to add mandatory automatic enrollment when the plan starts rather than monitoring the employee count each year. There is no definition that tells us how a predecessor employer is defined, but the language in Treas. Reg. 1.415(f)-1(c)(2) seems logical.

One of the biggest questions this guidance answered is exactly who needs to be automatically enrolled. We know now that "no provision in section 414A ... that excludes any category of employee from the automatic enrollment requirements ... if the plan is subject to section 414A." Which means that mandatory automatic enrollment must be applied to all employees who have met the eligibility requirements to make elective deferrals in the plan. This would include all long term/part time employees, seasonal employees, union employees, new employees, so basically everyone. We did not expect they would interpret the regulations to mean that any participant that has not made an affirmative election should be auto enrolled by the first plan year for which final regulations are effective even if they were a participant prior to the regulations went into effect. We are not expecting the regulations to be finalized until 2026 (at the earliest) which would mean that anyone that has not made an affirmative election will have to be auto enrolled in 2027 as though they had been subject to auto enrollment in 2025. This adds a new level of complexity to administering the timing of this new rule.

We can see this causing a lot of confusion on the part of the participants who will not understand why they are being auto enrolled at a bigger percentage than 3%. The regulations do however state, that participants who have made an affirmative election are not required to be automatically enrolled in the plan. We encourage all of our clients to get an affirmative election from all participants especially if the election is 0% to help elevate this administrative issue unless the plan sponsor wants to stipulate that everyone deferring less than 3% will be reenrolled at the higher percentage unless they make an annual affirmative election.
Rehired participants will be automatically enrolled upon rehire. The plan sponsor can either resume the percentage amount they would have been if they had not left or start them over at 3%. This also pertains to employees that move in and out of included class to excluded classes and back.

If a MEP or PEP was formed after December 29, 2022, and if a grandfathered Plan merged into the MEP or PEP, the grandfathered Plan retains its mandatory automatic enrollment exemption. If a grandfathered plan spins out of a grandfathered plan/MEP/PEP then the spin-off plan maintains the characteristics the MEP/PEP had. Also, in a M& A situation, if a non- grandfathered Plan merges into a grandfathered Plan in connection with a company transaction under Code section 410(b), and that merger occurs during the 410(b)(6)(c) transition period, the resulting plan is totally grandfathered, even with regard to the non-grandfathered acquired employees. The mandatory automatic enrollment Regulations also apply this rule to a merger of a plan into the MEP in connection with an acquisition by a participating employer of another company. This is great news!

The proposed regulations repeat the statutory requirement that plans subject to mandatory automatic enrollment allow permissible withdrawals under the EACA rules. This provides a brief period after automatic deferrals first apply to a participant in which the participant can withdraw those deferrals, plus earnings. The Regulation package also proposes to modify the regulations to Code section 414(w), dealing with EACAs. This change clarifies that no EACA notice is needed for unenrolled participants (if the plan provides the "annual reminder notice" discussed in Code §414(bb) and ERISA §111(c)), and that the EACA and PLESA notices may be combined with the QDIA and SH notices, so long as the combined notice:

- includes all required content of the individual notices,
- clearly identifies the issues addressed in the notice,
- furnished at a time that meets all notice timing requirements,
- written in a way to be understood by the average participant, and
- does not obscure or fail to highlight primary information.

One question that still remains is can a non-grandfathered plan not provide participant direction of investments? The mandatory auto enrollment regulations require the use of a Qualified Default Investment Alternative which is not used in a plan where the Trustee is directing the investment of assets.

Conclusion

Now that we have this guidance, it is important to make sure that affected plans are using a good faith interpretation. More to come!

Please contact your Account Executive at RMS if you are concerned that your plan doesn't comply. We will provide additional guidance as it becomes available.