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BY THE COMPTROLLER GENERAL

Report To The Congress

OF THE UNITED STATES

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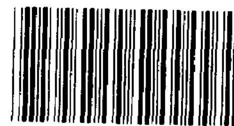
Effects Of The Employee Retirement Income Security Act On Pension Plans With Fewer Than 100 Participants

This report discusses effects of the Employee Retirement Income Security Act on about 471,000 pension plans of all types with fewer than 100 participants as of mid-1977.

GAO estimates that about 18 percent of the plans terminated and 82 percent continued. The act was a major factor in the decision to terminate about 41 percent of the plans. Of these, many did not meet the act's minimum participation and vesting standards. Of the plans that continued, 89 percent had to be revised to comply with the act's employee protection requirements.

Employers spent over $500 million in administrative costs resulting from the act. However, about 67 percent of these costs were one-time costs for revising the plans to meet the act's requirements; about 33 percent were increased annual administrative costs. Most sponsors considered these costs to be moderate or less though many considered the costs to be substantial.

The plan revisions and changes in administrative procedures should help assure that millions of American workers covered by private pension plans receive benefits.



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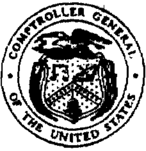


COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-164292

To the President of the Senate and the
Speaker of the House of Representatives

This report discusses the effects the Employee Retirement Income Security Act of 1974 had on pension plans with fewer than 100 participants. It is the second of two reports responding to a request by 116 Members of Congress that we examine the act's effects on small businesses. The first report, "Effect of the Employee Retirement Income Security Act on the Termination of Single Employer Defined Benefit Pension Plans," was issued on April 27, 1978 (HRD-78-90).

Copies of this report are being sent to the Director, Office of Management and Budget; the Secretaries of Labor and the Treasury; and the Executive Director, Pension Benefit Guaranty Corporation.

Comptroller General
of the United States

COMPTROLLER GENERAL'S
REPORT TO THE CONGRESS

EFFECTS OF THE EMPLOYEE RETIREMENT INCOME SECURITY ACT ON PENSION PLANS WITH FEWER THAN 100 PARTICIPANTS

DIGEST

After the enactment of the Employee Retirement Income Security Act, much congressional and public concern was expressed that the act was hurting small businesses and their employees.

The act was established in 1974 to correct indications of pension plan misuse and abuse which had deprived employees of retirement income. The act neither requires businesses to establish pension plans nor prohibits terminating them. However, sponsors of plans who elect to continue must comply with the act's provisions to protect the employees' interests. In 1975, sponsors of about 471,000 pension plans with fewer than 100 participants elected to continue under the act. (See pp. 1 to 3.)

Based on a 1977 survey of a random sample of these pension plans, GAO estimates about 18 percent of the plans have been terminated and about 82 percent continued. The act was a major factor in the decision to terminate about 41 percent of the plans no longer in existence. Of the plans continued, 89 percent had to be revised to meet the act's employee protection requirements. (See pp. 5, 8, and 9.)

Since the act's passage many workers have a greater assurance of receiving benefits from their private pension plans. About 61 percent of the plans that had to be revised did not meet participation standards and about 15 percent did not meet vesting standards. These revisions resulted in at least 410,000 additional employees becoming participants in small pension plans and about 197,000 participants having increased vested rights to pension benefits. (See pp. 8 to 17.)

In addition, many plans had to be revised to meet other provisions of the act. (See pp. 17 to 20.)

In spite of the number of plans which have terminated, the adverse effect on American workers is not as great as it appears. Based on responses to GAO's questionnaire, about 46 percent of the plans which were terminated did not meet the act's minimum participation and vesting standards, which are designed to guarantee that employees benefit from a pension plan without having to meet unreasonable service and age requirements. Also, about 28 percent of the sponsors who terminated plans provided or planned to provide continuing pension coverage for their employees through new or existing employer-sponsored plans. (See p. 7.)

