Automatic Enrollment Is Mandatory in 2025 – Now Is the Time to Prepare

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SECURE 2.0, as most people reading this article probably already know, was a sweeping piece of retirement plan legislation enacted on December 29, 2022. SECURE 2.0 implemented almost 100 different changes to the retirement plan landscape. However, this article is focused on one of the most impactful of such changes which is scheduled to first become effective in 2025. This change is the requirement that most plan sponsors adopt automatic enrollment provisions for their 401(k) and 403(b) plans.

For those plans that don't already have an automatic enrollment provision, this will require a significant adjustment to how those plans are operated and administered. Consequently, it is incumbent upon plan sponsors to understand what these changes require now so that they are prepared to satisfy these new requirements when they become mandatory in the near future.

Plans Subject to the Automatic Enrollment Requirement

With certain exceptions, SECURE 2.0 requires that 401(k) and 403(b) plans established on or after December 29, 2022 begin to automatically enroll participants upon becoming eligible for such plan by the first plan year beginning after December 31, 2024 ("Effective Date"). For a plan with a calendar year plan year, this means that automatic enrollment must be effective by January 1, 2025.

Plans established prior to December 29, 2022 are "grandfathered" meaning that they are not required to implement the SECURE 2.0 automatic enrollment provisions. The following categories of plans also are exempt from having to satisfy the automatic enrollment requirements:

1) Small businesses with 10 or fewer employees;
2) New businesses that have been in existence for less than three years;
3) Government and church plans; and
4) SIMPLE 401(k) Plans.

Automatic Enrollment Plan Design Requirements

SECURE 2.0 requires that, by the Effective Date, 401(k) and 403(b) plans must implement an automatic enrollment feature which also incorporates automatic escalation provisions. The initial automatic deferral must be at least three percent but no more than ten percent of compensation. Then an annual increase of at least one percent is required each year up to at least 10 percent of compensation. If desired by the sponsor, the automatic escalation is allowed to increase further up to 15 percent. However, of course, employees may always affirmatively elect a different deferral rate or opt out of participating in the plan entirely.

Defaulted participants must be invested in a "qualified default investment alternative" ("QDIA"). A QDIA is a specific type of "prudent" investment as defined by the U.S. Department of Labor. Further, automatically enrolled participants must be permitted to withdraw their automatic contributions during the 90 day period after the initial contribution occurs. This is intended to grant a

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grace period to any participant who initially failed to realize that they had been automatically enrolled so that, for a brief period of time, they have the ability to reclaim their prior deferrals.

These automatic enrollment provisions also trigger the obligation to provide annual notices to eligible employees advising them about the existence of the automatic enrollment feature and how it operates. Administratively, this notice obligation is very similar to the annual 401(k) "safe harbor contribution" notice which includes the timing of delivery. Consequently, most plans subject to the automatic enrollment requirements will need to supply their employees with an automatic enrollment notice by at least 30 days before the 2025 plan year begins which is December 2, 2024 for a calendar year plan.

One silver lining to compliance with the automatic enrollment requirements is that, for many plan sponsors, satisfaction of the SECURE 2.0 automatic enrollment requirements will qualify them to claim the automatic enrollment tax credit. This is a $500 tax credit that, in general, is available for the first three years that the plan has an automatic enrollment provision so long as the plan sponsor has 100 or fewer employees.

As suggested above, implementing automatic enrollment is a significant administrative undertaking that requires immediate changes to existing procedures and then on-going diligence. While Congress and the IRS have attempted to reduce the severity of the consequences of limited and/or short-term automatic enrollment compliance failures, potentially costly employer funded corrective contributions loom for those who fail to satisfy these requirements. Thus, proactive coordination among plan sponsors, payroll companies, financial advisors, recordkeepers and third-party retirement plan administrators should be pursued now in order to be prepared for this soon to be effective obligation.

We hope that this article helped you to better understand this topic and encouraged plan sponsors to begin to investigate what must be done to comply with the new law. However, please be advised that this article is not intended to serve as financial, tax or legal advice so it should not be construed as such. If you have questions about this topic, we strongly urge you to further discuss it with a qualified retirement plan professional. For more information about this topic, please contact our marketing department at 484-483-1044 or your administrator at Legacy.

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