DEPARTMENT OF LABOR

Pension and Welfare Benefits Administration

29 CFR Part 2520

RIN 1210–AA73

Small Pension Plan Security Amendments

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

ACTION: Final rule.

SUMMARY: This document contains a final rule amending the regulations governing the circumstances under which small pension plans are exempt from the requirements to engage an independent qualified public accountant (IQPA) and to include a report of the accountant as part of the plan's annual report under Title I of the Employee Retirement Income Security Act of 1974, as amended (ERISA). These regulatory amendments provide a waiver of the IQPA annual examination and report requirements for employee benefit plans with fewer than 100 participants at the beginning of the plan year. The amendments being made by this final rule are designed to increase the security of assets in small pension plans by conditioning the waiver on enhanced disclosure of information to participants and beneficiaries and, in certain instances, improved fidelity bonding requirements. The amendments do not affect the waiver for small welfare plans (such as group health plans) under 29 CFR 2520.104–46. Conforming amendments are also being made to the simplified annual reporting requirements for small pension plans specified in 29 CFR 2520.104–41. These amendments affect participants and beneficiaries covered by small pension plans, sponsors and administrators of small pension plans, and providers of investment and administrative services to small pension plans.

DATES: Effective Date: This rule is effective December 18, 2000. Applicability Date: The amendments made by this rule are applicable as of the first plan year beginning after April 17, 2001.

FOR FURTHER INFORMATION CONTACT: John Keene, Office of Regulations and Interpretations, Pension and Welfare Benefits Administration, Room N–5669, 200 Constitution Avenue, N.W., Washington, DC 20210, (202) 219–8521. This is not a toll-free number.

SUPPLEMENTARY INFORMATION: On December 1, 1999, the Department published in the **Federal Register** (64 FR 67436) 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 an opinion of the accountant as part of the plan's annual report under Title I of ERISA. The Department invited interested persons to submit written comments on the proposed amendments. The Department received 19 written comments from the public regarding the proposal. The following discussion summarizes the proposed regulation and the major issues raised by the commenters. It also explains the Department's reasons for the modifications reflected in the final regulation that is being published with this notice.

A. Background

In general, the administrator of an employee benefit plan required to file an annual report under Title I of ERISA must engage an IQPA and include the IQPA's opinion as part of the plan's annual report. These annual reporting requirements can be satisfied by filing the Form 5500 ''Annual Return/Report of Employee Benefit Plan'' in accordance with its instructions and related regulations.[1] The requirements governing the content of the opinion and report of the IQPA are set forth in section 103(a)(3)(A) of ERISA and 29 CFR 2520.103–1(b). Section 104(a)(2)(A) of ERISA permits the Department to prescribe, by regulation, simplified annual reports for pension plans with fewer than 100 participants, and section 103(a)(3)(A) permits the Department to waive the IQPA requirements for pension plans for which such simplified annual reporting has been prescribed. Section 104(a)(3) of ERISA permits the Department to prescribe exemptions and simplified reporting and disclosure requirements for welfare plans. In accordance with the Department's authority under sections 104(a)(2)(A) and 104(a)(3) of ERISA, 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 such small plans a waiver from the requirements 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 risen dramatically and small pension plans have become increasingly important retirement savings vehicles for a growing number of American workers. Media coverage of a particularly egregious case involving misappropriation of a small pension plan's assets over several years focused national attention on the potential vulnerability of small pension plans to fraud and abuse. The Department has had experience with other small pension plan cases involving service providers, administrators or other fiduciaries attempting to conceal fraud or misappropriations by falsifying financial and other information provided 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 concluded, given the increasing extent to which workers are depending on their employment-based pension plans as a primary source of retirement income, that it is appropriate to take steps to improve the security of assets in small pension plans.

One approach the Department considered to improve the security of assets in small pension plans was to require all such plans to comply with the audit requirements of section 103(a)(3)(A) of ERISA. While subjecting the assets of small pension plans to an annual 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. Rather, in developing the proposed regulation, the Department attempted to balance the interest in providing secure retirement savings for participants and beneficiaries with the interest in minimizing costs and burdens on small pension plans and the sponsors of those plans.

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

[1] See sections 101(b) and 103 of ERISA, and 29 CFR 2520.103–1.

requirement—could enhance the level of security and accountability while keeping administrative burdens and costs to a minimum by building on current recordkeeping, disclosure and bonding requirements and practices. In general, the Department believes that statements regarding plan assets prepared by certain regulated financial institutions (such as banks, insurance companies, mutual funds, and registered securities brokers), if made available to participants and beneficiaries, provide a reliable means by which participants and beneficiaries can independently confirm that the assets reported by the plan as being available to pay benefits as of the end of the plan year are, in fact, available according to the books and records of the regulated financial institution. 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 will serve to reduce the risk of loss due to acts of fraud or dishonestly where a substantial percentage of a plan's assets are held by entities that may not be subject to state or federal regulatory oversight. This approach was set forth as proposed new conditions for obtaining a waiver under § 2520.104–46 of the requirements to engage an IQPA and include the IQPA's opinion as part of the plan's annual report.

B. Summary of the Proposal

The first part of the proposal focused 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 used the term ''qualifying plan assets'' in applying the conditions of the waiver. ''Qualifying plan assets'' were defined 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 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 included 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 section 408(b)(1) of ERISA and qualifying employer securities as defined in section 407(d)(5) of ERISA. See Proposed § 2520.104–46(b)(1)(ii).

The proposal provided, with respect to each plan year for which the waiver is claimed, that at least 95% of the assets of the plan must constitute ''qualifying plan assets'' or that any person who handles assets that do not constitute ''qualifying plan assets'' is covered by a bond meeting the requirements of section 412 of ERISA, except that the amount of the bond is not less than the value of such assets.[2] The 95% test was 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. Only where more than 5% of a plan's assets do not constitute ''qualifying plan assets'' would the bonding component of the proposal apply.

The proposal required that 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 must 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. The proposal provided that, 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, the Department concluded that, assuming the administrator does not elect to engage an IQPA, the determination of ''qualifying plan assets'' should be made on the same basis as the required bond.[3]

Under the second part of the proposal, the waiver of the IQPA requirements was further conditioned on the disclosure of certain information to participants and beneficiaries. Specifically, § 2520.104–46(b)(1)(i)(B) required that the summary annual report (SAR) of a plan electing the waiver include, in addition to the other information required by § 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 that 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.

Nothing in the proposal affected the obligation of a plan that would be eligible for the audit waiver to file a Form 5500 ''Annual Return/Report of Employee Benefit Plan,'' including any schedules or statements required by the instructions to the form. On the other hand, the proposal made it clear that a plan electing to file a Form 5500 as a small pension plan pursuant to the ''80 to 120 rule'' in § 2520.103–1(d) may claim the audit waiver in the same manner and under the same conditions as a plan with fewer than 100 participants.[4]

Finally, conforming amendments to the simplified annual reporting provisions in § 2520.104–41 were included in the proposal to 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, to include with the plan's annual report the financial statements, notes and schedules prescribed in section 103(b) of ERISA and 29 CFR 2520.103–1, and to include within the plan's annual report a report of an IQPA as prescribed in section

[2] Section 412 of ERISA and the regulations issued thereunder, 29 CFR 2550.412–1, 2580.412–1 *et seq.*, set forth the bonding requirements generally applicable to ERISA-covered plans.

[3] 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.

[4] 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 audit waiver even though the plan covered more than 100 participants as of the beginning of the plan year. Conversely, 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 by this section to small plan filers.

103(a)(3)(A) of ERISA and 29 CFR 2520.103–1(b)(5).

C. Summary of Public Comments

As noted above, the Department received 19 written comments regarding the proposal. The commenters generally expressed the view that the Department's proposal, for the most part, struck a reasonable balance between enhancing the level of security and accountability for small pension plan assets and minimizing administrative burdens and costs on plans and plan sponsors. The commenters also generally concluded that, although the proposal will impose new costs on some small employers, the proposal was structured so that costs are generally proportionate to the risk and the additional burdens should be modest. The following discussion summarizes the major issues raised by the commenters and explains the Department's reasons for the modifications reflected in the final regulation.

1. Definition of Qualifying Plan Assets

Several commenters asked the Department to clarify the terms ''held by'' and ''hold'' as used in describing the requirements that assets must be held by certain regulated financial institutions and that year-end statements regarding plan assets must be from the financial institution holding the plan's assets. See § 2520.104–46(b)(1)(i)(B)(*1*), (b)(1)(ii)(C), and (b)(1)(ii)(F). The Department intended that the ''held'' term as used in the proposal would generally have the same meaning as it has in section 103(a)(2) of ERISA. Specifically, section 103(a)(2) provides that certain entities which ''holds'' some or all of the assets of the plan must transmit and certify to the plan administrator information regarding the assets that is needed by the administrator to comply with any requirement of Title I of ERISA. Although section 103(a)(2) is limited to insurance carriers and other organizations that hold plan assets in a separate account and to banks and similar institutions that hold plan assets in a common or collective trust, a separate trust or a custodial account, the concept of what constitutes ''holding'' of a plan's assets under the proposal was intended to be the same as under section 103(a)(2).

