

109TH CONGRESS
1ST SESSION

S. 1819

To amend the Internal Revenue Code of 1986 to increase participation and savings in cash or deferred plans through automatic contribution and default investment arrangements, and for other purposes.

IN THE SENATE OF THE UNITED STATES

OCTOBER 4, 2005

Mr. SANTORUM (for himself and Mr. BENNETT) introduced the following bill;
which was read twice and referred to the Committee on Finance

A BILL

To amend the Internal Revenue Code of 1986 to increase participation and savings in cash or deferred plans through automatic contribution and default investment arrangements, and for other purposes.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*

3 **SECTION 1. SHORT TITLE.**

4 This Act may be cited as the “401(k) Enhancement
5 Act: Encouraging Retirement Savings”.

1 **SEC. 2. INCREASING PARTICIPATION AND SAVINGS IN**
2 **CASH OR DEFERRED PLANS THROUGH AUTO-**
3 **MATIC CONTRIBUTION ARRANGEMENTS.**

4 (a) IN GENERAL.—Section 401(k) of the Internal
5 Revenue Code of 1986 (relating to cash or deferred ar-
6 rangement) is amended by adding at the end the following
7 new paragraph:

8 “(13) NONDISCRIMINATION REQUIREMENTS
9 FOR AUTOMATIC CONTRIBUTION TRUSTS.—

10 “(A) IN GENERAL.—A cash or deferred ar-
11 rangement shall be treated as meeting the re-
12 quirements of paragraph (3)(A)(ii) if such ar-
13 rangement constitutes an automatic contribu-
14 tion trust.

15 “(B) AUTOMATIC CONTRIBUTION TRUST.—

16 “(i) IN GENERAL.—For purposes of
17 this paragraph, the term ‘automatic con-
18 tribution trust’ means an arrangement—

19 “(I) except as provided in clause
20 (ii), under which each employee eligi-
21 ble to participate in the arrangement
22 is treated as having elected to have
23 the employer make elective contribu-
24 tions in an amount equal to the appli-
25 cable percentage of the employee’s
26 compensation, and

1 “(II) which meets the require-
2 ments of subparagraphs (C) and (D).

3 “(ii) EXCEPTIONS.—

4 “(I) EMPLOYER ELECTION WITH
5 RESPECT TO EXISTING EMPLOYEES.—

6 An employer may elect not to have
7 clause (i)(I) apply to all employees
8 who were eligible to participate in the
9 arrangement (or a predecessor ar-
10 rangement) immediately before the
11 first date on which the arrangement is
12 an automatic contribution trust. The
13 employer shall make the election
14 under this subclause before such first
15 date.

16 “(II) ELECTION OUT.—Each em-
17 ployee eligible to participate in the ar-
18 rangement may specifically elect not
19 to have contributions made under
20 clause (i), and such clause shall cease
21 to apply to compensation paid on or
22 after the effective date of the election.

23 “(iii) APPLICABLE PERCENTAGE.—

24 For purposes of this subparagraph—

1 “(I) IN GENERAL.—The term
2 ‘applicable percentage’ means, with
3 respect to any employee, the percent-
4 age (not less than 3 percent) deter-
5 mined under the arrangement.

6 “(II) INCREASE IN PERCENT-
7 AGE.—In the case of the second plan
8 year beginning after the first date on
9 which the election under clause (i)(I)
10 is in effect with respect to the em-
11 ployee and any succeeding plan year,
12 the applicable percentage shall be a
13 percentage equal to the sum of the
14 applicable percentage for the employee
15 as of the close of the preceding plan
16 year plus the number of percentage
17 points (not less than 1 percentage
18 point) specified by the plan. Such in-
19 crease shall continue until the applica-
20 ble percentage is at least 10 percent
21 or such higher percentage specified by
22 the plan.