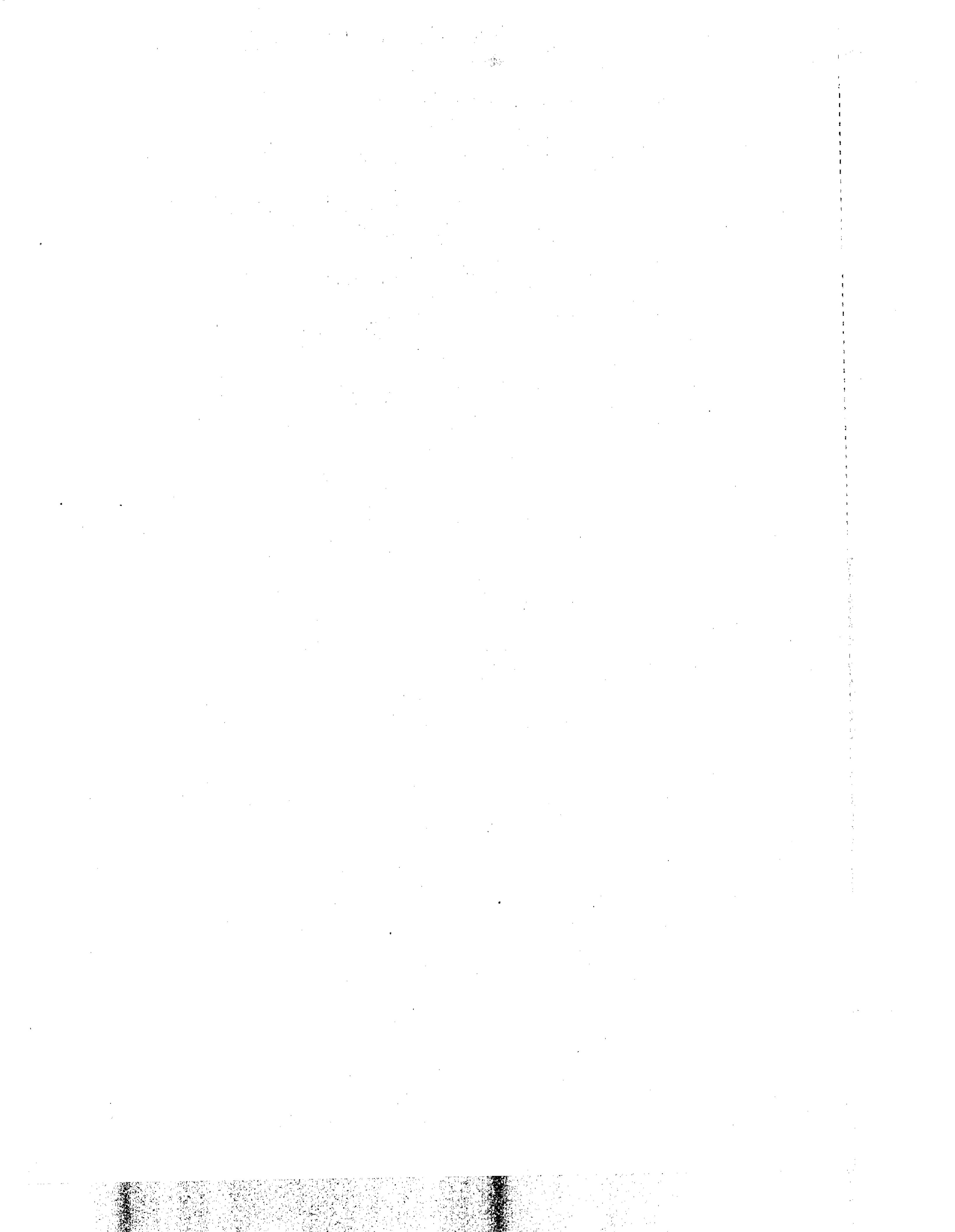
The act established extensive, complex minimum standards and requirements governing the design and operation of pension plans, and required sponsors to provide financial and other information to plan participants and to Federal agencies. While protecting workers' rights to benefits, these requirements resulted in significant increases in administrative costs for many pension plan sponsors. (See ch. 4.)