In that regard, two commenters requested confirmation that certain arrangements involving use of ''omnibus accounts'' by banks and registered broker-dealers would satisfy the ''holding'' requirement. The commenters stated that many banks and registered broker-dealers provide various investment related services to small pension plans, often acting as custodian, recordkeeper or investment manager. The commenters indicated that the bank or broker-dealer will keep internal records tracking the specific assets that belong to each of their small pension plan customers. The plans' assets may consist of individual securities (including stocks, bonds and mutual fund shares), real estate, limited partnerships or other types of assets. In the case of securities, according to the commenters, banks and registered broker dealers often make trades for the plans in the bank's or broker-dealer's name through omnibus accounts, with most of these trades being made through depositories, such as the Depository Trust Company, or through the National Securities Clearing Corporation in the case of mutual fund shares. In all these cases, the securities are held in the name of the bank or broker-dealer on behalf of the plans and the bank or broker-dealer maintains internal records that show what assets belong to what plan. The Department agrees that such omnibus account structures would constitute the bank or registered broker-dealer ''holding'' the plan's securities for purposes of satisfying the audit waiver requirements.

Other commenters asked for clarification of whether the Department intended to exclude from the definition of ''qualifying plan assets'' certain types of traditional plan investments, for example, investments in mutual funds and insurance company general account contracts, which may not involve a regulated financial institution ''holding'' plan assets.[5] The commenters noted that it is not uncommon for small pension plans to have an individual employee of the plan sponsor serve as the trustee of the plan. In such cases, plan assets may be invested in mutual fund shares or in an insurance company general account contract with the individual trustee holding the shares or contract in his or her name as trustee of the plan. The commenter stated that the plan may be unable to meet the conditions in the proposal for two reasons: (1) Plan assets, *i.e.*, the mutual fund shares and the insurance contract, will not be ''held'' by a regulated financial institution, and (2) year-end statements regarding the assets will not be from an institution ''holding'' the plan's assets.

The Department stated in the preamble to the proposal that ''[i]n 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.'' The Department agrees with the commenters that plan investments in mutual fund shares for which the registered investment company maintains records of shareholder accounts and prepares and mails shareholder account statements provides a commensurate level of security and accountability to that which would exist if the plan's assets were held by and disclosure statements were produced by a bank, insurance company, or registered broker-dealer.[6] The Department believes that the same is true for general account contracts of an insurance company qualified to do business under the laws of a state where the insurance company prepares and mails statements to the plan regarding the value of the contract as of the end of the year and transaction activity related to the contract during the plan year. Accordingly, the final rule includes a change to the definition of qualifying plan assets that is intended to include such mutual fund shares and insurance company general account contracts as ''qualifying plan assets.'' See § 2520.104–46(b)(1)(ii)(D) & (E). The final rule also includes corresponding changes to the Summary Annual Report (SAR) and related disclosure provisions to reflect the inclusion of mutual fund shares issued by a registered investment company and general account investment contracts issued by

[5] See the Department's regulation at 29 CFR 2550.401c–1 regarding the definition of plan assets as it relates to insurance company general accounts.

[6] According to the commenter, it is a common practice for a mutual fund to employ ''registered transfer agents'' to maintain records of shareholder accounts, calculate and disburse dividends, and prepare and mail shareholder account statements, federal income tax information and other shareholder notices. Some transfer agents prepare and mail statements confirming shareholder investment transactions and account balances and maintain customer service departments to respond to shareholder inquiries. Transfer agents are regulated by and subject to periodic examination by the Securities and Exchange Commission (SEC) under the Securities Exchange Act of 1934. Among other requirements, transfer agents must register with the SEC using a Form TA–1 and must file annually with the SEC a report prepared by an independent accountant concerning the transfer agent's system of accounting controls and related procedures for the transfer of record ownership and the safeguarding of related securities and funds. For purposes of the audit waiver, the Department would consider statements from a registered transfer agent employed by the mutual fund to be statements from the mutual fund.

insurance companies in the definition of ''qualifying plan assets.'' See § 2520.104–46(b)(1)(i).

Another commenter suggested that assets of individual account plans that are invested at the direction of participants or beneficiaries should be included in the definition of ''qualifying plan assets.'' The Department did not include such a provision in the proposal because information available to the Department regarding those assets indicated that they generally would meet the conditions in the proposal. The commenters stated, however, that the SAR disclosures and the requirement to make financial institution statements available to participants and beneficiaries in individual account plans, like 401(k) plans, could involve an extensive list of financial institutions in cases where the plan provides a broad range of investment options. Also, the commenters noted that especially in such individual account plans that cover a very small number of employees, the proposed SAR disclosures could give all the plan's participants and beneficiaries access to confidential financial information regarding the type and performance of individual account investments made by other participants. The commenters indicated that this result would particularly impact small business owners who often have the largest accounts in the plan, and, accordingly, could create a tension in the small business market that would be inconsistent with the Department's goal of encouraging pension plan establishment and maintenance. The commenters suggested that the Department address this concern by including such participant-directed assets in the definition of qualifying plan assets subject to the condition that participants and beneficiaries are furnished statements regarding the assets allocated to their individual accounts at least annually directly from a qualified independent financial institution, such as a bank, insurance company, registered broker-dealer, or mutual fund.

The Department believes that, in the case of an individual account plan, the security and accountability objectives of the proposal can be met for assets allocated to individual accounts if the participant or beneficiary has the opportunity to exercise control with respect to those assets and the participant or beneficiary is provided, at least annually, a statement from a regulated financial institution describing the assets held (or issued) by such institution and the value of such assets. In such a case, each participant can effectively monitor the assets in their individual accounts, and the regulated financial institution statements provide a reliable assurance that the assets reported to be in the individual account are in fact there. Accordingly, the definition of ''qualifying plan assets'' has been modified in the final rule so that plan administrators of individual account plans can rely on this alternative approach in determining whether participant directed assets allocated to individual accounts can be treated as ''qualifying plan assets'' for purposes of applying the 95% test.

Another commenter suggested that the Department exclude qualifying employer securities from those assets considered to be qualifying plan assets. The commenter stated that qualifying employer securities should not be treated as qualifying plan assets because they are ''frequently mis-valued'' and are subject to special rules. It was the intention of the Department in proposing these amendments to improve the security of plan assets against losses due to fraud or dishonesty by providing a means under which the existence and amount of the plan's investments could be independently verified by participants and beneficiaries. The comment regarding valuation practices raise issues that are beyond the scope of the proposal, and, accordingly, the Department did not make any changes to the proposal in response to this comment.

One commenter asked the Department to clarify in two respects the definition of qualifying plan assets as applied to participant loans. The commenter asked whether a loan that is treated as a distribution under section 72(p) of the Internal Revenue Code because it exceeds the maximum dollar limit set forth in Code 72(p)(2)(A)(1) will fail to be a qualifying plan asset. Under the proposal, qualifying plan assets included ''any loan meeting the requirements of section 408(b)(1) of the Act and the regulations issued thereunder.'' Neither section 408(b)(1) of ERISA nor the Department's regulations at § 2550.408b–1 expressly place a specific dollar limit on participant loans; however, § 2550.408b–1(a)(1)(iii) requires that loans must be made in accordance with specific provisions regarding such loans set forth in the plan. Accordingly, to the extent that the plan terms regarding participant loans include limits intended to ensure that the plan's loan program complies with requirements under Code 72(p)(2), those plan terms would have to be complied with for the loan to meet the requirements of section 408(b)(1) of ERISA.

The commenter also asked whether a loan would be seen as continuing to satisfy the requirements of section 408(b)(1) of ERISA, and therefore continue to constitute a qualifying plan asset, even after a participant was in default under terms of the loan agreement. The Department included participant loans within the term ''qualifying plan assets'' because of the belief that such loans are assets that present little risk of loss to participants and beneficiaries as a result of acts of fraud or dishonesty. Even where a participant defaults on a loan, that fact generally should not put the plan at greater risk of loss due to fraud or dishonesty. Accordingly, the Department does not believe that the characterization of a participant loan as ''in default'' should disqualify the loan from continuing to be treated as a ''qualifying plan asset.''

One commenter suggested that the audit waiver be conditioned on all the assets of the plan being held by qualifying financial institutions that file Form 5500 annual reports with the Department regarding the assets they hold. Several other commenters stated that the 95% test was reasonable, provided adequate flexibility, and was consistent with the investment practices of most small pension plans. It was not, and continues not to be, the intent of the Department to directly or indirectly influence the type of investments held by small pension plans through application of the audit requirements. Rather, the Department continues to believe that all plan assets do not need to be held by a regulated financial institution to achieve the improved level of security and accountability that is the objective of this rulemaking. Rather, the definition of ''qualifying plan assets,'' the disclosure requirements, and the bonding components of the rule provide plans with flexibility in structuring their investment portfolios while also ensuring an adequate level of security and accountability. Accordingly, the Department did not adopt this suggestion.