23 “(C) MATCHING OR NONELECTIVE CON-
24 TRIBUTIONS.—

1 “(i) IN GENERAL.—The requirements
2 of this subparagraph are met if, under the
3 arrangement, the employer—

4 “(I) makes matching contribu-
5 tions on behalf of each employee who
6 is not a highly compensated employee
7 in an amount equal to 50 percent of
8 the elective contributions of the em-
9 ployee to the extent such elective con-
10 tributions do not exceed 6 percent of
11 compensation; or

12 “(II) is required, without regard
13 to whether the employee makes an
14 elective contribution or employee con-
15 tribution, to make a contribution to a
16 defined contribution plan on behalf of
17 each employee who is not a highly
18 compensated employee and who is eli-
19 gible to participate in the arrange-
20 ment in an amount equal to at least
21 3 percent of the employee’s compensa-
22 tion,

23 The rules of clauses (ii) and (iii) of para-
24 graph (12)(B) shall apply for purposes of
25 subclause (I). The rules of paragraph

1 (12)(E)(ii) shall apply for purposes of sub-
2 clauses (I) and (II).

3 “(ii) OTHER PLANS.—An arrange-
4 ment shall be treated as meeting the re-
5 quirements under clause (i) if any other
6 plan maintained by the employer meets
7 such requirements with respect to employ-
8 ees eligible under the arrangement.

9 “(D) NOTICE REQUIREMENTS.—

10 “(i) IN GENERAL.—The requirements
11 of this subparagraph are met if the re-
12 quirements of clauses (ii) and (iii) are met.

13 “(ii) REASONABLE PERIOD TO MAKE
14 ELECTION.—The requirements of this
15 clause are met if each employee to whom
16 subparagraph (B)(i) applies—

17 “(I) receives a notice explaining
18 the employee’s right under the ar-
19 rangement to elect not to have elective
20 contributions made on the employee’s
21 behalf, and how contributions made
22 under the arrangement will be in-
23 vested in the absence of any invest-
24 ment election by the employee, and

1 “(II) has a reasonable period of
2 time after receipt of such notice and
3 before the first elective contribution is
4 made to make such election.

5 “(iii) ANNUAL NOTICE OF RIGHTS
6 AND OBLIGATIONS.—The requirements of
7 this clause are met if each employee eligi-
8 ble to participate in the arrangement is,
9 within a reasonable period before any year,
10 given notice of the employee’s rights and
11 obligations under the arrangement.

12 The requirements of clauses (i) and (ii) of para-
13 graph (12)(D) shall be met with respect to the
14 notices described in clauses (ii) and (iii) of this
15 subparagraph.”

16 (b) MATCHING CONTRIBUTIONS.—Section 401(m) of
17 the Internal Revenue Code of 1986 (relating to non-
18 discrimination test for matching contributions and em-
19 ployee contributions) is amended by redesignating para-
20 graph (12) as paragraph (13) and by inserting after para-
21 graph (11) the following new paragraph:

22 “(12) ALTERNATE METHOD FOR AUTOMATIC
23 CONTRIBUTION TRUSTS.—A defined contribution
24 plan shall be treated as meeting the requirements of

1 paragraph (2) with respect to matching contribu-
2 tions if the plan—

3 “(A) meets the contribution requirements
4 of subparagraphs (B)(i) and (C) of subsection
5 (k)(13);

6 “(B) meets the notice requirements of sub-
7 paragraph (D) of subsection (k)(13); and

8 “(C) meets the requirements of paragraph
9 (11)(B) (ii) and (iii).”.

10 (c) EXCLUSION FROM DEFINITION OF TOP-HEAVY
11 PLANS.—

12 (1) ELECTIVE CONTRIBUTION RULE.—Clause
13 (i) of section 416(g)(4)(H) of the Internal Revenue
14 Code of 1986 is amended by inserting “or
15 401(k)(13)” after “section 401(k)(12)”.

16 (2) MATCHING CONTRIBUTION RULE.—Clause
17 (ii) of section 416(g)(4)(H) of such Code is amended
18 by inserting “or 401(m)(12)” after “section
19 401(m)(11)”.