The one-time cost to revise the plans to comply with the act's requirements and the annual costs to administer plans in accordance with the act resulted in an increase in total estimated administrative costs of $553 million, or about 352 percent. However, about 67 percent of the increase was a one-time cost to revise the plans to meet the employee protection requirements of the act. The rest was for increased annual administrative costs. The GAO survey showed the average increase in administrative cost was $1,753 per plan--$1,167 to revise a plan and $586 to administer it annually. (See p. 21.)

Although many plan sponsors considered the increased administrative costs to be substantial or very great, most considered them to be moderate or less. (See pp. 22 and 24.)

The agencies have taken or are considering actions to reduce the act's administrative burden on businesses, especially smaller businesses. (See p. 26.)

Officials of the Department of Labor, the Internal Revenue Service, and the Pension Benefit Guaranty Corporation were given an opportunity to review and comment on this report. Their comments and suggestions were included in the report where appropriate. (See p. 4.)



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ABBREVIATIONS

ERISA Employee Retirement Income Security Act of 1974

GAO General Accounting Office

IRS Internal Revenue Service

PBGC Pension Benefit Guaranty Corporation

CHAPTER 1

INTRODUCTION

On September 2, 1974, the Employee Retirement Income Security Act of 1974 (ERISA) (29 U.S.C. 1001 et seq.) became the first comprehensive Federal legislation regulating the private system for providing working Americans with retirement income. ERISA's purpose is to make sure that an estimated 40 million participants in about 500,000 private pension plans receive earned benefits. The assets of these plans have been estimated at about $290 billion.

The act requires private pension plans and plan administrators to meet extensive, complex standards and reporting and disclosure requirements. During March 1976, 116 Members of Congress expressed to us their concern that many small businesses and their employees were being irreparably hurt by ERISA. Pointing to the large increase in defined benefit pension plan terminations after ERISA's enactment, they requested that we examine the act's effects on small businesses.

This is the second of two reports responding to those concerns. This report focuses on ERISA's effects on ongoing pension plans with fewer than 100 participants, which are estimated to number about 471,000 and cover about 5 million participants. The first report, "Effect of the Employee Retirement Income Security Act on the Termination of Single Employer Defined Benefit Pension Plans," was issued on April 27, 1978 (HRD-78-90).

BACKGROUND

Until ERISA, the primary legislation, other than the Internal Revenue Code, specifically directed to regulating pension plans was the Welfare and Pension Plans Disclosure Act, enacted in 1958 (Public Law 85-836). The Internal Revenue Code gives favorable tax treatment to businesses if their pension plans meet a general framework of requirements, including that plans be for the exclusive and nondiscriminatory benefit of employees.

The Welfare and Pension Plans Disclosure Act was intended to foster honest, responsible administration of pension plans by requiring disclosure of information on plan operations. Although the Department of Labor was authorized to interpret

and enforce the act, it had no authority to prescribe plan provisions, help plan participants collect benefits, or otherwise interfere in plan internal management.

ERISA was the first comprehensive Federal legislation regulating the internal workings of private pension plans. It was enacted because of indications that pension plan misuse and abuse had resulted in lost pension benefits to employees. ERISA neither requires businesses to establish, nor prohibits them from terminating, pension plans. However, with few exceptions, plans must comply with the act's provisions.

To protect employees' interests, ERISA established a comprehensive framework of minimum standards and requirements that specify

--how employees become eligible to participate in pension plans (participation standards),

--how employees earn a nonforfeitable right to pension benefits (vesting standards),

--how the plans are to be funded (funding provisions),

--how the plans are to be operated in the best interests of plan participants (fiduciary standards), and

--to what extent plan information is to be reported and disclosed to the Federal Government and plan participants (reporting and disclosure requirements).

