

DEPARTMENT OF LABOR**Pension and Welfare Benefits Administration****29 CFR Part 2520****RIN 1210-AA73****Proposed Small Pension Plan Security Amendments****AGENCY:** Pension and Welfare Benefits Administration, Department of Labor.**ACTION:** Notice of Proposed Rulemaking.

SUMMARY: This document contains proposed amendments to the regulations governing the circumstances under which small pension plans are exempt from the requirements to engage an independent qualified public accountant and to include a report of the accountant as part of the annual report under Title I of the Employee Retirement Income Security Act of 1974, as amended (ERISA). Regulation 29 CFR 2520.104-46 provides a waiver of the annual examination and report of an independent qualified public accountant for employee benefit plans with fewer than 100 participants at the beginning of the plan year. The proposed amendments are designed to increase the security of assets in small pension plans by conditioning the waiver of the requirements concerning the engagement of an accountant on enhanced disclosure of information to participants and beneficiaries and, in certain instances, improved bonding requirements. This regulatory action is being proposed as a way of enhancing the security and accountability of small pension plans because of recent cases involving embezzlement or other misappropriations of pension assets that have focused national attention on the potential vulnerability of small pension plans to fraud and abuse. The proposed amendments do not affect the exemption for small welfare plans (such as group health plans) under § 2520.104-46. Conforming amendments are made to the simplified annual reporting requirements specified in 29 CFR 2520.104-41. If adopted, the proposal would affect participants and beneficiaries covered by small pension plans, sponsors and administrators of small pension plans, and service providers holding assets of small pension plans.

DATES: Written comments concerning the proposed regulations must be received by January 31, 2000.

ADDRESSES: Written comments (preferably three copies) should be sent to: Office of Regulations and Interpretations, Room N-5669, Pension

and Welfare Benefits Administration, U.S. Department of Labor, 200 Constitution Avenue, NW, Washington, DC 20210, Attention: Small Pension Plan Security Proposal. All submissions will be open to public inspection in the Public Disclosure Room, Pension and Welfare Benefits Administration, Room N-5638, 200 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: John Keene, Office of Regulations and Interpretations, Pension and Welfare Benefits Administration, (202) 219-8521. This is not a toll-free number.

SUPPLEMENTARY INFORMATION:**A. Background**

In general, the administrator of an employee benefit plan required to file an annual report under Title I of ERISA must include as part of that report the opinion of an independent qualified public accountant (IQPA). These annual reporting requirements can be satisfied by filing the Form 5500 "Annual Return/Report of Employee Benefit Plan."¹ The requirements governing the content of the opinion and report of the IQPA are set forth in ERISA section 103(a)(3)(A) and 29 CFR 2520.103-1(b). Section 104(a)(2)(A) permits the Department of Labor (Department) to prescribe, by regulation, simplified annual reports for pension plans with fewer than 100 participants. Section 104(a)(3) permits the Department to prescribe exemptions from the reporting and disclosure requirements or simplified reporting and disclosure for welfare plans. In accordance with the Department's authority under sections 104(a)(2)(A) and 104(a)(3), the Department adopted, at 29 CFR 2520.104-41, simplified annual reporting requirements for pension and welfare benefit plans with fewer than 100 participants. In addition, the Department, at 29 CFR 2520.104-46, prescribed for small plans a waiver from the requirement of section 103(a)(3)(A) to engage an IQPA and to include the opinion of the accountant as part of the plan's annual report.

Since the adoption of § 2520.104-46 in 1976, the amount of assets held in small pension plans has increased dramatically and small pension plans have become important retirement savings vehicles for an increasing number of American workers. Recently, media coverage of a case involving misappropriation of pension assets over several years focused national attention on the potential vulnerability of small pension plans to fraud and abuse. There

¹ See sections 101(b)(4) and 103 of ERISA, and 29 CFR 2520.103-1.

have been other cases where service providers, administrators or other fiduciaries have misused retirement savings held in small pension plans and have concealed their acts by falsifying financial and other information to plan sponsors, trustees, and participants. Although such cases are rare and legal remedies often can be pursued in an effort to recover lost assets, the Department believes that, given the increasing extent to which workers are depending on their employment-based pension plans as a primary source of retirement income, it is appropriate to take steps to improve the security of pension assets in small pension plans.

One approach to improving the security of assets in small pension plans is to require all such plans to comply with the audit requirements of section 103(a)(3)(A). As noted above, the assets of plans with fewer than 100 participants, unlike larger plans, are not required to be examined by an IQPA. While subjecting the assets of small pension plans to an audit would, in the view of the Department, provide a high degree of certainty that the assets reported on a plan's annual report are actually available to pay benefits, the Department recognizes that the costs attendant to such a requirement may be significant for many plans and plan sponsors. Consistent with the Department's goal of encouraging pension plan establishment and maintenance, particularly in the small business community, the Department concluded that engaging an accountant should not be the only means by which the security of small plan pension assets can be improved.

In assessing alternatives to a mandatory audit requirement, the Department concluded that a three-pronged approach—focusing on (1) Who holds the plan's assets, (2) Enhanced disclosure to participants and beneficiaries and (3) In limited situations, an improved bonding requirement—could enhance the level of security and accountability for small pension plan assets, while keeping administrative burdens and costs to a minimum by building on current recordkeeping, disclosure and bonding requirements and practices. Based on our experience in dealing with thousands of inquiries every year from participants regarding their plans, we have determined that well informed participants and beneficiaries are often in the best position to be watchdogs over their own pension plans and can catch problems early. We also have determined that, based on industry estimates, the costs of enhancing fidelity bond coverage will be nominal for most

plans and less than the cost of an annual audit by an IQPA.

The alternative referenced above is set forth as proposed new conditions for obtaining a waiver from the requirements concerning the engagement of an IQPA under § 2520.104-46. A description of the proposal follows.

