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Plan Sponsor Update

JULY 2 | 2014

Auto-Enrollment: When a Good Plan Feature Goes Bad

By Andrew S. Zito, Executive Vice President

If you speak with many retirement plan professionals, you get the impression that auto-enrollment is the perfect medicine to cure participant apathy. Simply put the provision in the plan and the problem is cured with little downside. I have always been skeptical of this view. I know that I'm not alone in my opinion, but I am part of a very small percentage of retirement plan professionals who feel this way. It isn't that I don't understand the benefits of auto-enrollment, the results speak for themselves. And with an estimated 30% of all plans opting to use auto-enrollment, it is safe to say it is here to stay.

With all of that said, I have always been leery that the "*automatic*" nature of it could lead to increased administration, and subsequently increased liability, for plan sponsors. I have always feared that what a plan sponsor adopted as a good faith measure to increase plan participation would come back to bite them in their metaphorical retirement rears.

Auto-enrollment was actually invented by McDonalds back in 1984. This is a little known fact that I find to be appropriate because, in many ways, auto-enrollment is like a fast food restaurant. They are both highly efficient and do the job in the short term but, in the long term, both could lead to problems if not moderated. Fast food will never be a substitute for a well prepared meal and auto-enrollment will never be a substitute for a participant base that is well educated, engaged, and focused on saving for retirement.

Recently I had an experience with an auto-enrollment plan that justified all of my concerns, and cost the sponsor well over $100,000. This wasn't a hypothetical issue, nor did this happen to a huge $300 million plan with thousands of participants. This was a real situation that occurred with a well-run $30 million plan – and the error only affected 149 participants. The cause of the error was so minor that I felt compelled to write about it as a cautionary tale. So, if you are the sponsor or the administrator of a plan with auto-enrollment, read this article carefully, it could save you a lot of money.

The Good

I don't want to be accused of bashing a provision that has proven that it can and does work in increasing plan participation, so let's start with the basics of why auto-enrollment can be a good thing. By turning an employee's complacency toward saving for retirement against them, auto-enrollment forces eligible employees to opt NOT to save rather than to save. This works, and works well. I've seen it help plans pass ADP testing and I've seen it double participation. The percentage of "opt-outs" is usually low and the percentage of participants who stop deferring after they have been auto-enrolled is even lower. In short, auto-enrollment overcomes a participant's natural hesitancy toward saving, and, let's face it, their laziness.

The Bad

Unfortunately, for all its good, auto-enrollment has a few draw backs. First, it can lead to a lot of small terminated balances. This is especially true in plans with high turnover and liberal eligibility requirements. The participant starts deferring, and then 3 months later they terminate with a balance of less than $500. If they aren't immediately distributed, the sponsor runs the risk of creating an administrative backlog of participants with small terminated balances. This can be expensive to plans, as plans incur a cost for each participant in the plan (regardless of whether sponsors see it or not). Ironically, it is this problem that caused McDonald's to terminate auto-enrollment in 2002.

Unfortunately, there is a larger, more expensive risk with auto-enrollment – a Missed Deferral Opportunity.

What is a Missed Deferral Opportunity?

In any plan, once a participant becomes eligible, a sponsor must allow the participant to enroll, or they can be held accountable for what is called a Missed Deferral Opportunity. This holds true for plans that have auto-enrollment. If auto-enrollment fails, as it did in the plan I recently worked with, those who aren't enrolled are deemed to have had a Missed Deferral Opportunity. In this case, the sponsor needs to make a Qualified Non-Elective Contribution equal to 50% of the missed deferral opportunity PLUS 100% of any match PLUS earnings.

How Can Auto-Enrollment Fail, Isn't It Automatic?

With modernized recordkeeping platforms and heightened controls, failing to implement auto-enrollment at the plan level is becoming less of a problem. However, what is becoming more common is an inadvertent clerical error which leads to auto-enrollment not triggering for one or more participants. The error I recently encountered was just such an error - the net effect of an incorrect letter in a payroll file sent to one of the largest and most automated recordkeepers in the business. This incorrect code caused the recordkeeper's systems not to send out materials or auto-enroll the participants. These types of errors are not completely uncommon and usually impact only a small group of employees. Similar problems can be caused by incorrect or missing hire dates or even missing addresses.

The more concerning part was the length of time that elapsed before the error was caught. In this case not a single participant was auto-enrolled for a period of 16 months and neither the sponsor nor platform noticed.

After being discovered by the sponsor during an internal audit, the recordkeeper confirmed the cause of the problem and then promptly proclaimed that the sponsor was responsible for the error (shocking, I know). During the post-mortem, the root cause of the error was quickly traced to a simple miscommunication between the sponsor and the recordkeeper. The larger question remained for me *"how did this go unnoticed by either the sponsor or the recordkeeper?"*

The answer was as simple as it was scary; several participants enrolled themselves. This gave the perception to the sponsor that auto-enrollment was working.

Of the 200 participants affected, roughly 40 enrolled on their own. For the platform's part, we still haven't received a great answer on how they missed the problem. It's likely we never will.

When all the dust settled, the error resulted in a corrective contribution of well over $100,000 having to be made to the plan on behalf of the 142 affected employees. This does not include the hundreds of hours of work necessary to correct the error. At the time of publication, negotiations were still ongoing between the sponsor and the recordkeeper to determine who was responsible.

The Lesson

The bottom line is that auto-enrollment provisions take the responsibility of enrolling in the plan off the participants and put it on the sponsor, and while beneficial to the plan, auto-enrollment is not always automatic. Sponsors cannot simply rely on their recordkeeping platforms to insure auto-enrollment is being triggered properly. It must be monitored and reviewed frequently. Below are some tips for sponsors of auto-enrollment plans:

- **Watch the Payroll Data** – 9 times out of 10 these errors will be caused by bad payroll data. Missing or incorrect dates of hire, incorrect status codes, and even missing addresses can stop auto-enrollment from triggering. Be sure to scrub payroll data before it is sent to the provider.
- **Spot Check Once Per Quarter** – Pick 2 participants and verify that they enrolled or that they opted out.
- **Go Beyond Just a Surface Examination** - Remember, a participant may have enrolled themselves. Just because they have a deferral percentage, doesn't mean that they auto-enrolled. Verify with either the participant or the recordkeeper.
- **Monitor Auto-Enrollment in General** – Make sure to monitor what impact auto-enrollment is having on your plan overall. If it is creating a lot of small balances, consider increasing eligibility requirements. If a lot of participants auto-enroll then want to stop their deferrals immediately, consider increasing notification to participants to prevent participants from being "*surprised*" by the money missing from their check. ▪

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