2. Fidelity Bonding Requirements

A number of commenters requested clarification of what constitutes ''handling'' for purposes of the requirement that persons who handle non-qualifying plan assets must be covered by a fidelity bond in an amount equal to the value of the assets they handle. The term ''handling'' is defined in 29 CFR 2580.412–6 for purposes of the general fidelity bonding requirement under section 412 of ERISA. The proposal expressly required that persons handling non-qualifying plan assets would have to be 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.'' See Proposed § 2520.104–46(b)(1)(i)(A)(2). No change is being made in the final rule to this aspect of the proposal. Accordingly, the definition of handling in § 2580.412–6 would apply for purposes of meeting the fidelity bonding conditions in § 2520.104–46 as amended by the final rule.

The Department received several comments that focused on the amount of bonding coverage required under the proposal. One commenter was critical of the fidelity bonding provisions in the proposal because such bonds do not protect against losses resulting from imprudent investments and because the commenter believed that ''no amount of increased reporting or bonding will prevent a crook from being a crook.'' On the other hand, a comment submitted from the surety industry suggested as an alternative to the conditions in the proposal that the Department require 100% of the assets of a small pension plan be covered by a fidelity bond as the most effective way to increase the protection of plans from losses due to fraud or dishonesty. Another commenter observed that under the proposal some plans would be able to use their general fidelity bond under section 412 of ERISA to satisfy the fidelity bonding requirement in the proposal, and suggested that the amount of the fidelity bonding coverage be increased to condition the audit waiver on the plan having a bond in an amount equal to 10% of all plan assets plus 100% of all non-qualifying plan assets.

Although it may not be feasible to develop a regulation that would make it impossible for any plan to suffer any losses due to fraud or dishonesty, the Department does not consider that circumstance to be a valid reason for not adopting this regulation which will provide meaningful enhancements in security and accountability for participants and beneficiaries in small pension plans. The Department also is not prepared to adopt the suggestion that 100% of all small pension plans' assets be required to be covered by a fidelity bond because such a requirement would, in the Department's view, impose more costs on plans and plan sponsors without providing substantially more security for qualifying plan assets. The 100% bonding approach suggested by the commenter also would not provide participants and beneficiaries the improved disclosures set forth in the proposal. Lastly, the Department recognized in the proposal that inasmuch as compliance with section 412 generally requires a bond in an amount not less than 10% of all the plan's funds or other property handled, the bond acquired for section 412 purposes may in some cases be adequate to cover any non-qualifying assets under the proposal. Even in those cases, however, the bond would still equal 100% of the value of the non-qualifying plan assets. Accordingly, the Department did not adopt any of the suggested changes regarding the amount of fidelity bond coverage required to be eligible for the audit waiver.

The Department included fidelity bonding examples in the preamble to the proposal in an effort to explain the fidelity bonding requirements in the proposal and the interaction between those requirements and the general fidelity bonding requirements under section 412 of ERISA. To make those examples easily accessible, the Department inserted the examples in the final rule as a new § 2520.104–46(b)(1)(iii)(B).

3. Disclosure

As noted above, under the proposal, the waiver of the requirement to engage an accountant is further conditioned on the disclosure of certain information to participants and beneficiaries. Specifically, § 2520.104–46(b)(1)(i)(B) required that the SAR of a plan electing the waiver include, in addition to the other information required by § 2520.104b–10: (1) The name of the 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.

One commenter noted that in many cases more than one regulated financial institution may hold plan assets and asked the Department to confirm that multiple statements from separate institutions could be used to satisfy the conditions in the proposal. As the Department explained when it published the proposal, the rule 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. The Department did not intend, and the language of the proposal does not require, that the plan receive a single statement from one financial institution.

Another commenter suggested that the SAR and other disclosure requirements in the proposal should be applied to all large plans required to furnish SARs to participants, not just small pension plans. The commenter's suggestion called for regulatory changes that would be beyond the scope of this rulemaking which did not include any changes in the information disclosure or audit requirements applicable to large pension and welfare plans. Moreover, the annual reporting and audit requirements applicable to large plans generally result in the availability of more comprehensive and detailed information about the plan's investments than the disclosure requirements in the proposal. For example, large plans with investment portfolios are generally required to include various financial schedules in their annual report, including a detailed listing of the assets of the plan, and, pursuant to section 103(a)(3)(A) of ERISA, the IQPA report attached to the Form 5500 must include the accountant's opinion on whether those schedules ''present fairly, and in all material respects the information contained therein when considered in conjunction with the financial statements taken as a whole.'' Participants and beneficiaries in such large plans have a right, upon request, to examine and obtain copies of the Form 5500 and the IQPA report, and the SAR required to be furnished to participants must include a notification of that right.

Several commenters indicated that the disclosure requirements set forth in the proposal would require adjustments to the way SARs are currently prepared and asked the Department to adopt less detailed SAR disclosures. For example, one commenter suggested that the SAR be required to state only the percentage of assets held by regulated institutions and the amount of any fidelity bonds if plan does not meet the 95% test, along with a statement that participants and beneficiaries have a right to examine and get copies, on request, of statements from the institutions and evidence of any required fidelity bond. Another commenter stated that adding more information to that already required to be given in the SAR may be confusing to many participants. The commenter suggested that including a ''boilerplate'' notice in the SAR regarding the financial institution statements and fidelity bond would give participants and beneficiaries interested in reviewing the materials knowledge of their availability at no cost. As noted above, the Department believes that furnishing statements from certain regulated financial institutions regarding the plan's assets provides 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. Such disclosure, in the Department's view, reduces the likelihood of losses over long periods due to acts of fraud or dishonesty. The Department believes that the security and accountability objectives of the proposal are enhanced by the disclosure of the names of institutions holding (or issuing in the case of mutual fund shares and general account investment contracts with insurance companies) qualifying plan assets and the amount of such assets. A general disclosure that information is available upon request would not, in the view of the Department, provide participants with sufficient information to make an informed decision on whether to request the underlying financial institution statements or evidence of bonds.[7]

The Department is making one change in the SAR disclosure requirements to address the inclusion, discussed above, of participant directed assets in the definition of qualifying plan assets. As noted above, the final rule provides in § 2520.104–46(b)(1)(ii)(F) that, in the case of an individual account plan the definition of ''qualifying plan assets'' would include any assets in the individual account of a participant or beneficiary over which the participant or beneficiary has the opportunity to exercise control and with respect to which the participant or beneficiary is furnished, at least annually, a statement from one of the regulated financial institutions referred to in § 2520.104–46(b)(1)(ii)(C), (D) or (E) describing the assets held (or issued) by the institution and the amount of such assets. A new provision was added to the final rule to make it clear that the SAR disclosure requirements would not apply to individual account assets that meet the definition of qualifying plan assets pursuant to the alternative described in paragraph (b)(1)(ii)(F). See § 2520.104–46(b)(1)(i)(B)(*1*).[8]

A commenter suggested that the final regulation state that the requirement to provide these individual account statements could be satisfied by giving participants and beneficiaries access to individual account information via ''800'' numbers, automated voice response systems, website access, and other similar technologies. The Department does not believe that access to information is comparable to affirmatively providing participants and beneficiaries with information about their accounts. Accordingly, the final rule requires that, as with SARs, the individual account statements must be ''furnished'' to participants. See § 2520.10 4–46(b)(1)(ii)(F). In that regard, the Department notes that it has a separate regulation project pending under § 2520.104b-1 that is focused on the use of electronic communication technologies by ERISA covered plans to satisfy certain disclosure obligations under Part 1 of Title I, including the obligation to furnish SARs to participants. In the Department's view, measures and methods acceptable for furnishing SARs under the Department's regulation at § 2520.104b-1 would also be acceptable for regulated financial institutions to use in furnishing individual account statements under this final regulation.

4. Miscellaneous Issues

One commenter asked the Department to exclude from the audit waiver requirements plan assets in individual account plans belonging to owner-employees. The commenter posited that owner-employees generally would not need the additional disclosures set forth in the proposal. Another commenter in a similar vein argued that ''top heavy'' plans should be exempt from the audit requirement because ''[b]y definition, 60% or more of the accrued benefits of a top-heavy plan are those of ''key employees'' as defined by IRC § 416(i) * * * [and] these are the type of participants who are most likely to be able to police or monitor the performance of their accrued benefits.'' The Department does not believe that such carve outs for owner-employee assets or top heavy plans would be appropriate. First, the Department believes that inclusion of participant directed assets in individual account plans and the related adjustments to the disclosure provisions in the proposal adequately address the commenter's concerns regarding owner-employees. Second, ''top heavy'' status may vary from year to year which may result in intermittent and potentially confusing disclosures to plan participants. Moreover, the rationale presented by the commenter ignores the non-key employee participants in the plan. The Department, accordingly, did not adopt the carve-outs suggested by these commenters.