B. Proposed Amendment to § 2520.104-46

Currently, the conditions to obtaining a waiver from the requirement to engage an accountant under § 2520.104-46 are that a pension plan have fewer than 100 participants at the beginning of the plan year and the plan administrator properly file the "Form 5500-C/R Return/Report of Employee Benefit Plan (With fewer than 100 participants)." As discussed below, the proposal would, upon adoption, amend the regulation to further condition eligibility for the waiver on additional disclosures to plan participants and beneficiaries concerning the assets held by their plans and, in certain instances, an increase in the amount of a plan's fidelity bond.²

In general, the Department believes that statements of plan assets prepared by certain regulated financial institutions (such as banks, insurance companies, mutual funds, and securities broker-dealers), if made available to participants and beneficiaries, provide a means by which participants and beneficiaries can independently confirm that the assets reported by the plan to be available to pay benefits as of the end of the plan year were, in fact, available according to the books and records of the institution holding the assets. Such disclosure, in the Department's view, reduces the likelihood of losses over

long periods due to acts of fraud or dishonesty. The Department also believes that supplemental bonding requirements also will serve to reduce the risk of loss due to acts of fraud or dishonesty where a substantial percentage of a plan's assets are held by entities that may not be subject to state or federal regulatory oversight.

1. Qualifying plan assets and bond requirement

The first part of the proposal, therefore, focuses on the extent to which a plan's assets are held by regulated financial institutions. *See*: Proposed § 2520.104-46(b)(1)(i)(A). The proposal uses the term "qualifying plan assets" in applying the conditions of the waiver. "Qualifying plan assets" are defined in the proposal to include any assets held by: a bank or similar financial institution, as defined in § 2550.408b-4(c); an insurance company qualified to do business under the laws of a state; an organization registered as a broker-dealer under the Securities and Exchange Act of 1934; or any other organization authorized to act as a trustee for individual retirement accounts under section 408 of the Internal Revenue Code. The term "qualifying plan assets" also includes assets that the Department believes present little risk of loss to participants and beneficiaries as a result of acts of fraud or dishonesty "participant loans meeting the requirements of ERISA section 408(b)(1) and qualifying employer securities, as defined in ERISA section 407(d)(1). *See* Proposed § 2520.104-46(b)(1)(ii).

The proposal provides that, with respect to each plan year for which the waiver is claimed, at least 95% of the assets of the plan constitute "qualifying plan assets" or any person who handles plan funds or other property that do not constitute "qualifying plan assets" is covered by a bond meeting the requirements of ERISA section 412, except that the amount of the bond is not less than the value of such assets.³ The 95% test is provided in recognition of the fact that some small plans may have assets (such as limited partnership or real estate interests) held by parties that are not regulated financial institutions. It is not the intent of the Department in proposing these amendments to directly or indirectly influence how the assets of small plans are invested through application of the audit requirements. Accordingly, only

where more than 5% of a plan's assets do not constitute "qualifying plan assets" will the bonding component of the proposal apply. As noted above, the bonding component of the proposal would require a bond meeting the requirements of ERISA section 412 in an amount equal to 100% of the assets that do not constitute "qualifying plan assets." Based on industry estimates as detailed below, it does not appear that the costs attendant to compliance with the proposed bonding requirement will be significant enough to affect plan investments in assets that are not "qualifying plan assets."

Under the proposal, the percentage of a plan's assets that constitute "qualifying plan assets" and, as appropriate, the amount of supplemental bond coverage necessary to comply with the regulation are to be determined for each plan year for which the waiver is claimed. Accordingly, the administrator of a plan electing the waiver must make the required determinations as of the beginning of the plan year. For purposes of this requirement, the required determinations are to be made in a manner consistent with the requirements of section 412. Inasmuch as a determination that more than 5% of a plan's assets do not constitute "qualifying plan assets" may necessitate an increase in the amount of the plan's section 412 bond, assuming the administrator does not elect to engage an accountant, the Department concluded that the determination of "qualifying plan assets" should be made on the same basis as the required bond. In this regard, 29 CFR 2580.412-14 requires that the amount of the section 412 bond be determined by reference to the preceding reporting year. In the case of new plans, with respect to which there is no preceding report year, § 2580.412-15 provides procedures for making estimates for the current year.

For example, Plan A, which reports on a calendar year basis, has total assets of \$600,000 as of the end of the 1999 plan year. Plan A's assets, as of the end of year, include: investments in various bank, insurance company and mutual fund products of \$520,000; investments in qualifying employer securities of \$40,000; participants loans, meeting the requirements of ERISA section 408(b)(1) totaling \$20,000; and a \$20,000 investment in a real estate limited partnership. Because the only asset of the plan that does not constitute a "qualifying plan asset" is the \$20,000 real estate investment and that investment represents less than 5% of the plan's total assets, no bond would be required under the proposal as a

²On September 3, 1997, the Department of Labor, the Internal Revenue Service, and the Pension Benefit Guaranty Corporation published (62 FR 46556) proposed revisions to the annual return/report forms filed for employee benefit plans. The Agencies proposal replaced the Form 5500, Form 5500-C and Form 5500-R with one Form 5500 to be used by both large and small plan filers beginning with 1999 plan year filings. On June 24, 1998 the Agencies published a notice of the submission of the revised Form 5500 for OMB review (63 FR 34493). PWBA received conditional approval for the revised Form 5500 under OMB control number 1210-0110. The Department also published on December 10, 1998 (63 FR 68370) a notice of proposed rulemaking to conform its regulations relating to the annual reporting and disclosure requirements of Part 1 of Title I of ERISA to the revised forms. The proposed amendments to the small pension plan IQPA waiver contained in this notice would modify the proposed amendments to § 2520.104-41 and § 2520.104-46 published in the December 10 notice. The Form 5500 series may need to be adjusted following adoption of a final rule in connection with this proposal to reflect changes to the small pension plan IQPA waiver.

³Section 412 of ERISA and the regulations issued thereunder, 29 C.F.R. § 2580.412-1 *et seq.*, set forth the bonding requirements generally applicable to ERISA-covered pension and welfare benefit plans.

condition for the waiver for the 2000 plan year. By contrast, Plan B also has total assets of \$600,000 as of the end of the 1999 plan year, of which \$558,000 constitutes "qualifying plan assets" and \$42,000 constitutes non-qualifying plan assets. Because 7%—more than 5%—of Plan B's assets do not constitute "qualifying plan assets," Plan B, as a condition to electing the waiver for the 2000 plan year, must ensure that it has a fidelity bond in an amount equal to at least \$42,000 covering persons handling non-qualifying plan assets. Inasmuch as compliance with section 412 generally requires the amount of bonds to be not less than 10% of the amount of all the plan's funds or other property handled, the bond acquired for section 412 purposes may be adequate to cover the non-qualifying plan assets without an increase (i.e., if the amount of the bond determined to be needed for the relevant persons for section 412 purposes is at least \$42,000). As demonstrated by the foregoing example, where a plan has more than 5% of its assets in non-qualifying plan assets, the bond required by the proposal is for the total amount of the non-qualifying plan assets, not just the amount in excess of 5%.

