



Employee Benefits Alert!

News Concerning Recent Employee Benefits Issues

September 1, 2006

DEFINED CONTRIBUTION PLAN ASPECTS OF THE PENSION PROTECTION ACT OF 2006 - AUTOMATIC PARTICIPANT ENROLLMENT

Automatic enrollment, also called “negative participant election”, is not a new idea for 401(k) and similar plans. Now, under the Pension Protection Act of 2006 (the “Act”), plan sponsors have assurances that such a plan feature will not run afoul of state wage withholding laws and will not heighten the responsibility of plan fiduciaries. Under a plan with an automatic enrollment feature, participants contribute, on a pre-tax basis, a specified percentage of their compensation to their employer’s 401(k) or 403(b) plan, unless they affirmatively “opt out” of the specified contribution level (either by electing to not participate or by electing a different contribution amount). However, if the participant fails to take any action, the specified contribution amount will be withheld from their paycheck and contributed to their account in the plan. Automatic enrollment has been used to encourage savings by participants and also to assist in the plans required non-discrimination testing of contributions.

The Act includes several provisions which facilitate and encourage plan sponsors to utilize automatic enrollment.

Preemption of State Wage Payment Laws

One of the legal issues hindering automatic enrollment was that certain state wage payment laws require an employee’s consent before amounts may be withheld from pay. Prior to passage of the Act, it was unclear whether such laws would prevent automatically enrolling a participant in a contributory plan without the participant’s affirmative consent. The Act provides that such wage payment laws are preempted by ERISA, provided: (i) participants are notified prior to each plan year that they have the right to change or not make a plan contribution and how the contribution will be invested in the absence of their

Principal Office: 1900 Market Street Philadelphia, PA 19103 (215) 665-2000 (800) 523-2900	Cherry Hill (856) 910-5000 (800) 989-0499	Houston (832) 214-3900 (800) 448-8502	New York Downtown (212) 509-9400 (800) 437-7040	San Diego (619) 234-1700 (800) 782-3366	Trenton (609) 989-8620
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investment election, and (ii) contributions are invested in a safe harbor default investment (in accordance with regulations to be issued by the Department of Labor).

Fiduciary Relief

Plan fiduciaries will be protected under ERISA Section 404(c) to the extent automatic contributions are invested in a safe harbor default investment option that complies with Department of Labor regulations (to be issued by the Department of Labor within 6 months of passage of the Act). In addition, to be eligible for the fiduciary protection, an annual notice must be provided to participants explaining their rights and the manner in which their automatic contributions will be invested if the employee fails to make an investment election.

Safe Harbor Automatic Enrollment Plan

Automatic enrollment can be used in a new safe harbor plan design starting in 2008. Prior to the Act, 401(k) plans that satisfied certain safe harbor provisions were automatically deemed to satisfy the non-discrimination tests for employee and matching employer contributions (the "ADP" and "ACP" tests respectively). The Act establishes an additional safe harbor provision that will allow an automatic enrollment plan to also satisfy these tests. Participants and those eligible to become participants must be provided with a notice prior to the beginning of the plan year advising them of their right not to contribute to the plan and to opt out of or change the automatic contribution. Additionally, the notice must describe how the contributions will be invested if the employee does not make an investment election.

In order for a plan to qualify for exemption from ADP testing under the new safe harbor, the plan must have a minimum automatic deferral contribution amount of 3% of pay increasing 1% per year until it reaches 6% in the fourth plan year and thereafter. Although the plan is permitted to set a higher automatic deferral rate, at no point can the plan require an automatic deferral contribution greater than 10%. Additionally, the plan must provide a minimum employer contribution for nonhighly compensated employees. This contribution may either be a matching contribution (equal to 100% of the first 1% deferred and 50% of the next 5% deferred) or a non-elective contribution equal to 3% of compensation. A higher matching contribution rate can be used provided it is at least equal to the minimum required matching contribution under the safe harbor. All required employer contributions must vest 100% after two years of service. To obtain relief from the ACP test the matching contribution cannot match deferrals in excess of 6% of the employee's pay.

Keep in mind... Plan sponsors who currently have a safe harbor plan may wish to consider converting in 2008 to an automatic enrollment safe harbor plan, as the new safe-harbor plan design has all the advantages and then some of the old safe harbor design, including a lower level of required employer



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contributions and no immediate 100% vesting requirement. Of course, plan sponsors who wish may keep their current safe harbor plan design.

This Alert is part of a series of Alerts on the Act, each focusing on a specific topic. If you have any questions regarding the implications of the Act on your benefit programs, please contact any member of the Cozen O'Connor Employee Benefits and Executive Compensation Department.

Jay A. Dorsch	215 665-4685	Jeffrey Pasek	215-665-2072
Dennis Cohen	215-665-4154	Kathleen Drapeau	212-908-1286
L. Stephen Bowers		215-665-7283	

**Principal Office: 1900 Market Street, Philadelphia, PA 19103
(800) 523-2900 or (215) 665-2000 • fax (215) 665-2013**