20 (d) DEFINITION OF COMPENSATION.—

21 (1) BASE PAY OR RATE OF PAY.—The Sec-
22 retary of the Treasury shall, not later than Decem-
23 ber 31, 2006, modify Treasury Regulation section
24 1.414(s)–1(d)(3) to facilitate the use of the safe har-
25 bors in sections 401(k)(12), 401(k)(13),

1 401(m)(11), and 401(m)(12) of the Internal Rev-
2 enue Code of 1986, and in Treasury Regulation sec-
3 tion 1.401(a)(4)–3(b), by plans that use base pay or
4 rate of pay in determining contributions or benefits.
5 Such modifications shall include increased flexibility
6 in satisfying section 414(s) of such Code in any case
7 where the amount of overtime compensation payable
8 in a year can vary significantly.

9 (2) APPLICATION OF REQUIREMENTS TO SEPA-
10 RATE PAYROLL PERIODS.—Not later than December
11 31, 2005, the Secretary of the Treasury shall issue
12 rules under subparagraphs (B)(i) and (C)(i) of sec-
13 tion 401(k)(13) of such Code and under clause (i)
14 of section 401(m)(12)(A) of such Code that, effec-
15 tive for plan years beginning after December 31,
16 2005, permit such requirements to be applied sepa-
17 rately to separate payroll periods based on rules
18 similar to the rules described in Treasury Regulation
19 sections 1.401(k)–3(c)(5)(ii) and 1.401(m)–3(d)(4).

20 (e) SECTION 403(b) CONTRACTS.—Paragraph (11) of
21 section 401(m) of the Internal Revenue Code of 1986 is
22 amended by adding at the end the following:

23 “(C) SECTION 403(b) CONTRACTS.—An
24 annuity contract under section 403(b) shall be
25 treated as meeting the requirements of para-

1 graph (2) with respect to matching contribu-
2 tions if such contract meets requirements simi-
3 lar to the requirements under subparagraph
4 (A).”.

5 (f) INVESTMENTS AND PREEMPTION.—

6 (1) CONTROL DEEMED TO HAVE BEEN EXER-
7 CISED WITH RESPECT TO DEFAULT INVESTMENT AR-
8 RANGEMENTS.—Section 404(c) of the Employee Re-
9 tirement Income Security Act of 1974 (29 U.S.C.
10 1104(c)) is amended by adding at the end the fol-
11 lowing new paragraph:

12 “(4) TREATMENT OF DEFAULT INVESTMENT
13 ARRANGEMENT.—

14 “(A) IN GENERAL.—A participant in an
15 individual account plan shall, for purposes of
16 paragraph (1), be treated as exercising control
17 over the assets in the account with respect to
18 the amount of contributions made under a de-
19 fault investment arrangement.

20 “(B) DEFAULT INVESTMENT ARRANGE-
21 MENT DEFINED.—For purposes of this para-
22 graph, the term ‘default investment arrange-
23 ment’ means an arrangement—

24 “(i) which meets the requirements of
25 subparagraph (C),

1 “(ii) under which the participant is
2 treated as having elected to have the em-
3 ployer exercise control over the assets in
4 his account until the participant specifi-
5 cally elects to exercise such control, and

6 “(iii) under which assets described in
7 clause (ii) are invested in accordance with
8 regulations prescribed by the Secretary.

9 Such regulations shall provide guidance on the
10 appropriateness of designating default invest-
11 ments that include a mix of asset classes con-
12 sistent with long-term capital appreciation. The
13 regulations shall also provide guidance on the
14 designation of default investments in individual
15 account plans that are not designed to meet the
16 requirements of this section.

17 “(C) NOTICE REQUIREMENTS.—

18 “(i) TIME FOR NOTICE.—The admin-
19 istrator of a default investment arrange-
20 ment shall, within a reasonable period be-
21 fore each plan year, give to each employee
22 to whom a default investment arrangement
23 applies for such plan year notice of the em-
24 ployee’s rights and obligations under the
25 arrangement which—

1 “(I) is sufficiently accurate and
2 comprehensive to apprise the employee
3 of such rights and obligations, and

4 “(II) is written in a manner cal-
5 culated to be understood by the aver-
6 age employee to whom the arrange-
7 ment applies.