A commenter urged the Department to improve the remedies available for aggrieved participants in cases where there have been losses due to fraud or dishonesty. The commenter observed that participants often do not have the financial resources to retain experienced ERISA counsel even in cases of clear fiduciary violations, that fiduciaries in cases involving interpretation of plan documents may benefit from courts' reviewing their interpretations under a deferential ''arbitrary and capricious'' standard, that statutory remedies are limited in fiduciary cases and do not include compensatory and punitive damages, and that courts may not award full attorney's fee awards even in cases where the participant prevails. The commenter concluded that enhancing retirement security would be better accomplished by improving the remedies available to aggrieved plan participants. Expanding the ERISA remedies available to participants and beneficiaries in cases involving plan losses due to fraud or dishonesty would, in the Department's view, generally require legislation and, accordingly, is beyond the scope of this administrative rulemaking.

5. Request for Public Comments on Alternatives

To aid in its effort to develop a cost-effective final regulation, the Department solicited 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

[7] Several commenters asked questions about and/or suggested modifications of certain conclusions regarding estimated costs and burdens associated with complying with the SAR and related disclosure requirements that were contained in the Department's regulatory impact analysis published in the **Federal Register** along with the proposal. Those comments are addressed in the regulatory impact analysis section of this notice.

[8] The final rule also includes qualifying employer securities and participant loans in this new provision in paragraph (b)(1)(i)(B)(1) to make it clear that the there are no special SAR disclosures associated with the treatment of such assets as qualifying plan assets.

handling those assets and that would be more effective or involve less cost and burden than this proposal. In that regard, the Department specifically invited 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. No commenter supported this alternative approach. The two commenters that specifically addressed this alternative concluded that it would be more disruptive and more costly for most employers and would be unlikely to provide sufficient additional benefits to plan participants and beneficiaries to justify the extra administrative costs and burden to small plan sponsors.

6. Effective Date

Finally, several commenters requested a delayed effective date to give small pension plans sufficient time to comply with the new summary annual report and bonding requirements provided for in this rule. The proposal envisioned that the final regulation would be effective 60 days after publication in the **Federal Register**. One commenter suggested that the new requirements should not be applicable until the later of: (1) the first plan year beginning after 180 days after the final regulation is published in the **Federal Register**, or (2) the first plan year beginning after the first surety bond policy expiration date that is at least 60 days after the regulation is finalized. Another commenter asked that the effective date be delayed for all plans until the first plan year beginning on or after January 1, 2002.

The Department believes that it is important to make this final rule effective in a timely fashion so that participants and beneficiaries get the enhanced security and accountability protections of the new audit waiver conditions. The Department is also sensitive to the need for plans and plan sponsors to have sufficient time to make adjustments to comply with the disclosure and bonding provisions in the regulation. In light of the fact that fidelity bonds may be issued for multi-year periods, although the amount of the coverage is required to be set annually, an effective date based on the surety bond policy expiration date could provide for a overly long period before some plans would be required to comply with the new audit waiver conditions. Similarly, making the amendments effective for the first plan year beginning on or after January 1, 2002, could provide a prolonged period following publication of the final rule for plans with non-calendar fiscal years before they would have to comply with the new SAR disclosure requirements (as long as four years for some plans with non-calendar fiscal years). The Department believes that making the amendments applicable as of the first plan year beginning after 180 days after the final regulation is published in the **Federal Register** provides an adequate period of time for plans and plan sponsors to make any necessary adjustments while not unduly delaying the implementation of the new audit waiver conditions. Accordingly, the final rule will be effective 60 days after publication in the **Federal Register** but the amendments to the audit waiver conditions will be applicable as of the first plan year beginning after 180 days after the final regulation is published in the **Federal Register**.

Executive Order 12866 Statement

Under Executive Order 12866, the Department must determine whether a 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

This regulation is intended to accomplish two purposes: to limit pension plan fraud and to provide participants and beneficiaries of small pension plans with the information they need to monitor their plan assets and to hold plan fiduciaries accountable. 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 (§ 2520.104–46) will enhance pension plan security. Imposing the additional conditions on the audit waiver will help to reduce the risk of loss due to acts of fraud or dishonesty with small plan assets. It will 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.

The cost to small pension plans of the provisions of this final rule 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 meet the requirement to obtain a waiver that at least 95% of the plan assets must be ''qualifying plan assets.'' For the few plans not meeting this requirement, the cost of obtaining a fidelity bond to enable them to meet the conditions for a waiver is low relative to the increased security provided to participants and beneficiaries. Likewise, the cost of meeting disclosure requirements is small because, after an initial start up cost to include new language in the SAR and allow for the inclusion of additional detail concerning qualifying plan assets, the subsequent annual cost consists only of updating the SAR with data already provided at least annually by the financial institutions in the normal course of business. Other costs include a small cost for the preparation and distribution of documents to participants and beneficiaries who request copies of statements from financial institutions and evidence of fidelity bonding.

The costs imposed by the additional conditions this regulation places on the existing small plan audit waiver are expected to total $24.1 million annually.[9] This total includes $714,000 for all 605,115 small pension plans to determine whether they satisfy the conditions for the audit waiver with respect to the percentage of plan assets held by regulated financial institutions, $6.5 million to obtain additional fidelity bonding coverage for the 29,414 plans not expected to meet the condition that at least 95% of the plan's assets are held by a regulated financial institution, $16.3 million to satisfy additional disclosure conditions of the audit waiver, and $628,000 to respond to requests by participants and beneficiaries for copies of the statements of financial institutions and evidence of fidelity bonding. As explained further below, the cost estimates of the final rule are greater than the $15.6 million estimate presented in the proposal, due primarily to the adjustment of certain assumptions used in estimating the rule's impact. The revised estimates also take into account the substantive modifications made to the proposal in the development of the final rule.

In the Department's view, the benefits (although not quantified) of the final rule's requirements for the IQPA waiver outweigh the costs. The enhanced accountability and security of small pension plans resulting from the additional IQPA waiver conditions will benefit plan participants who are counting on these pensions for retirement security. With minimum government intervention, participants and other parties to the plan will have an improved ability to verify and monitor plan assets. 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. The following items highlight other potential benefits of the 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 plan 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. A more secure system for monitoring pension plan assets will reduce productivity loss to employers.

Comments on Estimated Economic Impact

The Department received 19 written comments regarding the proposed regulation. Of these, the majority commended the Department for its efforts to strike a reasonable balance between improving the security of small pension plan assets and allowing small plans and small plan sponsors to function efficiently without the imposition of undue administrative burdens and costs. The principal concerns of those commenters who focused on the economic impact of the proposal related to the Department's estimates of the costs to comply with the bonding and disclosure provisions, as well as to the Department's methodology for estimating the number of plans potentially impacted by the proposed amendments to the waiver of the requirement to engage an independent qualified public accountant. Specifically, commenters questioned whether the cost burden for the bond would be ''nominal'' as the Department suggested in the proposal, and whether the cost burden for developing and modifying the SAR was greater than the Department had estimated. These issues are addressed in more detail below.

Four commenters addressed the cost of the surety bond. The proposed regulation provided that, for each plan year for which the waiver is claimed, if at least 95% of the assets of the plan do not constitute ''qualifying plan assets'' any person who handles assets that do not constitute qualifying plan assets must be covered by a bond meeting the requirements of section 412 of ERISA, except that the amount of the bond must be not less than the amount of such assets. Based on Department data and consultation with industry representatives, the original estimate for the average additional premium cost of an enhanced surety bond was $200 per plan. One commenter questioned the Department's conclusion that the cost of additional fidelity coverage would be ''nominal,'' and whether, in fact, bonding under this regulation would be as broadly available to plans as under section 412. The comment was based on the fact that the enhanced bond requirement applies to only a small portion of the pension plan population—specifically, a population which is not audited and which maintains less than 95% of its assets in a qualified financial institution. The commenter further questioned whether, even if a plan were able to obtain a bond, it might be at a higher cost than that estimated by the Department because the requirement represented adverse selection against the surety. In any case, the eventual premium cost and impact on the availability of surety bonds under the proposal was viewed by the commenter as having a potentially high level of unpredictability because surety bonds meeting these requirements are not currently offered. Finally, the commenter proposed that a surety might request an audit by an independent accountant, or subject the plan to other more stringent underwriting requirements, in order to issue a bond for unqualified plan assets, resulting in additional attendant costs to the plan or plan sponsor.

Before concluding that enhanced bonding offered a cost effective way of protecting small plan assets, the Department had originally considered eliminating the waiver of the audit requirement for all small plans that did not meet the 95% requirement (approximately 37,000 plans). In examining the cost, however, the Department concluded that the audit cost, $230 million dollars for the 5% of plans not meeting the 95% requirement, was too great in relation to other alternatives. The Department therefore explored alternatives available to enhance pension plan security and the burdens imposed by these various alternatives. The regulation was crafted by assessing the net benefits of these alternatives and is intended to

[9] The cost estimates are derived from 1995 data on pension plans and 1998 BLS data on occupational wages as adjusted for non-wage compensation and overhead.

accomplish the goal of increased security without imposing significant costs on pension plans. Alternatives considered included on-site inspection, periodic reporting, additional compliance penalties, and additional bonding as a stand-alone requirement. However, all of these options were either (1) 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, (2) not feasible to implement, or (3) would not have sufficiently enhanced small pension plan security.

