

MEMO# 12300

July 18, 2000

IRS ISSUES GUIDANCE ON AUTOMATIC ENROLLMENT

[12300] July 18, 2000 TO: PENSION MEMBERS No. 37-00 PENSION OPERATIONS ADVISORY COMMITTEE No. 51-00 RE: IRS ISSUES GUIDANCE ON AUTOMATIC ENROLLMENT The Internal Revenue Service recently published three releases relating to automatic enrollment: (i) Announcement 2000-60, which reminds prototype plan sponsors and employers about the availability of automatic enrollment features in 401(k) plans, (ii) Revenue Ruling 2000-35, which clarifies the circumstances under which an automatic enrollment program under a 403(b) annuity contract is treated as a salary reduction agreement, and (iii) Revenue Ruling 2000-33, which provides similar guidance with respect to 457 plans. Announcement 2000-60 The Service, in Announcement 2000-60, seeks to “bring to the attention of prototype plan sponsors and employers” the availability of automatic enrollment features in pre-approved 401(k) plans. The Announcement notes that such plans reportedly have higher employee participation rates than plans without the feature. The Announcement briefly describes automatic enrollment programs, citing Rev. Rul. 2000-8,¹ and indicates that such provisions may be included in prototype plans.² Revenue Ruling 2000-35 Revenue Ruling 2000-35 provides that employer contributions to a 403(b) annuity contract do not fail to qualify as being made under a salary reduction agreement merely because they are made pursuant to an arrangement under which a fixed percentage of an employee’s compensation is contributed pursuant to an automatic enrollment program. The ruling would permit a 403(b) plan to be amended to add an automatic deferral election feature applicable to current and newly-hired employees. The Service based the ruling on the following conditions: (i) the employees have a reasonable period to elect to receive cash in lieu of having it contributed to the purchase of an annuity contract, (ii) the employees are unable to receive amounts contributed prior to a distributable event described in Code section 403(b)(11) (such as attainment of age 59 ½ or separation of service), and (iii) the employees are permitted to change the election. The Service noted that the same ruling would apply to (i) plans described in Code section 403(b)(1)(A)(ii) (relating to arrangements maintained by state and local school systems) and (ii) plans 1 See Institute Memorandum to Pension Members No. 9-00 and Pension Operations Advisory Committee No. 7-00, dated February 1, 2000. 2 See Institute Memorandum to Pension Members No. 7-00 and Pension Operations Advisory Committee No. 6-00, dated January 28, 2000 (IRS guidance on master and prototype plans). 2with funding vehicles that are custodial accounts described in section 403(b)(7) or retirement income accounts described in section 403(b)(9). With respect to potential fiduciary issues arising from automatic enrollment programs, the Revenue Ruling notes that “[w]hile ERISA 404(c) may serve to relieve certain fiduciaries from liability when participants or beneficiaries exercise control over the assets in their individual accounts, the Department of Labor has taken the position that a participant or beneficiary will not be considered to have exercised control when the

participant or beneficiary is merely apprised of investments that will be made on his or her behalf in the absence of instructions to the contrary.” Revenue Ruling 2000-33 Revenue Ruling 2000-33 provides similar guidance with respect to 457 plans. This ruling holds that a 457 plan does not fail to be an “eligible deferred compensation plan” under Code section 457(b) because deferrals are made under an arrangement whereby a fixed percentage of an employee’s compensation is deferred on the employee’s behalf unless the employee affirmatively elects to receive the amount in cash. According to the Revenue Ruling, such an arrangement to make automatic deferrals to a 457 plan for a particular month with respect to an employee’s compensation should be established before the beginning of that month. Revenue Ruling 2000-33 also would allow a 457 plan to be amended to add an automatic deferral feature applicable to both current and newly-hired employees. Thomas T. Kim Assistant Counsel Attachment Note: Not all recipients receive the attachment. To obtain a copy of the attachment to which this memo refers, please call the ICI Library at (202) 326-8304 and request the attachment for memo 12300. ICI Members may retrieve this memo and its attachment from ICINet (<http://members.ici.org>). Attachment (in .pdf format)

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