8 “(ii) FORM OF NOTICE; RESPONSE.—
9 A notice shall not be treated as meeting
10 the requirements of clause (i) with respect
11 to an employee unless—

12 “(I) the notice includes a notice
13 explaining the employee’s right under
14 the arrangement to elect to exercise
15 control over the assets in his account,

16 “(II) the employee has a reason-
17 able period of time after receipt of the
18 notice described in subclause (I) and
19 before the assets are first invested to
20 make such election, and

21 “(III) the notice explains how
22 contributions made under the ar-
23 rangement will be invested in the ab-
24 sence of any investment election by
25 the employee.”.

1 (2) PREEMPTION OF CONFLICTING STATE REG-
2 ULATION.—Section 514 of such Act (29 U.S.C.
3 1144) is amended by adding at the end the following
4 new subsection:

5 “(e) AUTOMATIC CONTRIBUTION ARRANGEMENTS.—

6 “(1) IN GENERAL.—Notwithstanding any other
7 provision of this section, any law of a State which
8 would directly or indirectly prohibit or restrict the
9 inclusion in any plan of an automatic contribution
10 arrangement shall be superseded. The Secretary may
11 prescribe regulations which would establish min-
12 imum standards that such arrangements would be
13 required to satisfy in order for this subsection to
14 apply.

15 “(2) AUTOMATIC CONTRIBUTION ARRANGE-
16 MENT DEFINED.—For purposes of this subsection,
17 the term ‘automatic contribution arrangement’
18 means an arrangement—

19 “(A) which meets the requirements of
20 paragraph (3),

21 “(B) under which a participant may elect
22 to have the employer make payments as con-
23 tributions under the plan on behalf of the par-
24 ticipant, or to the participant directly in cash,

1 “(C) under which the participant is treated
2 as having elected to have the employer make
3 such contributions in an amount equal to a uni-
4 form percentage of compensation provided
5 under the plan until the participant specifically
6 elects not to have such contributions made (or
7 specifically elects to have such contributions
8 made at a different percentage), and

9 “(D) under which contributions described
10 in subparagraph (C) are invested in accordance
11 with regulations prescribed by the Secretary.

12 Such regulations shall provide guidance on the ap-
13 propriateness of designating default investments
14 that include a mix of asset classes consistent with
15 long-term capital appreciation.

16 “(3) NOTICE REQUIREMENT.—

17 “(A) IN GENERAL.—The administrator of
18 an individual account plan shall, within a rea-
19 sonable period before each plan year, give to
20 each employee to whom an automatic contribu-
21 tion arrangement applies for such plan year no-
22 tice of the employee’s rights and obligations
23 under the arrangement which—

1 “(i) is sufficiently accurate and com-
2 prehensive to apprise the employee of such
3 rights and obligations, and

4 “(ii) is written in a manner calculated
5 to be understood by the average employee
6 to whom the arrangement applies.

7 “(B) OTHER REQUIREMENTS.—A notice
8 shall not be treated as meeting the require-
9 ments of subparagraph (A) with respect to an
10 employee unless—

11 “(i) the notice includes a notice ex-
12 plaining the employee’s right under the ar-
13 rangement to elect not to have elective con-
14 tributions made on the employee’s behalf
15 (or to elect to have such contributions
16 made at a different percentage),

17 “(ii) the employee has a reasonable
18 period of time after receipt of the notice
19 described in clause (i) and before the first
20 elective contribution is made to make such
21 election, and

22 “(iii) the notice explains how contribu-
23 tions made under the arrangement will be
24 invested in the absence of any investment
25 election by the employee.”.

