

MEMO# 12790

October 26, 2000

DOL FINAL REGULATION ON SMALL PENSION PLAN AUDIT WAIVER

[12790] October 26, 2000 TO: PENSION MEMBERS No. 52-00 PENSION OPERATIONS ADVISORY COMMITTEE No. 79-00 AD HOC COMMITTEE ON SMALL EMPLOYER PLAN ASSET REGULATION RE: DOL FINAL REGULATION ON SMALL PENSION PLAN AUDIT WAIVER The Department of Labor on October 19, 2000, published a final regulation addressing the small pension plan waiver from annual audit. The guidance substantially amends the small plan waiver from the requirement to engage an independent qualified accountant to conduct an annual audit of the plan. This final regulation is based on a proposed regulation that was published on December 1, 1999.¹ The final regulation is effective December 18, 2000 and is applicable as of the first plan year beginning after April 17, 2001. As discussed below, the Institute had submitted comments on the proposed regulation, which were addressed by the Department in the final regulation. Final Regulation Described. Section 2520.104-46 of the regulations provides a waiver of the annual audit requirement for employee benefit plans with fewer than 100 participants at the beginning of the plan year. The final regulation conditions this waiver on the plan's annually satisfying requirements that focus on (1) who holds the plan's assets, (2) in limited situations, additional bonding, and (3) enhanced disclosure to participants and beneficiaries. Specifically, to qualify for the waiver from the audit requirement, at least 95% of plan assets must constitute "qualifying plan assets." Alternatively, if more than 5% of a plan's assets do not constitute "qualifying plan assets," the amount of the plan's ERISA section 412 bond may need to be increased to qualify for the waiver. The determination that these conditions are satisfied must be made by the plan administrator at the beginning of each plan year for which the waiver is claimed. The final rule expands the initially proposed definition of "qualifying plan assets" by adding mutual funds, investment and annuity contracts (general account investment contracts) issued by an insurance company, and the individual account plan provisions. The regulation defines "qualifying plan assets" to mean: 1 See Institute Memorandum to Pension Committee No. 68-99 and Pension Operations Advisory Committee No. 54- 99, dated December 1, 1999, for the proposed regulation. 2(A) qualifying employer securities, as defined in ERISA section 407(d)(5); (B) any loan meeting the requirements of ERISA section 408(b)(1); (C) any assets held by a bank or similar financial institution, an insurance company, or registered broker-dealer², or any other organization authorized to act as a trustee for individual retirement accounts; (D) shares issued by an investment company registered under the Investment Company Act of 1940;³ (E) investment and annuity contracts issued by an insurance company; and (E) 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 he or she is furnished, at least annually, a statement from a regulated institution specified in the regulation (including from a registered investment company) that describes the

assets held or issued by such institution and the amount of those assets. The final regulation also conditions the waiver from the audit requirement on the disclosure of certain information to participants and beneficiaries. Specifically, the summary annual report (SAR) of a plan electing the waiver must include (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 required 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 as of the end of the plan year; and (4) a notice stating that participants and beneficiaries should contact the Department of Labor 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. This SAR disclosure requirement does not apply to individual account plan assets that meet the definition of “qualifying plan assets.” See Section 2520.104-46(b)(1)(i)(B)(1) of the final regulation. Financial institutions with qualifying plan assets must provide annually to each plan a statement of assets “held” under the regulation. In the preamble to the final regulation, the Department clarifies that the regulation does not require these statements to be in any particular form, but, at a minimum, the statements must identify the institution holding the assets and the amount held at the end of the year. The Department explicitly recognizes in its discussion in the preamble that in many cases more than one financial institution may hold plan assets and 2 The Department clarifies in the preamble to the final regulation that if plan assets are held in an omnibus account of a registered broker-dealer or bank, that the broker-dealer or bank would be treated as “holding” the plan’s assets for purpose of satisfying the rules. 3 The Department addresses the role of transfer agents in the preamble to the final regulation, as requested by the Institute, which is discussed below. 3 confirms that multiple statements can be used by an employer to satisfy the disclosure requirements to plan participants. Response to Institute Comments. The final regulation addresses issues raised by the Institute in a comment letter it submitted on the proposed regulation. 4 First, the Institute requested that the final regulation clarify that plan assets invested in mutual funds and for which registered transfer agents maintain records be included in the definition of “qualifying plan assets.” The final regulation, as noted above, includes shares of investment companies registered under the Investment Company Act of 1940 in the definition of “qualifying plan assets.” 5 The Department also explicitly acknowledges that it is common practice for a mutual fund to employ a registered transfer agent to perform various recordkeeping functions, including the production of account statements, and states in the preamble, that “[f]or the purpose of the audit waiver, the Department considers statements from a registered transfer agent employed by the mutual fund to be statements from the mutual fund.” 65 Fed. Reg. 62960, fn. 6 (October 19, 2000). Second, the Institute also had requested that the annual audit requirement be waived for small pension plans whose participants directly receive investment account statements, at least quarterly, from an independent qualifying plan recordkeeper. The DOL, responding to this suggestion, as noted above, includes in the “qualifying plan assets” definition plan assets in participant-directed individual account plans to the extent that participants and beneficiaries are furnished at least annually account statements directly from a qualifying independent financial institution, including mutual funds. Russell G. Galer Senior Counsel Attachment Note: Not all recipients receive the attachment. To obtain a copy of the attachment to which this memo refers, please call the ICI Library at (202) 326-8304 and request the attachment for memo 12790. ICI Members may retrieve this memo and its attachment from ICINet (<http://members.ici.org>). Attachment (in .pdf format) 4 See Institute Memorandum to

Pension Committee No. 13-00, Pension Operations Advisory Committee No. 11-00 and Ad Hoc Committee On Small Plan Asset Regulation, dated February 8, 2000, for the Institute's comment letter. 5 In the preamble to the final regulation, the Department stated 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." 65 Fed. Reg. 62960 (October 19, 2000).

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