2. Disclosure

In addition to the bonding requirement, discussed above, the proposal further conditions the waiver of the requirement to engage an accountant on the disclosure of certain information to participants and beneficiaries. Specifically, § 2520.104–46(b)(1)(i)(B) of the proposal requires that the summary annual report (SAR) of a plan electing the waiver include, in addition to the other information required by 29 C.F.R. § 2520.104b–10: (1) The name of each institution holding "qualifying plan assets" and the amount of such assets held by each institution as of the end of the plan year; (2) The name of the surety company issuing the bond, if the plan has more than 5% of its assets in non-qualifying plan assets; (3) A notice indicating that participants and beneficiaries may, upon request and without charge, examine, or receive copies, of evidence of the required bond and statements received from each institution holding qualifying assets which describe the assets held by the institution as of the end of the plan year; and (4) A notice stating that participants and beneficiaries should contact the Regional Office of the U.S. Department of Labor's Pension and Welfare Benefits Administration if they are unable to examine or obtain copies of statements received from each institution holding qualifying assets or evidence of the

required bond, if applicable. Proposed § 2520.104–46(b)(1)(i)(C) is intended to make clear that plan administrators must, without charge, make the required documents available for examination and, upon request, provide copies of those documents to participants and beneficiaries.

As indicated earlier, these requirements, in an effort to minimize costs to plans, are intended to build on existing recordkeeping and disclosure requirements. In this regard, the Department believes that all plans will receive year-end statements from institutions holding "qualifying plan assets." The proposal does not require the year-end statements to be in any particular form, but the statements, at a minimum, must identify the institution holding the assets and the amount of assets held as of the end of the year. Such information is typically furnished in the normal course of business and would, nonetheless, be necessary for administrators to properly discharge their annual reporting obligations under ERISA. Moreover, because annual reports generally are not required to be filed earlier than the end of the 7th month after the end of plan year and summary annual reports are not required to be distributed until 9 months after the close of the plan year or, if there is an approved extension of time to file, 2 months after the close of the extension period,⁴ administrators are afforded ample time to ensure the availability of the information necessary to satisfy the disclosure obligation on which the waiver is conditioned.

3. Limitations

The proposal would also make clear that this section does not affect the obligation of a plan electing a waiver of the audit requirement to file a Form 5500 "Annual Return/Report of Employee Benefit Plan," including any schedules or statements required by the instructions to the form. In addition, the proposal would clarify that a plan electing to file a Form 5500 as a small plan pursuant to the "80 to 120 rule" in 29 CFR 2520.103–1(d) may also claim the waiver afforded in this section in the same manner as a plan with fewer than 100 participants. Under the "80 to 120 rule," if the number of participants covered under the plan as of the beginning of the plan year is between 80 and 120, and an annual report was filed

as a small plan filer for the prior year, the plan administrator may elect to continue to file as a small plan filer and claim the waiver afforded by this section even though the plan covered more than 100 participants as of the beginning of the plan year. On the other hand, a plan with fewer than 100 participants as of the beginning of the plan year that elects to continue to file a Form 5500 as a large plan pursuant to the "80 to 120 rule" is not eligible to claim the waiver afforded to small plan filers.

C. Conforming Changes to the Simplified Annual Reporting Regulation

Conforming amendments to the simplified annual reporting provisions in § 2520.104–41 would clarify that, although other simplified reporting options would continue to be available, if an employee benefit plan with fewer than 100 participants does not meet the criteria set forth in § 2520.104–46, it would be required to engage an IQPA to conduct an examination of the financial statements of the plan, include with the plan's annual report the financial statements, notes and schedules prescribed in ERISA section 103(b) and 29 CFR 2520.103–1, and include within the plan's annual report a report of an IQPA as prescribed in ERISA section 103(a)(3)(A) and 29 CFR 2520.103–1(b)(5).

D. Effective Date

This regulation is proposed to be effective 60 days after publication of a final rule in the **Federal Register**. If adopted, the proposed amendments would be applicable to the first plan year beginning after the effective date of the final regulations.

E. Request for Public Comments on Alternatives

During the development of this proposal, small business groups expressed concern about the Department taking actions in this area that would increase administrative costs for small business owners thinking about continuing existing pension plans or offering new ones. The Department shares these concerns. Data indicate that more than one half of the private sector workforce does not participate in a pension plan, and this problem is particularly serious in the small business sector. In developing this proposal we attempted to balance the interest in providing secure retirement savings for participants and beneficiaries with the interest in minimizing costs and burdens on small

⁴ See 29 C.F.R. 2520.104a–5 (regulation on date of filing for annual reports), 29 C.F.R. 2520.104a–6 (regulation on date of filing for annual reports for plans which are part of a group insurance arrangement) and 29 C.F.R. 2520.104b–10(c) (regulation on when to furnish summary annual reports)

pension plans and the sponsors of those plans.

To aid in this effort as we develop a final regulation, the Department is interested in obtaining views and comments from the benefit plan community on whether there are alternative approaches that would provide significant enhancements in the security of small pension plan assets and the accountability of persons handling those assets which would be more effective or involve less cost and burden than this proposal. In that regard, the Department specifically invites comments on requiring as conditions of being eligible for the audit waiver that small pension plans (1) Obtain a fidelity bond covering persons who handle plan funds in an amount equal to at least 80% of the value of the plan's assets and (2) Make available to participants and beneficiaries a schedule of the plan's assets held for investment purposes as of the end of the plan year similar to the schedule currently required as part of the Form 5500 annual report filed by pension plans with 100 or more participants. Additionally, the Department requests comments on the investment of small pension plans assets; specifically, the proportion of assets that are "qualifying plan assets" as defined in this proposal.