1 (g) CORRECTIVE DISTRIBUTIONS.—

2 (1) IN GENERAL.—Section 414 of the Internal
3 Revenue Code of 1986 (relating to definitions and
4 special rules) is amended by adding at the end the
5 following new subsection:

6 “(w) AUTOMATIC CONTRIBUTION ARRANGEMENTS.—

7 “(1) IN GENERAL.—For purposes of this title,
8 the amount of any corrective distribution from a
9 plan shall be treated as if such amount had never
10 been held in such plan and shall be treated as a pay-
11 ment of compensation from the employer maintain-
12 ing the plan to the employee receiving such distribu-
13 tion.

14 “(2) CORRECTIVE DISTRIBUTION.—For pur-
15 poses of this subsection, the term ‘corrective dis-
16 tribution’ means a distribution from an applicable
17 employer plan of all amounts attributable to an erro-
18 neous automatic contribution.

19 “(3) ERRONEOUS AUTOMATIC CONTRIBU-
20 TION.—For purposes of this subsection, the term
21 ‘erroneous automatic contribution’ means an elective
22 contribution made on behalf of an employee under
23 any applicable employer plan pursuant to a plan pro-
24 vision treating the employee as having elected to
25 have the employer make such elective contribution

1 until the employee affirmatively elects not to have
2 such contribution made or affirmatively elects to
3 make contributions at a specified level, if the fol-
4 lowing requirements are satisfied:

5 “(A) Within the applicable period, the em-
6 ployee notifies the plan administrator that the
7 employee elects to have the elective contribution
8 treated as an erroneous automatic contribution.

9 “(B) The sum of the elective contributions
10 that are treated as erroneous automatic con-
11 tributions with respect to an employee does not
12 exceed \$500.

13 “(4) APPLICABLE EMPLOYER PLAN.—For pur-
14 poses of this subsection, the term ‘applicable em-
15 ployer plan’ has the meaning given such term by
16 subsection (v)(6)(A).

17 “(5) APPLICABLE PERIOD.—For purposes of
18 this subsection, the term ‘applicable period’ means,
19 with respect to an employee, the 3-month period
20 that begins on the first date that an amount is with-
21 held from compensation payable to the employee in
22 order to make a plan contribution pursuant to a
23 plan provision described in paragraph (3).”.

24 (2) VESTING CONFORMING AMENDMENTS.—

25 (A) INTERNAL REVENUE CODE OF 1986.—

1 (i) Section 411(a)(3)(G) of such Code
2 is amended by inserting “an erroneous
3 automatic contribution under section
4 414(w),” after “402(g)(2)(A),”.

5 (ii) The heading of section
6 411(a)(3)(G) of such Code is amended by
7 inserting “OR ERRONEOUS AUTOMATIC
8 CONTRIBUTION” before the period.

9 (iii) Section 401(k)(8)(E) of such
10 Code is amended by inserting “an erro-
11 neous automatic contribution under section
12 414(w),” after “402(g)(2)(A),”.

13 (iv) The heading of section
14 401(k)(8)(E) of such Code is amended by
15 inserting “OR ERRONEOUS AUTOMATIC
16 CONTRIBUTION” before the period.

17 (B) EMPLOYEE RETIREMENT INCOME SE-
18 CURITY ACT OF 1974.—Section 203(a)(3)(F) of
19 the Employee Retirement Income Security Act
20 of 1974 (29 U.S.C. 1053(a)(3)(F)) is amended
21 by inserting “an erroneous automatic contribu-
22 tion under section 414(w) of such Code,” after
23 “402(g)(2)(A) of such Code,”.

24 (h) EFFECTIVE DATE.—

1 (1) IN GENERAL.—Except as provided in para-
2 graph (2), the amendments made by this section
3 shall apply to plan years beginning after December
4 31, 2005.

5 (2) SECTION 403(b) CONTRACTS.—The amend-
6 ments made by subsection (e) shall apply to years
7 beginning after December 31, 1998.

8 (3) REGULATIONS.—Final regulations under
9 section 404(c)(4)(B)(iii) of the Employee Retirement
10 Income Security Act of 1974 (added by this section)
11 shall be issued no later than 6 months after the date
12 of enactment of this Act.

○