ERISA also established insurance programs to guarantee the payment of certain vested benefits to participants of a defined benefit pension plan that terminates without sufficient assets to provide promised benefits. Defined benefit pension plans provide definitely determinable benefits based on such factors as years of employment and compensation received.

Responsibilities for carrying out the act are assigned to Labor, the Internal Revenue Service (IRS), and the Pension Benefit Guaranty Corporation (PBGC), which was established by ERISA. Labor is primarily responsible for issuing regulations on and enforcing ERISA's reporting, disclosure, and fiduciary provisions. IRS issues regulations on and enforces the act's participation, vesting, and funding provisions. PBGC administers the defined benefit plan termination insurance programs.

SCOPE OF REVIEW

In May 1977 we randomly selected a sample of all types of pension plans with fewer than 100 participants from Labor's most current information on the universe of private plans. Labor obtained this information from the 1975 Plan Description Report (EBS-1 Form) required to be filed by administrators of all ongoing plans. Most Plan Description Reports were filed during mid-1975. This information indicates that there were 504,293 private pension plans, 471,341 (93 percent) of which had fewer than 100 participants.

In selecting our sample, we separated the 471,341 plans with fewer than 100 participants into three groups (those with 1 to 10, 11 to 25, and 26 to 99 participants) and randomly selected 250 plans from each group, for a total sample of 750 plans. The sample included defined benefit, defined contribution, and Keogh-type plans. Defined contribution plans are plans in which the contributions, but not the benefits, for each participant are fixed and readily determinable. For example, contributions can be a fixed amount for hours worked or a percentage of compensation received, whereas benefits are based on the amount contributed and any income, expenses, and investment gains and losses to the participant's account. Keogh plans, also known as H.R. 10 plans, are established by self-employed individuals for themselves and their employees.

We sent questionnaires to the sponsors of the 750 plans in our sample, asking whether the plans were still in operation, whether they had to be changed because of ERISA, what types of changes had to be made, what effect those changes had, and what effect ERISA had on the plans' administrative costs. The questionnaires were mailed in May 1977; as of November 1977, we had received 467 responses--a response rate of 62 percent.

To ensure the reasonableness, accuracy, and completeness of the questionnaire responses, we reviewed all the responses and called respondents who had not answered certain questions or whose answers needed clarification. We also compared the questionnaire respondents and nonrespondents with the universe of plans by plan participant size, type, and location. This comparison showed no significant differences between the respondents, nonrespondents, and universe of plans. In addition, we compared the results of this study with those of our previous study. (See p. 1.) This comparison also showed no significant differences in (1) reasons for plan

terminations, (2) percentages of sponsors of terminated defined benefit plans providing continuing pension coverage, (3) percentages of defined benefit plans not meeting some key ERISA provisions designed to protect plan participants' benefits, and (4) methods used in computing costs to administer plans, such as a set fee based on the number of participants. As a result, we can statistically address the status of and ERISA's overall effect on the 471,341 plans with fewer than 100 participants.

We reviewed applicable legislation, regulations, publications, and other information related to pension plan operations. We also interviewed headquarters officials of the Department of Labor, IRS, and PBGC and spoke with consulting firms that help administer private pension plans.

We also attempted to develop case studies from the different types of plans in our sample. Because ERISA does not give us access to plan sponsors' records, we had to rely on sponsors' willingness to provide the necessary information. Most plan sponsors, however, were reluctant to provide the details on their plans and companies necessary to perform the studies. As a result, we discontinued this effort.

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Officials of the Department of Labor, IRS, and PBGC were given an opportunity to review and comment on this report. Their comments and suggestions were included in the report where appropriate.

CHAPTER 2

THE AFTERMATH OF ERISA:

MOST SMALL PENSION PLANS CONTINUED,

BUT MANY TERMINATED

On September 2, 1974, the Employee Retirement Income Security Act established numerous, complex standards and requirements for private pension plans. Based on the 62-percent response to our sample of 750 pension plans, we estimate that, as of mid-1977--about 2 years after the plan sponsors told Labor they were continuing their plans--388,813 (about 82 percent) of the 471,341 plans with fewer than 100 participants were continuing and 82,528 (about 18 percent) had been or were being terminated. Defined benefit and defined contribution plans terminated at about the same rate--16 and 15 percent, respectively. Keogh-type plans, however, terminated at a much greater rate--26 percent. By plan participant size, 14 percent of plans with 11 to 99 participants terminated, while about 19 percent of the plans with 1 to 10 participants terminated.