Executive Order 12866 Statement

Under Executive Order 12866, the Department must determine whether the regulatory action is "significant" and therefore subject to the requirements of the Executive Order and subject to review by the Office of Management and Budget (OMB). Under section 3(f), the order defines a "significant regulatory action" as an action that is likely to result in a rule: (1) Having an annual effect on the economy of \$100 million or more, or adversely and materially

affecting a sector of the economy, productivity, competition, jobs, the environment, public health or safety, or State, local or tribal governments or communities (also referred to as "economically significant"); (2) Creating serious inconsistency or otherwise interfering with an action taken or planned by another agency; (3) Materially altering the budgetary impacts of entitlement grants, user fees, or loan programs or the rights and obligations of recipients thereof; or (4) Raising novel legal or policy issues arising out of legal mandates, the President's priorities, or the principles set forth in the Executive Order.

Pursuant to the terms of the Executive Order, it has been determined that this action is "significant" and subject to OMB review under Section 3(f)(4) of the Executive Order. Consistent with the Executive Order, the Department has undertaken to assess the costs and benefits of this regulatory action. The Department's assessment, and the analysis underlying that assessment, is detailed below.

Overview

In the Department's view, the benefits of the proposed additional requirements for the IQPA waiver outweigh the costs. The enhanced accountability and security of small pension plans resulting from additional IQPA waiver conditions will benefit plan participants who are counting on these pensions for retirement security. Given the more than \$300 billion in small pension plan assets, any increase in security and accountability is valuable. The additional conditions will also strengthen confidence in the pension system as a whole, and this added confidence may encourage more employers to offer pension plans, as well as additional workers to participate

in pension plans that are offered. The costs to small pension plans will not be large " it is estimated to be less than 1% of total annual administrative costs for all small pension plans. Estimates from Form 5500 data indicate that most small pension plans (as quantified below) would meet the requirement that at least 95% of their assets be "qualifying plan assets." For the few plans not meeting this requirement, the cost of obtaining fidelity bonds to enable them to meet the conditions required for the waiver are low. The statements required from qualifying financial institutions will impose no additional costs on plans because these records are kept as part of usual and customary business practices as the information is necessary for administrators to properly discharge their annual reporting obligations under ERISA. Finally, the cost of meeting disclosure requirements is small because after an initial start up cost to modify the SAR, no additional preparation costs are associated with SAR disclosure beyond the SAR statutory requirements. Additionally, no preparation is associated with distributing the statements and evidence of fidelity bonds that participants may request under the proposal.

The total costs imposed by the additional conditions this proposal would place on the small plan audit waiver are expected to be a one time cost of \$5.9 million, plus \$9.0 million annually.⁵ This is composed of a \$5.9 million start up cost to include summary language on the financial statements and bonds in the SAR, an \$8.0 million cost for the estimated 37,000 plans not meeting the 95% test to obtain a bond, and a \$995,000 cost to plans for providing copies of the statements and bonds upon request.

COSTS IMPOSED BY PROPOSED SMALL PENSION PLAN SECURITY AMENDMENTS

Proposed regulatory provision	SAR summary language	Obtain a bond	Provide requested copies of statements and bonds
Number of plans impacted	605,000	37,000	605,000
Total Cost	\$5.9 million	\$8.0 million	\$995,000
Cost per plan	\$10	\$220	\$1.64

Statement of Need for Proposed Action

As noted earlier, recent cases involving embezzlement or other misappropriations of pension assets

have focused national attention on the potential vulnerability of small pension plans to fraud and abuse. As a result, the Department has determined that

modifications to the small plan audit waiver would enhance pension plan security. Imposing the additional conditions on the audit waiver would

⁵ The cost estimates are derived from 1995 data on pension plans (the latest available) and 1997 BLS data on occupational wages.

help reduce the risk of loss due to acts of fraud or dishonesty with small plan assets. It would also provide participants with more information about their pension plans, thus better enabling them to help provide the checks and balances needed to ensure the integrity of the pension plan.

Examination of Alternative Approaches

To improve the security of pension plan assets, and to better provide participants and other parties to the plan the ability to verify and monitor the existence of small pension plan assets, various alternatives to the proposal were considered. The voluntary nature of the private pension system requires the Department to be particularly sensitive to costs imposed by regulations and to avoid, when possible, any action that would negatively impact small pension plan formation or maintenance. The Department therefore consulted industry groups and associations regarding alternatives available to enhance pension plan security and the burdens imposed by these various alternatives. The proposed regulation was crafted using these suggestions, and is intended to accomplish these goals without imposing significant costs on pension plans.

Among the alternatives considered were on-site inspection, periodic reporting, additional compliance penalties, additional bonding requirements, and eliminating the existing small plan audit waiver of examination and report of an accountant. However, all of these options were either extremely expensive (ranging in cost from \$200 million to \$4 billion paid by plans or plan sponsors) and thus conflicted with the

Department's priority of creating a regulatory environment that encourages pension plan formation, not feasible to implement, or would not have sufficiently enhanced small pension plan security.

Cost Analysis

The requirements contained in this proposal were developed to best conform to the actual investment patterns of small plans, rather than to alter these patterns. To understand the investment patterns of plans and the typical percentage of plan assets that would meet the "qualifying plan assets" requirement, we used Form 5500 data to examine how pension plans report their allocation of assets among various investment categories. Plan asset allocation information on the Form 5500 C/R filed by small plans is currently limited to very general categories. Because of this lack of detailed financial information, the Form 5500 filings of plans with more than 100 participants but less than \$2 million in assets (within two standard deviations of the mean asset value of small plans) were used as a proxy. Data show that within this proxy group, the proportion of investments in "qualifying plan assets" to total investments does not vary with plan size except among the largest plans (those with 2,500 or more participants), which represent less than 1 percent of the proxy group. We obtained a distribution of these plans based upon the proportion of each plan's assets that are "qualifying plan assets." We then applied this distribution to the actual 1995 count of small plans to estimate a distribution of small plans based on the proportion of assets that are "qualifying plan assets." We assumed that assets reported as cash, CD's, U.S. Government

Securities, corporate debt and equity, loans, employer securities and the value of interest in direct filing entities, registered investment companies, and insurance company general accounts constitute "qualified plan assets" as defined in this proposal.

