Ask The Lawyer

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NEW BOND REQUIREMENTS for Small Plans

The U.S. Department of Labor (DOL) has issued new rules regarding bonding and reporting requirements for sponsors of pension or profit sharing plans with less than 100 participants. They apply to plan years beginning after April 17, 2002 (for most plans that will be the 2003 calendar year).

The Employee Retirement Income Security Act (ERISA) generally requires a fidelity bond for every fiduciary or person who handles funds or other assets of an employee benefit plan to protect the assets of a pension plan. As concerns about the security of assets in small pension plans have increased, the bonding rules have been updated."

In the absence of an exception, ERISA requires that all employee benefit plans filing an IRS Form 5500 must engage an independent qualified public accountant (IQPA) to prepare and include audited financial statements and an accountant's opinion. Shortly after passage of ERISA, the DOL issued regulations creating an exception from the IQPA and audit requirements for plans with fewer than 100 participants as of the beginning of the plan year.

But the regulations add new hurdles for small plan sponsors seeking to avoid the IQPA and audit requirements. Now the plan must also satisfy one of two alternative requirements, in addition to having fewer than 100 participants:

- At least 95% of the plan's assets must constitute "qualifying plan assets;" or
- The ERISA bonding requirement for the plan is increased to 100% of the total amount of assets that are considered "non-qualifying plan assets."

Under the regulations, "qualifying plan assets" include:

- Qualifying employer securities, such as employer stock or other marketable obligations issued by an employer of the employees covered by the plan;
- Participant loans that meet the prohibited transaction exemption requirements of ERISA;
- Assets held by a regulated financial institution, such as an insurance company, bank or similar financial institution;
- Shares issued or held by an investment company registered under the Investment Company Act of 1940 (e.g., registered mutual funds);
- Investments and annuity contracts issued by an insurance company qualified to do business under the laws of any state; and
- In the case of an individual account plan, any assets in an account of a plan participant or beneficiary who has the opportunity to exercise investment control and for which the participant or beneficiary is furnished a statement from a regulated financial institution describing the assets held (or issued) and the amounts of such assets.

Most plan sponsors should be able to meet the alternative requirement of having at least 95% of the assets in qualifying plan assets. But if you have "non-qualifying plan assets" such as real estate interests held by parties that are not regulated financial institutions, stock certificates held by the sponsor or trustee rather than in the street name by a brokerage firm, or limited partnership interests in your plan in an amount that exceeds 5% of the total plan assets, you will have to meet the new bonding requirement or comply with the IQPA audit rules.

Most small plan sponsors would prefer to avoid a financial audit of their plan because of the expense and time involved(plan audits can take months and cost thousands). To do so, the plan must have a fidelity bond equal to at least 100% of the non-qualifying plan assets covering those handling the non-qualifying plan assets.

Whether a plan has the appropriate fidelity bond is a major concern of the DOL, which is charged with protecting plan participants. We are aware of several situations in which the DOL has filed suit against a plan sponsor for failing to provide the required fidelity bond. Form 5500 requests information concerning whether the plan is covered by a fidelity bond. If this question is answered "No," a visit from a DOL auditor is quite likely.

In addition to the bonding requirement, plan sponsors who wish to waive the IQPA audit requirements must also provide certain additional information in the ERISA-required summary annual report (SAR). The SAR summarizes the information in the Form 5500 and must be furnished to plan participants.

Plan sponsors wanting to avoid ERISA's audit requirement should review their plan assets, current bonding and their SAR, taking whatever steps necessary to ensure that they can still qualify for the exception in 2002. You may want to consider removing troublesome assets from your plan. The time to find out that your retirement plan needs a financial audit and opinion of an IQPA is not two weeks before the Form 5500 filing deadline (or worse, when the DOL contacts you and rejects your Form 5500 filing as incomplete). ❑