Both before and after the comment period, the Department consulted with industry representatives about the premium cost for a bond, including the details of their formal comment, and the potential risk to the surety associated with accomplishing enhanced security through bonding of non-qualified assets. Representatives emphasized that the cost for a bond covering plan assets not held or issued by regulated financial institutions can only be assessed after some period of time in which loss experience can accumulate and the industry is able to evaluate the risk and respond through pricing. It was considered possible that, initially, due to lack of actual experience, industry costs would remain stable but would require an upward or downward adjustment at a future date. It is also possible that sureties might respond to a perceived additional exposure associated with segmenting the risk of assets that inherently represent a greater risk of loss (*i.e.,* the assets not held by financial institutions) by applying more stringent underwriting and rating this risk accordingly. The Department will monitor this situation in the future and, if in the Department's view serious problems arise, would consider amending this regulation. The Department would welcome concerned parties notifying it of any problems they encounter.

The Department agrees that the estimate of additional premium costs and other impacts on the market for fidelity bonds in near term and over time bears a degree of uncertainty. However, as discussed with industry representatives, the Department does not believe that non-qualifying assets necessarily represent an inherently greater risk of loss. Rather, the manner in which they are held simply does not afford a mechanism for an independent confirmation of the existence of the asset that is comparable to the confirmation associated with statements from regulated financial institutions, or with an examination conducted by an IQPA. Industry representatives also agreed that the surety market as a whole is very large, and that pricing is generally very affordable. It is also worth noting that, for some plans, compliance with the bonding requirements under section 412 of ERISA will also cover the bonding requirement under this regulation. Section 412 generally requires any person who handles plan funds or other property to be bonded in an amount not less than 10 percent of the amount of funds handled. Unless the value of a small plan's non-qualifying plan assets exceeds the value of 10 percent of total plan funds or other property, there is likely to be no additional risk to the surety or increase in bonding cost to plans because of this regulation.

Commenters and industry representatives called attention to potential uncertainty in future costs, but did not suggest that the estimate of an average of $200 in additional premium would result in an unreasonable cost estimate. Accordingly, the Department has not changed its earlier estimate of $200 as an average cost increase per affected plan for an enhanced fidelity bond. Our analysis shows, therefore, that bonding continues to be the least costly alternative for increasing the security of small plan assets, lowering aggregate costs by a factor of more than 20 compared to other alternatives while still accomplishing the goal of enhancing small pension plan security.

Four commenters suggested that the Department's cost estimate for the SAR disclosure underestimated the costs that would be imposed on plans. The regulation requires that, for a plan to be able to take advantage of the waiver of an audit by an IQPA, a plan's SAR must include certain specific information relating to: the financial institutions which hold or issue plan assets; bonding; the right of participants and beneficiaries to year-end statements of the financial institutions and bonding information; and a notice that participants and beneficiaries may contact the Regional Office of the Pension and Welfare Benefits Administration, U.S. Department of Labor, if they are unable to examine or obtain copies of the statements received by the plan from each institution holding or issuing qualifying plan assets, or evidence of the bond, if applicable. Two commenters suggested that most SARs are generated directly by software packages that produce the Form 5500 annual report; therefore, they thought that inserting new language might require a programming change and a greater start up expense to the plan than computed in the proposal. In addition to the initial changes, plans are also required to make annual modifications to the SAR which will reflect the current assets of the plan, the amount of the assets held or issued, and the bonding at the end of the plan year. In its economic analysis of the proposed regulation, the Department did not include the cost of annual modification of the SAR, because it was believed to be nominal. Commenters questioned this assumption as to the time it would take to update the SAR, on an annual basis, with the names of each regulated financial institution holding or issuing plan assets and the year end amount of those assets. The commenters added that preparing an annual disclosure document, with multiple custodians, would take more time than that attributed to the usual preparation of an SAR and, with the additional reporting of specific account totals, the Department should include a cost factor in the economic analysis for this obligation. The Department has responded to these comments in three ways.

First, we have increased the cost estimates for the start up changes to the SAR. Using the same basis used for burden estimates of the Form 5500 annual report, the Department assumes that 90% of SARs and 90% of the changes required by the final rule will be accomplished by service providers. Because the information required to be added to the SAR by this regulation is not currently separately reported by small pension plans as part of their Form 5500 annual filing or currently used by Form 5500 software packages, it is likely, as commenters observed, that system modifications will be required. Accordingly, the Department assumes that a systems analyst or financial manager will complete the work and has increased the hourly rate of the professional performing this activity from $39 to $57 per hour. In response to comments indicating that revising an SAR will take more time than previously anticipated, the Department has also increased its assumption for the time required to modify software and procedures to produce an amended SAR disclosure from 15 minutes to 30 minutes. However, the Department believes the time required to make these changes is moderated by the economies of scale resulting from those service providers who have multiple client plans, and whose efforts will result in a systematic SAR modification for multiple plans, usually as a part of a software package integrated with Form 5500 preparation software. Based on changes to cost estimates for wage rates and time requirements, the resulting cost estimate for this SAR start up modification is $12.1 million, compared with the $5.9 million originally estimated. Lastly, individual account plans are not included in this cost burden because an alternative SAR disclosure for these plans is now described in the final regulation. This has the result of lowering the original cost estimate for small plans, although the net effect is the $6.2 million increase.

Second, in response to comments, the Department added new paragraph (b)(1)(ii)(F) to § 2520.104.46 which modifies the SAR reporting requirements under paragraphs (b)(1)(i)(B) in the case of individual account plans holding qualified plan assets. This new paragraph provides that, in the case of an individual account plan, the SAR disclosure requirement may be satisfied as to any assets in the individual account of a participant or beneficiary over which the participant or beneficiary has the opportunity to exercise control by having a regulated financial institution referred to in paragraphs (b)(1)(ii)(C), (D) or (E) of section 2520.104–46 furnish a statement, at least annually, to participants or beneficiaries describing the assets held (or issued) by such institution and the amount of such assets. As described above, the change to the regulation is warranted because of the existing protective features of the at least annual reporting procedures for individually directed individual accounts. The change in the regulation will eliminate the need for annual modification of SARs for many individual account plans.

Third, the Department has included in the final cost $4.2 million for annual modification of the SAR to reflect changes in the financial institutions holding or issuing qualifying plan assets, the amounts of assets, and/or fidelity bonding information. Because the information used to modify the SAR is provided by the financial institutions in the regular course of business and the time needed to transfer the information to the SAR was assumed to be minimal, the Department did not originally propose a cost for such annual modification of the SAR. However, the Department recognized that most SARs are completed by service providers in a systematic fashion, either through the use of software packages interrelated with the preparation of the Form 5500 or by means of extracting figures from financial statements. The Department recognizes that some plans may require time to modify the SAR each year, but the Department believes that this time will be reduced to the extent that SAR preparation software and processes are modified to accept new information over time. The Department also believes that some of the concerns of the commenters with respect to annual modification costs have been addressed through the alternative method to SAR disclosure for individually directed account plans.

Finally, the regulation requires that plans furnish copies of year end statements from financial institutions and bonding information to those participants and beneficiaries who request them. For purposes of its cost estimates, the Department assumes that 5% of participants and beneficiaries who are not in individually directed account plans will request this information. The Department further assumes that participants and beneficiaries with individual account plans taking advantage of the alternative disclosure approach under the regulation, *i.e.,* those who receive annual statements from a regulated financial institution reporting on the value of their assets, will not request this general plan level information. Because the documents required to be disclosed by the plan have already been provided by bonding companies and financial institutions, the aggregate cost for plans to produce the copies of statements and bonding information is estimated at $627,700, reflecting labor costs of $15 per hour for assembling and photocopying and distribution costs of $.37 per request. The aggregate cost represents a reduction from the $995,000 estimated in the proposed regulation. The cost savings is a result of excluding individual account plans eligible to take advantage of the alternative disclosure approach under the regulation.

Cost Analysis

The requirements contained in this final regulation 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 formerly 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. 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 approximate the current distribution of small plans based on the proportion of assets that are ‘‘qualifying plan assets.’’ Form 5500 does not categorize ‘‘qualifying plan assets,’’ nor does it identify the holder of assets. For purposes of this analysis, we have considered the nature of the asset to be an indicator of the holder of the asset. Accordingly, we assumed that assets reported as cash, CD's, U.S. Government Securities, corporate debt and equity, loans, employer securities, and the value of interests in direct filing entities, registered investment companies, and insurance company general accounts are typically held or issued by regulated financial institutions, and as such constitute ‘‘qualified plan assets.’’

Based on a total of 605,000 small plans, 1995 data, and using the assumptions outlined above, we determined that the vast majority of the assets of small plans are ‘‘qualifying plan assets.’’ Specifically, for all but 5% of small pension plans, at least 95% of plan assets constitute ‘‘qualifying plan assets.’’ The plans that will not meet the 95% threshold are atypical of the industry standard and are sufficiently few in number such that additional conditions for an audit waiver to protect participants and plan assets are both warranted and cost effective.