The chart below shows the results of the analysis of 1995 data (the most recent year of available data) using these assumptions, and how many plans out of the 605,000 would not meet the "qualifying plan assets" test if the threshold were set at the various percentages outlined in the table. This shows that the vast majority of the assets of small plans are "qualifying plan assets." Specifically, for all but 6% of small pension plans, at least 95% of plan assets constitute "qualifying plan assets." Similarly, for all but 3% of plans, at least 90% of plan assets constitute "qualifying plan assets." As the threshold moves below 90%, very few additional plans are added to the list of those having the required percentage of "qualifying plan assets." The analysis of the data indicates that the 95% threshold represents the point at which most small plans maintain their assets in investments which represent minimal risks to their security. Consequently, the 95% threshold requirement is the means by which most plans will meet the requirement for the audit waiver. The plans that will not meet the 95% threshold are atypical of the industry standard, impose a greater risk on plan asset security, and are sufficiently few in number such that additional conditions for an audit waiver to protect participants and plan assets are warranted and are also cost effective.

ESTIMATES OF THE NUMBER AND PERCENTAGE OF SMALL PENSION PLANS (1-99 PARTICIPANTS) NOT MEETING THE "QUALIFYING PLAN ASSETS" TEST AT VARIOUS THRESHOLD LEVELS

	Alternative Threshold Levels for Qualifying Plan Assets						
	100%	95%	90%	85%	80%	75%	<75%
Number of plans	347,148	36,595	18,590	16,218	15,036	13,924	50
Percent of plans	57%	6%	3%	3%	2%	2%	.01%

Imposing an audit on small pension plans that do not meet the 95% requirement was initially considered. However, the audit cost for these 6% of small pension plans—\$230 million annually—was determined to be comparatively too great in relation to other alternatives. We considered the alternative of adjusting bonding requirements and calculated the cost of requiring those plans that do not meet

the 95% test to obtain fidelity bonds for the funds that are not "qualifying plan assets." Our analysis shows that bonding is a substantially less costly alternative, lowering aggregate costs by a factor of more than 20 while similarly accomplishing the goal of enhancing small pension plan security.

This alternative was feasible because for the 6% of plans that do not meet the 95% test, nearly all meet the condition

that at least 75% of assets are "qualifying plan assets." This means that nearly all of the affected plans would be able, at a relatively low cost, to purchase a fidelity bond in the amount equal to, at most, those 25% of plan assets that are not "qualifying plan assets." For the average plan with \$600,000 in assets, this leaves an upper bound of \$150,000 in assets that would need to be covered by a bond. Applying

an annual premium of \$200⁶ to the 6% of plans with these \$150,000 in assets needing bonding coverage yields a cost of \$7.3 million. In addition to the average bond premium of \$200 per plan, obtaining the bond is estimated to involve one-half hour of an analyst's time at \$39 per hour per small plan, for a cost of \$0.7 million. Summing these costs yields \$8.0 million to comply with the additional bonding requirement.

To address the need to enhance the ability of participants to monitor the financial status of plans that do not receive financial audits, the proposed regulation would require that the SAR be modified to include summary information describing the statements and fidelity bonds and a notice that copies are available upon request. This requirement merely involves an initial start up cost to plans to modify their automated SAR forms to include the language required by the regulation. Similar to the assumptions made for the Form 5500 and SAR regulatory analyses, 90% of plans are assumed to use service providers for the required SAR modifications, with the remaining plans performing the modifications in-house. The one-time cost of modifying the SAR form is estimated to be \$5.9 million—15 minutes of a professional's time at \$39 per hour for all small plans. Any preparation burden associated with completing the SAR form is not attributable to this proposal, but rather, to SAR requirements in general. Another burden associated with disclosure requirements is providing copies of the statements and bonding information to those participants and beneficiaries who request them. The Department assumes that 5% of participants and beneficiaries will request this information. Since the documents already have been provided by bonding companies and financial institutions, the cost of compliance merely involves assembling the appropriate documents and photocopying, by a clerical worker at \$15 per hour, and mailing costs at \$.37 per distribution—for an aggregate cost of about \$995,000 to plans.

Benefits Analysis

The proposed regulation is intended to accomplish two purposes: to limit pension plan fraud and to provide all parties of small pension plans with information to monitor their plan assets and plan fiduciaries. The benefits of reducing fraud and improving information disclosure are numerous. In addition to the benefits listed below,

this proposal strengthens the self-regulating aspects of ERISA. With minimum government intervention, participants and other parties to the plan will have an improved ability to verify and monitor plan assets. The following bullets highlight the other potential benefits of the proposed regulation in a qualitative, and when possible, quantitative, way:

- Confidence in the private pension system may be strengthened and may result in increased participation among the nearly 600,000 private wage and salary workers who currently elect not to participate in a small plan that is offered;
- In 1998, more than \$6 million in pension plans assets were recovered as a result of criminal investigations. If new conditions are imposed on the small plan audit exemption, fewer assets may be missing from plans in the future because of the checks and balances put in place by improved information disclosure;
- The investigations and litigation associated with recovering assets of small pension plans can be very costly to private parties and to the Government. In 1998, nearly 6,000 civil investigations were initiated by the Department. If new conditions are imposed on the small plan audit exemption, losses will likely decline and fewer investigations of small pension plans may be needed. This will have the dual effect of lowering investigation-related costs for small plans and permitting Federal authorities to enhance the security of other participants by directing their efforts elsewhere; and
- When workers discover that their pension plan assets are missing or are jeopardized, worker productivity declines. Time at work may be spent investigating what happened to plan assets, whether they will be restored, and whether retirement will be possible without these pension assets. If fewer instances of embezzlement occur as a result of additional conditions being imposed on the small plan audit exemption, this productivity loss will likely be reduced or eliminated.

Regulatory Flexibility Act

The Regulatory Flexibility Act (5 U.S.C. 601 *et seq.*) (RFA) imposes certain requirements with respect to Federal rules that are subject to the notice and comment requirements of section 553(b) of the Administrative Procedure Act (5 U.S.C. 551 *et seq.*) and which are likely to have a significant economic impact on a substantial number of small entities. Unless an agency determines that a proposed rule

is not likely to have a significant economic impact on a substantial number of small entities, section 603 of the RFA requires that the agency present an initial regulatory flexibility analysis at the time of the publication of the notice of proposed rulemaking describing the impact of the rule on small entities and seeking public comment on such impact. Small entities include small businesses, organizations and governmental jurisdictions.