The following table shows, by plan type and plan participant size, the estimated number and percentage of the 471,341 plans that were continuing or had terminated as of mid-1977.

Plan type	Total plans	Continuing plans Number	Continuing plans Percent of total	Terminated plans Number	Terminated plans Percent of total
Defined benefit	105,315	88,187	84	17,128	16
Defined contribution	276,743	234,803	86	41,940	15
Keogh	89,283	65,823	74	23,460	26
Total	471,341	388,813	82	82,528	18
Plan size (participants)					
1 to 10	360,111	293,056	81	67,055	19
11 to 25	67,114	57,943	86	9,171	14
26 to 99	44,116	37,814	86	6,302	14
Total	471,341	388,813	82	82,528	18

Our study was primarily intended to identify the effects of ERISA on continuing pension plans. These effects are discussed in chapters 3 and 4. The information plan sponsors provided on ERISA's effects on plan terminations is summarized below.

ERISA'S EFFECT ON PLAN TERMINATIONS

Although plan sponsors indicated that ERISA was a major factor in many plan terminations, other factors were more significant. We estimate that ERISA was a major factor in decisions to terminate 34,245 (41 percent) of the 82,528 plans of all types that terminated between mid-1975 and mid-1977. Based on responses from sponsors of terminated Keogh plans, ERISA was a major factor in about 12 percent of the terminations. According to plan sponsors, other reasons for termination included adverse business conditions, change of ownership, and the retirement of the sole participant in the plan.

As indicated in the following table, anticipated administrative costs were the most predominant ERISA factor indicated by plan sponsors as moderately or greatly affecting the decisions to terminate the 34,245 plans.

ERISA factors noted as reasons for termination	Estimated number of plans	Percent
Desire to eliminate or reduce administrative costs	15,330	45
Desire to have more control over and/or flexibility in contribution levels	11,065	32
Desire to reduce actuarial consulting fees	10,083	29
Desire to reduce annual contribution costs	9,267	27
Desire to eliminate 30-percent employer liability (note a)	2,358	7
Desire to eliminate an unfunded liability	1,108	3
Total	b/49,211	

a/ERISA makes sponsors of defined benefit plans liable for up to 30 percent of their net worth for any funding insufficiency when the plan is terminated.

b/Totals more than 34,245 because some sponsors indicated more than one factor.

Plan sponsors also cited other reasons for termination, including excessive and duplicative reporting requirements, lack of clarifying regulations, and too much Government involvement.

In our report on the effects of ERISA on the termination of defined benefit plans from September 1974 to June 1976 (see p. 1), we pointed out that the indicated adverse effect of plan terminations on American workers was not as great as it appeared because the plans generally did not meet ERISA requirements designed to ensure that employees benefited from the plans. We also noted that about 41 percent of the sponsors terminating defined benefit plans continued pension coverage through new or existing pension plans.

The results of this study indicate that the apparent adverse effect of all types of pension plan terminations on workers from mid-1975 to mid-1977 was also misleading, for the same two reasons. We estimate that 23,186 (28 percent) of the 82,528 sponsors who terminated plans provided or planned to provide continuing pension coverage for their employees through new or existing employer-sponsored plans. The 23,186 plans had a projected 261,986 (or 38 percent) of the estimated participants in the 82,528 terminated plans.