The Department received a comment that expressed the view that the proxy group used for assessing the number of small plans that will not have 95% of assets held or issued by regulated financial institutions resulted in a significantly inaccurate estimate of the number of plans impacted, and thus the ultimate cost of the regulation. In the commenter's view, the distribution of assets in plans with more than 100 participants but less than $2 million in assets would be new plans, which would be attempting to minimize administrative costs. The commenter further suggests that the Department assumed a relationship between the holder of qualifying plan assets and the manner in which a plan is ‘‘trusteed’’ (*i.e.,* uses a corporate trustee such as a bank as opposed to an individual person such as a representative of the plan sponsor). Moreover, the commenter suggests delaying any action amending the audit waiver until an actual study of the potentially impacted small plan universe is conducted.

The Department notes that while the statute clearly envisions the Department adopting rules intended to limit the administrative burdens imposed on small plans to comply with the annual reporting provisions in ERISA, and although the more limited reporting requirements actually in place for small plans results in the availability of more limited detail concerning the assets of small plans, the annual reports filed by small plans do provide accurate data with respect to the features of small plans, their total income, expenses, and assets, and the breakdown of those assets in broad investment categories. The Department's methodology in developing detailed estimates of small plan assets by investment type involved distributing the breakdown of assets in a slightly larger proxy group across the actual assets of the small plans potentially affected by this regulation. This larger group is still within two standard deviations of the mean asset value of the plans with fewer than 100 participants. The Department continues to believe this approach offers a reasonable basis for estimating detail needed to accurately assess economic impact, given that this level of detail is not available under existing regulatory requirements.

Furthermore, this methodology results only in an estimate of the types of assets held by small plans. The types of assets, such as mutual funds, marketable securities, or certificates of deposit, are assumed to be an indicator of who holds the assets and, thus, the extent to which they will be qualifying plan assets for purposes of this regulation. The methodology is not intended to identify the trustee of the plan, nor is it necessary to do so to assess the economic impact of the regulation. As the Department has indicated, it does not intend to alter the investment choices of small plans, or their arrangements for designating a trustee, but rather to ensure that either a mechanism is in place for regular confirmation of the existence of small plan assets by regulated financial institutions holding those assets, or that enhanced bonding is in place. The Department continues to be of the view that its approach to identifying the plans and assets potentially impacted is reasonable in light of the data available to conduct this analysis.

Finally, as noted earlier, several commenters requested clarification of the definition of ''qualifying plan assets,'' particularly with respect to assets allocated to individual account plans in which individuals direct their investments. As discussed in the Summary of Public Comments section, the Department agrees with the commenters that the security and accountability objectives of the proposal can be met, in the case of an individual account plan, for assets over which the participant or beneficiary has the opportunity to exercise control if the participant or beneficiary is furnished, at least annually, a statement from a regulated financial institution describing the assets held (or issued) by such institution and the amount of such assets. The final rule includes such assets within the definition of qualifying plan assets. This has the effect of reducing the number of plans otherwise subject to the enhanced bonding requirement from 37,000 to 29,400, and reducing the number of plans impacted by the new SAR disclosures from 605,115 to 425,709. In addition to meeting the Department's objectives with respect to small plan asset security, this modification from the proposal also limits the potential for imposition of disclosure requirements in this rule that duplicate the disclosure requirement of other regulatory provisions, such as those set forth in ERISA section 404(c) and related regulations, or disclosures made as part of normal business practice.

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 certifies that a final rule will not have a significant economic impact on a substantial number of small entities, section 603 of the RFA requires that the agency present a final regulatory flexibility analysis describing the impact of the rule on small entities at the time of publication of the notice of final rulemaking. Small entities include small businesses, organizations and governmental jurisdictions.

For purposes of analysis under the RFA, the Department continues 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 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) of ERISA, 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) of ERISA, the Department has previously issued at 29 CFR 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 satisfying certain other requirements.

Further, while some large employers may have small plans, in general most small plans are maintained by small employers. Thus, the Department believes that assessing the impact of this 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.*). No comments were received with respect to the standard. Therefore, a summary of the final regulatory flexibility analysis based on the 100 participant size standard is presented below.

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 regulation has been written to enhance the security and accountability of small pension plans.

The rule amends the Department's existing waiver of examination and report of IQPA for employee benefit plans under ERISA with fewer than 100 participants. This rule impacts all classes of small pension plans subject to Title I of ERISA with fewer than 100 participants. As shown by the regulatory analysis, the regulation accomplishes the objective of enhancing pension plan security without imposing significant costs via additional reporting, recordkeeping, or other compliance requirements.

Under the regulation, for each year in which a waiver is claimed, at least 95 per cent of the assets of the plan must constitute ''qualifying plan assets'' or any person who handles assets of the plan that do not constitute qualifying plan assets must be bonded in accordance with the requirements of section 412, except that the amount of the bond shall not be less than the amount of such assets. In 1995, there were approximately 605,000 employee pension plans with fewer than 100 participants that met the requirements for the audit waiver. The Department estimates that, under the regulation, only 29,400 small plans will not meet the 95 per cent limit for qualifying plan assets and will be required to either purchase a fidelity bond or undergo an audit. We assume that plans will choose the less costly alternative of bonding to satisfy the regulation. All 605,000 small pension plans, however, will be subject to SAR disclosure requirements, which include adding new language to the SAR, providing copies of statements from regulated financial institutions and bonding information free of charge to participants and beneficiaries who request them and, for those plans which are not individual account plans, modifying the SAR on and annual basis.

The Department received 19 comments regarding the proposal. The majority commended the Department for striking a reasonable balance between providing accountability and protection for small pension plans and minimizing administrative costs and recordkeeping. Four commenters raised the issue of bonding and its impact on small plans, specifically questioning whether the cost of the bond would be nominal as described in the proposal. Commenters expressed the view that a surety might respond to a perceived additional exposure associated with segregating a particular group of plans which have the potential of posing greater risk to the surety because of adverse selection by requesting an audit by an independent accountant or subjecting the plan to other more stringent underwriting requirements. The Department had estimated that cost of a fidelity bond to be $200 per plan.

Before determining that bonding was the best and most cost efficient way of protecting small assets, the Department considered several alternatives, including imposing an audit on all small plans that do not meet the 95% requirement, on-site inspection, periodic reporting, and eliminating the existing small plan audit waiver for examination and reporting by an IQPA. All of these options, however, were either extremely expensive (ranging in cost from $200 million to $4 billion), thereby conflicting 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. After the comment period, the Department consulted with representatives of the surety industry to further assess the impact of bonding on small plans. Taking into consideration the information received from industry representatives as well as other comments received by the public, the Department has decided not to change its original estimate of $200 per plan for a fidelity bond.

The actual cost of a bond, according to representatives from the surety industry, will best be determined after some period of time in which the industry will be able to evaluate the risk involved. The cost of a premium may not change initially, but could be adjusted upward or downward at some future date. On the other hand, the risk for bonding small plans invested in assets which are not held or issued by regulated financial institutions will not be any greater under the regulation than it is now, and the industry risk factor for ERISA plans is low. Industry representatives did not believe that audits would be required. Because underwriting judgment is necessarily applied on a case-by-case basis, actual industry experience will be the best predictor of premium cost. Our analysis of available information shows, therefore, that bonding is the least costly alternative, lowering aggregate costs by a factor of more than 20 while similarly accomplishing the goal of enhancing small pension plan security.

It is also worth pointing out that, for some small plans, compliance with the existing bonding requirements under section 412 of ERISA will also cover the bonding requirement under this regulation. Section 412 requires that any person who handles funds or other property must be bonded in an amount not less than 10 percent of the amount of funds handled. Unless the value of a small plan's non-qualifying plan assets exceeds the value of 10 percent of total plan funds or other property handled, there is no additional cost to small plans because of this regulation.

For those plans that do not have 95% qualifying plan assets (approximately 29,414 plans), the Department estimates that the cost for obtaining a bond will be $574,000 for labor for a professional's time at $39 per hour. This represents a reduction in cost from the proposed estimate of $713,600. The Department has made this adjustment because small pension plans that are individual account plans, which are generally invested in mutual funds or insurance company investments, have been provided under the final regulation with an alternative disclosure approach that should result in a fewer number of these plans needing to purchase a bond. The cost to small plans for bond premiums is therefore lower by $1,436,000. The aggregate cost for labor and for the premiums is $6.5 million, which represents a cost savings of $1.5 million from the original proposal. The per plan cost for meeting the bonding requirement is $220.