For purposes of analysis under the RFA, PWBA proposes to continue to consider a small entity to be an employee benefit plan with fewer than 100 participants. The basis of this definition is found in section 104(a)(2) of the Employee Retirement Income Security Act of 1974 (ERISA), which permits the Secretary of Labor to prescribe simplified annual reports for pension plans which cover fewer than 100 participants. Under section 104(a)(3), the Secretary may also provide for exemptions or simplified annual reporting and disclosure for welfare benefit plans. Pursuant to the authority of section 104(a)(3), the Department has previously issued at 29 C.F.R. §§ 2520.104–20, 2520.104–21, 2520.104–41, 2520.104–46 and 2520.104b–10 certain simplified reporting provisions and limited exemptions from reporting and disclosure requirements for small plans, including unfunded or insured welfare plans covering fewer than 100 participants and which satisfy certain other requirements.

Further, while some large employers may have small plans, in general most small plans are maintained by small employers. Thus, PWBA believes that assessing the impact of this proposed rule on small plans is an appropriate substitute for evaluating the effect on small entities. The definition of small entity considered appropriate for this purpose differs, however, from a definition of small business which is based on size standards promulgated by the Small Business Administration (SBA) (13 CFR 121.201) pursuant to the Small Business Act (15 U.S.C. 631 *et seq.*). PWBA therefore requests comments on the appropriateness of the size standard used in evaluating the impact of this proposed rule on small entities.

On this basis, however, PWBA has preliminarily determined that this rule will not have a significant economic impact on a substantial number of small entities. In support of this determination, and in an effort to provide a sound basis for this conclusion, PWBA has prepared the following regulatory flexibility analysis.

⁶ The bonding premium was estimated based on information supplied by industry representatives.

The amount of assets in small pension plans has grown nearly tenfold since 1975, making small pension plans an increasingly important retirement savings vehicle for Americans. In light of recent cases involving embezzlement or other misappropriations of pension assets that have focused national attention on the potential vulnerability of small pension plans to fraud and abuse, this regulatory action is being considered to enhance the security and accountability of small pension plans.

The objective of the proposed rule is to verify the existence of small pension plan assets and to provide information to all parties to the plan in order to enhance pension plan security. The requirements governing the proposed regulation are set forth in ERISA section 104(a)(2), in which Congress evidenced specific intent to provide small plans with relief from burdensome and expensive reporting requirements, and in the regulations §§ 2520.104-41 and 2520.104-46.

The proposed regulation amends the Department's existing waiver of examination and report of an independent qualified public accountant for employee benefit plans with fewer than 100 participants under ERISA. In 1995, there were about 605,000 employee pension plans with fewer than 100 participants that met the requirements for the audit waiver. Under the proposed regulation, an estimated 94% of these plans will meet the additional audit waiver requirement that at least 95% of plan assets be "qualifying plan assets." This means that only about 37,000 small plans will

be subject to the requirement that the plan either purchase fidelity bonds for those assets that are not "qualifying plan assets" or obtain an audit. All 605,000 small pension plans will be subject to the disclosure requirement that the SAR contain summary information on the financial institution statements and bonds, and that the information be provided free of charge upon request.

This proposed rule impacts all classes of small pension plans with fewer than 100 participants subject to Title I of ERISA. The proposal described here is the one that accomplishes the objective of enhancing pension plan security without imposing significant costs via additional reporting, recordkeeping, and other compliance requirements. The 6% of plans that do not meet the proposed criteria for an audit waiver must either purchase a fidelity bond to cover the funds that are not "qualifying plan assets" or obtain an audit. We assume plans will choose the less costly alternative—bonding. In addition to the average bond premium of \$200 per plan, obtaining the bond is estimated to involve one-half hour of an analyst's time at \$39 per hour per small plan, for an aggregate cost of \$8 million. Second, the plan administrator would have to receive from each qualifying financial institution a statement identifying each plan asset held. No cost is associated with this requirement because the statements required from qualifying financial institutions are records that these institution dispense as part of usual and customary business practices and that plan administrators must

obtain to properly discharge their annual reporting obligations under ERISA. Third, the plan's SAR would have to include summary information describing the statements and fidelity bonds and a notice that copies of the statements and bonds are available at no charge. This requirement involves an initial start up cost of \$5.9 million—15 minutes of a professional's time at \$39 for all 605,000 small plans to modify their SAR forms to include the language required by the regulation. Additionally, plans would be required to provide participants and beneficiaries copies of the statements and bonding information upon request. The Department assumes that 5% of participants and beneficiaries will request this information at a cost of \$995,000 to plans—assembling and photocopying by a clerical worker at \$15 per hour for 7 minutes per distribution, and mailing costs of \$.37 per mailing. The aggregate annual disclosure cost of \$995,000 translates to only \$1.64 per plan and is the only annual cost imposed by this regulation on the estimated 568,000 plans meeting the 95% test. For the 37,000 plans not meeting the 95% test, they also face an annual cost of \$8 million for bonding requirements, or an additional \$220 per plan. Additionally, all 605,000 plans face the one time start up cost of \$10 per plan.

When considering any regulatory action, it is important to consider the impact on businesses of various sizes. Given that well over half of all small pension plans (57%) have between 1 and 10 participants, it is important to focus on these small plans in particular.

ESTIMATES OF THE NUMBER AND PERCENTAGE OF VERY SMALL PENSION PLANS (1-9 PARTICIPANTS) NOT MEETING THE "QUALIFYING PLAN ASSETS" TEST AT VARIOUS THRESHOLD LEVELS

	Alternative Threshold Levels for Qualifying Plan Assets						
	100%	95%	90%	85%	80%	75%	<75%
Number of plans	186,142	20,377	10,771	9,402	8,737	8,100	49
Percent of plans	54%	6%	3%	3%	3%	2%	.01%

As the above table shows,⁷ the percent of plans with 1-9 participants that would meet the requirement that 95% of assets be "qualifying plan assets" is the same as that for all small plans with fewer than 100 participants. Therefore, the 95% threshold is reasonable for all classes of plans within the category of those with fewer than 100 participants.