Commenters also suggested various changes to the proposed SAR disclosure requirements. Under the regulation, the SAR must disclose to participants and beneficiaries the names of the regulated financial institutions which hold or issue qualified plan assets, the amount of those assets, the fact that the plan must furnish to participants and beneficiaries on request statements from the financial institutions and information on bonding, and, finally, that if they do not receive the statements and bonding information from the plan, they may contact the plan administrator or the Pension and Welfare Benefits Administration, U.S. Department of Labor. A number of commenters suggested that, as an alternative to listing each financial institution and the amount of assets held or issued by the institution, the SAR could include a model statement which explained that the statements were available to participants and beneficiaries on request. The Department considered changing the disclosure requirements to reflect this alternative, but determined that the protection offered by furnishing statements and bonding information about the plans assets to participants and beneficiaries was of primary consideration in guarding pension plan assets. A general disclosure about availability of information will not offer the level of plan protection from fraud and dishonesty to participants and beneficiaries that they will receive from a plan's actually furnishing to them on an annual basis statements from financial institutions and bonding information.

Certain commenters expressed the view that SAR disclosure for individual account plans should not include statements concerning the amount of assets held or issued by financial institutions. Participants and beneficiaries in these plans regularly receive statements informing them of their asset allocation and the value of the assets in their individually directed accounts. The commenters stated that furnishing statements from financial institutions which do not hold or issue their investments would not be relevant and would not offer additional protection from fraud or dishonesty. In addition, commenters were concerned about the lack of privacy for individual participant investors if very small plans were required to furnish the names of the financial institutions and the amount of assets they held to all participants. As a result of these comments, the Department has revised the regulation for individual account plan disclosure. The Department agreed that it was unnecessary to require small plans to furnish duplicative information. This has the effect of eliminating both start up and annual modification costs for individual account plans as well as protecting individual investor privacy, without compromising SAR disclosure.

As part of the disclosure requirement under the regulation, plans must add new language to the SAR. Because service providers typically use software programs to generate SARs, commenters indicated that estimates for revising existing programs which generate SARs would cost more than the Department had estimated and would require a professional's time. The Department agreed with this assessment and increased its estimate for start up costs for the additional time needed to rewrite existing software programs. Due to the lack of data on the number of service providers and the number of plans they serve, the Department can not specifically estimate a cost for a service provider to make the required changes. The Department is aware, however, that some service providers serve very large numbers of plans and believes that some economies of scale will arise from the repetition of processes. The Department also increased labor costs for a professional to $57 per hour from $39 per hour to more accurately reflect the level of expertise required to accomplish the revision. Therefore, for the 425,709 non-individually directed small plans, the start up cost is $12.1 million, based on a professional's time at $57 per hour. This represents an increase of $6.5 million in start up costs. The start up cost per plan is $29.

Annual modification of the SAR requires updating the list of financial institutions holding qualified plan assets, including the amount of those assets as expressed in the institutions' financial statements, and bonding information. Because plan administrators should receive from qualifying financial institutions statements identifying plan assets held or issued by that institution in order to properly discharge their annual reporting and other obligations under ERISA, no cost is associated with obtaining the statements. Originally, the Department did not include an estimate for annual modification because there is no burden in obtaining the statements from the financial institutions and little time was involved in transferring the information to the SAR. However, commenters suggested that modifying the SAR to include a list of financial institutions holding or issuing qualifying plan assets and reporting the changing amount of those assets annually would require a professional's time. The Department has considered these comments and believes that the costs should include an adjustment for annual modification of the SAR. The cost to plans, which are not individual account plans, for annual modification of the SAR is $4.2 million base on a professional's time at $39 per hour. As explained above, individual account plans eligible for the alternative disclosure approach set forth in the final rule are not required to annually modify SAR information and are therefore not included in the cost estimate. For those plans meeting the 95% test, the aggregate annual disclosure cost of $4.2 million translates to $6 per plan.

Finally, plans are required to furnish participants and beneficiaries with copies of the financial institution statements and bonding information upon request. Excluding participants and beneficiaries in individual account plans, the Department assumes that 5% of all small plan participants and beneficiaries will request this information. The cost to provide the information is $.6 million, which includes assembling and photocopying by a clerical worker at $15 per hour and mailing costs of $.37 per mailing. Participants and beneficiaries of individual account plans are excluded because they are generally invested in mutual funds and receive statements, at least annually, related to their personal accounts.

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 (54%) 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
Percentage of plans	54	6	3	3	3	2	.01

As the above table shows,[10] 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 as indicated below. Therefore, the 95% threshold is reasonable for all classes of plans within the category of those with fewer than 100 participants.

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	339,967	29,414	11,409	9,037	7,855	6,743	0

[10] 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).

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

	Alternative threshold levels for qualifying plan assets						
	100%	95%	90%	85%	80%	75%	<75%
Percentage of plans	56	4	2	2	1	1	0

Paperwork Reduction Act

In accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3501–3520) (PRA 95), the Department submitted the information collection request (ICR) included in the proposed Small Pension Plan Security Amendments to OMB for review and clearance at the time the Notice of Proposed Rulemaking (NPRM) was published in the **Federal Register** (December 1, 1999, 64 FR 67436). OMB approved the revisions to the existing information collection, the ERISA Summary Annual Report, under control number 1210–0040 on February 2, 2000. This approval will expire on February 28, 2003. Certain additional adjustments have been made to the ICR and the estimates of burden in response to public comments. The information collection provisions of this final rule, as well as the adjustments made to the information collection provisions and the burden estimates originally incorporated in the proposal, are discussed below.

The revisions to the small plan audit waiver implemented by this final rule will increase the security and accountability of small pension plans, while minimizing the additional paperwork burden imposed on small plans. No additional 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 more protective bonding requirement for those plans not meeting the 95% test. For those plans which are not individual account plans, additional burden does arise from three other provisions: including new language in the SAR; modifying the SAR annually to identify the institutions holding or issuing qualifying plan assets and amounts of the assets reported by the institutions as of the end of the plan year, and; furnishing copies of financial institution statements and bonding information upon request.

It is assumed that adding the additional language to the SAR form will be accomplished by service providers for 90% of plans, and in-house for the remaining plans. The start up cost is estimated to be $10.9 million for the 90% of small plans using service providers for 30 minutes of a professional's time at $57 per hour. This amounts to about $3.6 million when annualized over a three-year period. The hourly burden for plans that will be required to add additional information to their SAR themselves (assumed to be 10% of small plans) is 21,286 hours, based on 30 minutes of a professional's time at $57 per hour. This estimate has been adjusted from the one outlined in the original proposal. The increase of $6.2 million is the result of an adjustment in the hourly rate for a professional from $39 per hour to $57 per hour to reflect the fact that this work may more likely be done by systems analysts and financial managers rather than the auditors and accountants previously assumed to perform the task of revising the SAR format. We have also adjusted the estimated time required to complete this work from 15 minutes per plan to 30 minutes per plan.

These adjustments are the result of comments received in response to the NPRM that indicated that both the hourly rate for a professional and the time allotted for drafting new SAR language and modifying existing software and information management procedures to produce a detailed listing of qualifying assets by financial institution at year end were too low. The revised hourly rate is derived from 1998 BLS data on occupational wages for financial managers, which is the higher of the wage rates for financial managers and systems analysts, the two professional categories assumed most likely to complete this work. The change in the hourly burden reflects a reevaluation by the Department in response to comments of the time it will take to make changes to a plan's current SAR, particularly where these changes may involve rewriting an existing software package. The Department also recognized that most SARs are completed by service providers in a systematic fashion, either through the use of existing software packages interrelated with the preparation of the Form 5500 (which the SAR summarizes), or by means of extracting figures from financial statements supporting the Form 5500. In either case, the service provider is expected to have ready access to the year end statements needed to set up an appropriate format for listing institutions and amounts, as well as modifying the institutions and amounts from year to year, because the statements must be used in the preparation of the annual report.

Commenters noted, and the Department recognizes, that revising software or procedures may in many instances require more than 30 minutes. However, the Department believes that the time required to change the SAR format and procedures used to produce the detail figures will be moderated by several factors. First, with the exception of the institutions and amounts, and the name of the surety issuing the plan's fidelity bond if the plan has more than 5% of its assets in non-qualifying assets, the Department has supplied in § 2520.104–46(b)(1)(i)(B)(*3*) and (*4*) the general format of the language to be added.

In addition, where service providers serve multiple client plans, it is assumed that they will achieve certain efficiencies in modifying systems and procedures to generate the revised SAR format, resulting in lower per plan costs. The Department can not specifically estimate this effect or develop an estimate of burden per service provider due to the lack of information, especially with respect to small plans, on the number of service providers and number of providers servicing multiple plans. However, the Department is aware that some service providers prepare annual reports and SARs for very large numbers of plans, and believes that economies of scale do arise in those situations, generally lowering estimates derived on a per plan basis.

Finally, the existing systems of service providers to small plans may more readily accommodate the required format changes to the extent that these service providers also have large plan clients. As part of their annual reporting obligations, large pension plans are currently required to submit a listing of assets held for investment that is similar in certain respects to the listing of the regulated financial institutions holding qualifying assets and the amounts held required under the final rule. Adjusting a system already designed to produce the listing of assets held for investment may require a smaller commitment of resources to meet the SAR disclosure conditions of the final rule than revising a system that does not include this capability. For these reasons, the Department considers 30 minutes per plan to be a reasonable estimate of the average time required for modification of the SAR format.