A discussion of alternatives to the proposed rule that the Department considered appears above in the "Examination of Alternative Approaches" section of the Executive Order 12866 Statement.

No relevant federal rules are anticipated to duplicate, overlap, or conflict with this proposed rule.

Paperwork Reduction Act

The Department of Labor, as part of its continuing effort to reduce paperwork and respondent burden, conducts a preclearance consultation program to

provide the general public and Federal agencies with an opportunity to comment on proposed and continuing collections of information in accordance with the Paperwork Reduction Act of 1995 (PRA 95) (44 U.S.C. § 3506(c)(2)(A)). This helps to ensure that requested data can be provided in the desired format, reporting burden (time and financial resources) is minimized, collection instruments are clearly understood, and the impact of collection requirements on respondents can be properly assessed.

⁷ The data in the table was estimated in the same way as that for pension plans with more than 100 participants (see Executive Order 12866 Statement).

Currently, the Pension and Welfare Benefits Administration is soliciting comments concerning the proposed revision of the information collection request (ICR) included in this Notice of Proposed Small Pension Plan Security Amendments. A copy of the ICR may be obtained by contacting the office listed in the addressee section of this notice.

The Department of Labor (Department) has submitted a copy of the proposed information collection to the Office of Management and Budget (OMB) in accordance with 44 U.S.C. § 3507(d) of PRA 95 for review of its information collections. The Department and OMB are particularly interested in comments which:

- Evaluate whether the proposed collection of information is necessary for the proper performance of the functions of the agency, including whether the information will have practical utility;
- Evaluate the accuracy of the agency's estimate of the burden of the proposed collection of information, including the validity of the methodology and assumptions used;
- Enhance the quality, utility, and clarity of the information to be collected; and
- Minimize the burden of the collection of information on those who are to respond, including through the use of appropriate automated, electronic, mechanical, or other technological collection techniques or other forms of information technology, e.g., permitting electronic submission of responses.

Comments should be sent to the Office of Information and Regulatory Affairs, Office of Management and Budget, Room 10235, New Executive Office Building, Washington, D.C. 20503; Attention: Desk Officer for the Pension and Welfare Benefits Administration. Although comments may be submitted through January 31, 2000, OMB requests that comments be received within 30 days of publication of the Notice of Proposed Rulemaking to ensure their consideration.

ADDRESSEE (PRA 95): Gerald B. Lindrew, Office of Policy and Research, U.S. Department of Labor, Pension and Welfare Benefits Administration, 200 Constitution Avenue, NW, Room N-5647, Washington, D.C. 20210. Telephone: (202) 219-4782 (this is not a toll-free number); Fax: (202) 219-4745.

The proposed modifications to the small plan audit waiver will increase the security and accountability of small pension plans. The paperwork burden imposed on plans will be minimal. No paperwork burden is associated with

two of the three provisions in the regulation—the requirement that 95% of plan assets be—qualifying plan assets” and the improved bonding requirement for those plans not meeting the 95% test. Paperwork does arise from the third provision—modifying the SAR to include summary information describing the statements and bonds and noting that copies are available upon request. This requirement involves a one-time start up cost to plans to modify their SAR forms to include the language required by the regulation. Since 90% of plans are assumed to use service providers to comply with ERISA Form 5500 and SAR reporting requirements, it is assumed that the modifications to the SAR form will be done by service providers for 90% of plans, and in-house for the remaining plans. The start up cost (averaged over a three year period) is estimated to be \$1.8 million for the 90% small plans using service providers and 15,000 hours for the remaining plans—15 minutes per plan, at \$39 per hour (professional's rate) for those plans using service providers. Another cost associated with the SAR disclosure requirements is providing copies of the statements and bonding information to participants and beneficiaries who request them. The Department assumes that 5% of participants and beneficiaries will request this information. Since the documents already have been provided by bonding companies and financial institutions, the cost of compliance per distribution merely involves 5 minutes to ready the appropriate documents for mailing and 2 minutes of photocopying by a clerical worker, at a \$15 hourly rate for plans using service providers, and mailing costs of \$.37 per mailing. The aggregate burden is \$912,000 and 5,500 hours.

Type of Review: Revision of an existing information collection.

Agency: Pension and Welfare Benefits Administration, Department of Labor.

Title: ERISA Summary Annual Report Requirement.

OMB Number: 1210-0040.

Affected Public: Individuals or households; Business or other for-profit; Not-for-profit institutions.

Frequency of Response: Annually.

Total Respondents: 817,000.

Total Responses: 235,000,000.

Estimated Burden Hours: 1,390,172 total (1,369,577 for existing information collection request, and 20,595 for proposed amendments).

Estimated Annual Cost (Capital/Startup): \$1,770,000 total.

Estimated Annual Costs (Operating and Maintenance): \$112,287,000 total (\$111,375,000 for the existing

information collection request, and \$912,000 for proposed amendments).

Total Annualized Costs: \$114,057,000 total (\$111,375,000 for the existing information collection request, and \$2,682,000 for proposed amendments).

Comments submitted in response to this notice will be summarized and/or included in the request for OMB approval of the information collection request; they will also become a matter of public record.

Unfunded Mandates Reform Act

For purposes of the Unfunded Mandates Reform Act of 1995 (Pub. L. 104-4), as well as Executive Order 12875, this proposed rule does not include any Federal mandate that may result in expenditures by State, local or tribal governments, and does not impose an annual burden exceeding \$100 million on the private sector.

Small Business Regulatory Enforcement Fairness Act

The rule proposed in this action is subject to the provisions of the Small Business Regulatory Enforcement Fairness Act of 1996 (5 U.S.C. 801, *et seq.*) (SBREFA) and is a major rule under SBREFA. The rule, if finalized, will be transmitted to Congress and the Comptroller General for review.

Statutory Authority

These regulations are proposed pursuant to authority contained in section 505 of ERISA (Pub. L. 93-406, 88 Stat. 894, 29 U.S.C. 1135) and section 104(a) of ERISA, as amended, (Pub. L. 104-191, 110 Stat. 1936, 1951, 29 U.S.C. 1024), and under Secretary of Labor's Order No. 1-87, 52 FR 13139, April 21, 1987.

List of Subjects in 29 CFR Part 2520

Accountants, Disclosure requirements, Employee benefit plans, Employee Retirement Income Security Act, Pension plans, and Reporting and recordkeeping requirements.

For the reasons set out in the preamble, Part 2520 of Chapter XXV of Title 29 of the Code of Federal Regulations is proposed to be amended as follows:

PART 2520—RULES AND REGULATIONS FOR REPORTING AND DISCLOSURE

PART 2520—[AMENDED]

1. The authority for Part 2520 continues to read as follows:

Authority: Secs. 101, 102, 103, 104, 105, 109, 110, 111(b)(2), 111(c) and 505, Pub. L. 93-406, 88 Stat. 840-52 and 894 (29 U.S.C. 1021-1025, 1029-31, and 1135); Secretary of

Labor's Order No. 27-74, 13-76, 1-87, and Labor Management Services Administration Order 2-6.

Sections 2520.102-3, 2520.104b-1 and 2520.104b-3 also are issued under sec. 101(a), (c) and (g)(4) of Pub. L. 104-191, 110 Stat. 1936, 1939, 1951 and 1955, and sec. 603 of Pub. L. 104-204, 110 Stat. 2935 (29 U.S.C. 1185 and 1191c).

2. Section 2520.104-41 is amended by revising paragraph (c) as follows:

§ 2520.104-41 Simplified annual reporting requirements for plans with fewer than 100 participants.

* * * * *

(c) *Contents.* The administrator of an employee pension or welfare benefit plan described in paragraph (b) of this section shall file, in the manner prescribed in § 2520.104a-5, a completed Form 5500 "Annual Return/Report of Employee Benefit Plan," including any required schedules or statements prescribed by the instructions to the form, and, unless waived by § 2520.104-46, a report of an independent qualified public accountant meeting the requirements of § 2520.103-1(b).

* * * * *

3. Section 2520.104-46 is amended by revising paragraphs (b)(1) and (d) to read as follows:

§ 2520.104-46 Waiver of examination and report of an independent qualified public accountant for employee benefit plans with fewer than 100 participants.

* * * * *

(b) *Application.* (1)(i) The administrator of an employee pension benefit plan for which simplified annual reporting has been prescribed in accordance with section 104(a)(2)(A) of the Act and § 2520.104-41 is not required to comply with the annual reporting requirements described in paragraph (c) of this section, provided that with respect to each plan year for which the waiver is claimed—

(A) (1) At least 95 percent of the assets of the plan constitute qualifying plan assets within the meaning of paragraph (b)(1)(ii) of this section, or

(2) Any person who handles assets of the plan that do not constitute qualifying plan assets is bonded in accordance with the requirements of section 412 of the Act and the

regulations issued thereunder, except that the amount of the bond shall not be less than the value of such assets;

(B) The summary annual report, described in § 2520.104b-10, includes, in addition to any other required information:

(1) The name of each institution holding qualifying plan assets and the amount of such assets held by each institution as of the end of the plan year;

(2) The name of the surety company issuing a bond for purposes of paragraph (b)(1)(i)(A)(2);

(3) A notice indicating that participants and beneficiaries may, upon request and without charge, examine or receive copies of evidence of any bond required by paragraph (b)(1)(i)(A)(2) and copies of statements received from each institution holding qualifying assets which describe the assets held by the institution as of the end of the plan year; and

(4) A notice stating that participants and beneficiaries should contact the Regional Office of the U.S. Department of Labor's Pension and Welfare Benefits Administration if they are unable to examine or obtain copies of the statements received from each institution holding qualifying assets or evidence of the bond, if applicable; and

(C) In response to a request from any participant or beneficiary, the administrator, without charge to the participant or beneficiary, makes available for examination, or upon request furnishes copies of, evidence of any bond required by paragraph (b)(1)(i)(A)(2) and the statement of assets from each financial institution holding qualifying assets as of the end of the plan year.

(ii) For purposes of paragraph (b)(1), the term "qualifying plan assets" means:

(A) Qualifying employer securities, as defined in section 407(d)(1) of the Act and the regulations issued thereunder;

(B) Any loan meeting the requirements of section 408(b)(1) of the Act and the regulations issued thereunder; and

(C) Any assets held by the following institutions:

(1) A bank or similar financial institution as defined in § 2550.408b-4(c);

(2) An insurance company qualified to do business under the laws of a state;

(3) An organization registered as a broker-dealer under the Securities and Exchange Act of 1934; or

(4) Any other organization authorized to act as a trustee for individual retirement accounts under section 408 of the Internal Revenue Code.

(iii) For purposes of paragraph (b)(1), the determination of the percentage of all plan assets consisting of qualifying plan assets with respect to a given plan year shall be made in the same manner as the amount of the bond is determined pursuant to §§ 2580.412-11, 2580.412-14, and 2580.412-15.

* * * * *

(d) *Limitations.* (1) The waiver described in this section does not affect the obligation of a plan described in paragraph (b) (1) or (2) of this section to file a Form 5500 "Annual Return/Report of Employee Benefit Plan," including any required schedules or statements prescribed by the instructions to the form. See § 2520.104-41.

(2) For purposes of this section, an employee pension benefit plan for which simplified annual reporting has been prescribed includes an employee pension benefit plan which elects to file a Form 5500 as a small plan pursuant to § 2520.103-1(d) with respect to the plan year for which the waiver is claimed. See § 2520.104-41.

(3) For purposes of this section, an employee welfare benefit plan that covers fewer than 100 participants at the beginning of the plan year includes an employee welfare benefit plan which elects to file a Form 5500 as a small plan pursuant to § 2520.103-1(d) with respect to the plan year for which the waiver is claimed. See § 2520.104-41.

(4) A plan that elects to file a Form 5500 as a large plan pursuant to § 2520.103-1(d) may not claim a waiver under this section.

Signed at Washington, D.C., this 24th day of November, 1999.

Richard M. McGahey,

Assistant Secretary, Pension and Welfare Benefits Administration, U.S. Department of Labor.

[FR Doc. 99-31110 Filed 11-30-99; 8:45 am]

BILLING CODE 4510-29-P