The regulation also provides that a plan administrator must, on an annual basis, modify the SAR to include the names of regulated financial institutions holding or issuing qualifying plan assets, the amount of those assets at the end of the plan year, and certain bonding information. Originally, the Department did not include a cost burden for the annual modification in the proposal's estimates because there is no burden associated with obtaining the statements from the financial institutions and the amount of time required to transfer the information to the SAR was believed to be nominal. Commenters, however, observed that modifying the SAR to include a list of financial institutions holding or issuing qualified plan assets and reporting the amount of those assets would require a professional's time each year to accomplish because assets and amounts will typically change from year to year. The Department has taken these comments into consideration, and concludes that they support an adjustment of the hour and cost burdens originally estimated for annual modification of the SAR. This adjustment results in increases of 10,643 hours and $3.7 million from prior estimates for the 425,709 plans required to modify the SAR for changes in the assets and amounts annually. This estimate is based on an average of 15 minutes of a professional's time at $39 per hour each year, and the assumption that 90% of plans purchase services to comply with SAR requirements. Again, some plans may require more time to modify the SAR listing each year, but the Department notes that the time required for annual modifications will be reduced to the extent that plans and service providers are in a position to invest in the modification of systems and SAR formatting to fully automate the annual modification process.

It should be noted that the adjustments to the assumptions described above would have resulted in more substantial increases in burden estimates in the absence of the modification of the requirements of the proposal as they relate to those individual account plans in which investments are individually directed.

As described in detail above in the Summary of Public Comments section of this Notice, the Department has modified both the definition of qualifying plan assets to include participant directed assets under specific circumstances and the disclosure provisions as they relate to participant directed assets. These changes have the effect of lowering the number of plans impacted by the SAR and system design modification and the annual asset listing requirement from 605,115 to 425,709 (179,406 small plans are reported on Form 5500 to have individually directed assets) while ensuring that the objectives of the regulation are met without the imposition of duplicative disclosure obligations. The participants in those 179,406 plans represent 3,512,000 of the 9,373,000 participants in all small pension plans.

It is possible that the estimate of individual account plans that will be excepted from the requirement to list assets, amounts, and institutions in the SAR because the investments are individually directed, and account statements for these assets are provided by the financial institutions to participants at least annually, will differ to some degree from the actual number that will be excepted. Because the Form 5500 data element used to estimate this number is an indicator that some or all of the assets of an individual account plan filer are individually directed, no data is available to support an estimate of the number of such plans in which all assets are individually directed. However, the Department is aware that the assets not subject to individual direction in these plans often include participant loans and employer securities, which are also excepted from the detailed SAR disclosure requirement. Accordingly, the Department believes that the actual degree of variation from the number of plans assumed to be excepted will be small.

In addition to addressing the privacy concerns raised by commenters with respect to the disclosure in the SAR of assets and amounts held in individually directed accounts, the Department also wished to address the coordination of the requirements of this rule with other statutory and regulatory requirements,[11] as well as existing business practices relevant to individually directed account plans. While not all plans that permit participants or beneficiaries to exercise control over assets in their individual accounts for purposes of this final rule would intend to meet all of the conditions of section 404(c) and related regulations, the Department believes that the majority of these plans do customarily make the statements of the financial institutions holding the individual account assets available to participants and beneficiaries at least annually, either to satisfy the conditions of section 404(c)[12] or as a result of the business practice of advising participants of their valued benefits.

Although the Department considered alternatives in the development of the final rule that would retain some individual-level SAR disclosure features for individually directed accounts while addressing privacy concerns, it ultimately concluded that providing an exception from plan level disclosures when statements from the regulated financial institutions are in fact provided annually to individually directed account holders would adequately protect the assets of these small plans while ensuring that the information collection is useful and non-duplicative. As a result, the total cost of system modification and annual modifications to the SAR is approximately $7 million lower than it would have been had this exception not been considered an appropriate response in light of both public comment and the principles of the Paperwork Reduction Act.

Finally, plan administrators are required under the regulation to make available for examination or furnish copies of the statements from the regulated financial institutions and the evidence of bonding when less than 95% of the assets of the plan are qualifying plans assets, to participants and beneficiaries who request them. The 3,512,000 participants in the 179,406 small individual account plans in which assets are reported on Form 5500 to be individually directed are assumed to be receiving annual statements related to their particular accounts and are therefore not included in the burden estimates for furnishing documents on request. The Department assumes that 5% of the remaining 5,681,000 participants in small plans will request this information annually. Because the documents already have been provided by bonding companies and financial institutions, the cost of compliance involves 5 minutes to ready the appropriate documents for mailing and 2 minutes of photocopying by a clerical worker, at $15 per hour, and mailing

[11] See section 404(c) of ERISA and the regulations issued thereunder, 29 CFR § 2550.404c–1 *et seq.*

[12] The burden of the disclosure provisions of the Department's regulation under section 404(c) of ERISA is accounted for separately under the currently approved OMB control number 1210–0090.

costs of $.37 per mailing. The hour burden for the in house furnishing of the documents is estimated at 3,419. The cost burden for the 90% of plans assumed to purchase services to comply with the requirement to make this additional information available upon request is estimated at $576,479. This estimate is lower than the $995,000 estimated in connection with the proposal due to the modification of the proposed requirements with respect to assets in the individual account of a participant or beneficiary over which the participant or beneficiary has the opportunity to exercise control, and with respect to which the participant is furnished a statement at least annually describing the assets held or issued by the financial institution issuing the statement.

In summary, the estimated hour and cost burdens of the information collection provisions of this final rule are as follows:

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: 1,404,924.

Estimated Annual Cost (Capital/Startup): $3,639,817.

Estimated Annual Costs (Operating and Maintenance): $115,687,000.

Total Annualized Costs: $119,327,000.

Persons are not required to respond to an information collection request unless it displays a currently valid OMB control number.

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 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.

Federalism Statement

Executive Order 13132 (August 4, 1999) outlines fundamental principles of federalism and requires the adherence to specific criteria by federal agencies in the process of their formulation and implementation of policies that have substantial direct effects on the States, the relationship between the national government and States, or on the distribution of power and responsibilities among the various levels of government. This final rule does not have federalism implications because it has no substantial direct effect on the States, on the relationship between the national government and the States, or on the distribution of power and responsibilities among the various levels of government. Section 514 of ERISA provides, with certain exceptions specifically enumerated, that the provisions of Titles I and IV of ERISA supercede any and all laws of the States as they relate to any employee benefit plan covered under ERISA. Further, this final rule amends annual reporting and disclosure regulations that have been in effect in similar form for many years pursuant to the Department's authority under section 104(a)(2)(A) of ERISA to prescribe, by regulation, simplified annual reports for pension plans with fewer than 100 participants. The amendments incorporated in this final rule do not alter the fundamental requirements of the statute with respect to the reporting and disclosure requirements for employee benefit plans, and as such have no implications for the States or the relationship or distribution of power between the national government and the States.

Small Business Regulatory Enforcement Fairness Act

The final rule being issued here is subject to the provisions of the Small Business Regulatory Enforcement Fairness Act of 1996 (5 U.S.C. 801 *et seq.*) (SBREFA) and has been transmitted to Congress and the Comptroller General for review.

Statutory Authority

These regulations are issued pursuant to authority contained in section 505 of ERISA (Pub. L. 93–406, 88 Stat. 894, 29 U.S.C. 1135) and sections 103(a) and 104(a) of ERISA, as amended, (Pub. L. 104–191, 110 Stat. 1936, 1951, 29 U.S.C. 1023 and 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 amended as follows:

PART 2520—RULES AND REGULATIONS FOR REPORTING AND DISCLOSURE

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*) Except for qualifying plan assets described in paragraph (b)(1)(ii)(A), (B) and (F) of this section, the name of each regulated financial institution holding (or issuing) qualifying plan assets and the amount of such assets reported by the 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 the regulated financial institutions describing the qualifying plan assets; 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 regulated financial institution statements or evidence of the required 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, each regulated financial institution statement and evidence of any bond required by paragraph (b)(1)(i)(A)(*2*).

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

(A) Qualifying employer securities, as defined in section 407(d)(5) 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;

(C) Any assets held by any of 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 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.

(D) Shares issued by an investment company registered under the Investment Company Act of 1940;

(E) Investment and annuity contracts issued by any insurance company qualified to do business under the laws of a state; and,

(F) In the case of an individual account plan, any assets in the individual account of a participant or beneficiary over which the participant or beneficiary has the opportunity to exercise control and with respect to which the participant or beneficiary is furnished, at least annually, a statement from a regulated financial institution referred to in paragraphs (b)(1)(ii)(C), (D) or (E) of this section describing the assets held (or issued) by such institution and the amount of such assets.

(iii)(A) For purposes of this 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.

(B) Examples. 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; participant 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 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 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%.

* * * * *

(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 16th day of October, 2000.

Leslie B. Kramerich,

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

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