In addition, many terminated plans did not meet ERISA requirements designed to protect the employees' interests. For example, plan sponsors responding to our questionnaire provided sufficient information for us to estimate whether 57,686 of the 82,528 terminating plans met two of ERISA's important requirements: the minimum standards governing employee participation and the vesting standards, designed to ensure that employees benefit from a pension plan without having to meet unreasonable age and service requirements. Based on this information, we estimate that of the 57,686 plans, 26,783 (46 percent) with an estimated 395,925 participants did not meet one or both of the requirements. To continue, the plans would have had to have been revised to meet ERISA's participation and vesting requirements. Also, most of the continuing plans had to be revised because they did not meet the participation, vesting, and other requirements, as discussed in chapter 3,

CHAPTER 3

MOST CONTINUING SMALL PLANS HAD TO BE REVISED TO MEET ERISA REQUIREMENTS

To help ensure that American workers have an equitable right to and receive benefits promised by employers through private pension plans, the Congress enacted the Employee Retirement Income Security Act. To achieve this goal, ERISA established minimum standards and other requirements to govern the equitable character, proper administration, and financial soundness of pension plans. The fact that many plans had to be revised to meet ERISA's requirements indicates that Federal legislation was needed to ensure that plans meet the employee protection standards the Congress deemed necessary.

Based on the 62-percent response to our sample of 750 pension plans, we estimate that 388,813 plans of all types with fewer than 100 participants that continued after ERISA was enacted were still in operation during mid-1977. About 89 percent of these small plans had to be revised to meet ERISA's requirements.

Regarding two of ERISA's important minimum standards--participation and vesting--our study indicates, based on plan sponsors' responses to our questionnaire, that about 61 percent of the plans that had to be revised did not meet the participation standards and about 15 percent did not meet the vesting standards. We estimate that revising plans to meet ERISA's minimum participation and vesting requirements resulted in at least 410,000 additional employees becoming participants in small pension plans and at least 197,000 participants receiving increased vested rights to pension benefits. In addition, many of the continuing plans had to be revised to meet other ERISA provisions.

We estimate that about 345,205 (89 percent) of the 388,813 continuing plans had to be revised to comply with ERISA. As shown in the following table, almost all the defined benefit and defined contribution plans (about 99 and 94 percent, respectively) had to be revised, and about 58 percent of the Keogh plans required revision. Further, about 96 percent of the plans with 11 to 99 participants and about 86 percent of those with 1 to 10 participants had to be revised.

Plan type	Total plans	Unrevised plans Number	Unrevised plans Percent of total	Revised plans Number	Revised plans Percent of total
Defined benefit	88,187	1,108	1	87,079	99
Defined contribution	234,803	15,181	6	219,622	94
Keogh	65,823	27,319	42	38,504	58
Total	388,813	43,608	11	345,205	89
Plan size (participants)					
1 to 10	293,056	39,737	14	253,319	86
11 to 25	57,943	2,501	4	55,442	96
26 to 99	37,814	1,370	4	36,444	96
Total	388,813	43,608	11	345,205	89

MOST PLANS REVISED TO MEET ERISA PARTICIPATION STANDARDS

Before ERISA, many employees had to work several years for their private employer before becoming eligible to participate in the pension plan, others were excluded from participation because of their age, and still others could not participate because of the number of hours that had to be worked each year. ERISA established minimum participation standards so that employees otherwise eligible do not have to satisfy unreasonable age and service requirements to participate in pension plans.

Plan sponsors responding to our questionnaire provided sufficient information for us to estimate that about 61 percent of their plans needing revisions had to be revised to meet the ERISA participation standards.

Revisions for ERISA participation standards

The ERISA minimum participation standards include the following three major requirements.

1. Employees generally must be allowed to participate in a plan after they are 25 years old and have completed 1 year of service (age and service requirements).

2. Employees that work 1,000 hours for the plan sponsor within a 12-month period must be credited with a year of service (year of service requirement).

3. Older employees cannot be excluded from pension plan participation because of age unless the plan is a defined benefit or target benefit 1/ plan (maximum age requirement). For these types of plans, older employees may be excluded from participation if their age at the time they begin employment is within 5 years of the plan's normal retirement age.

ERISA's minimum age and service, maximum age, and hours of service requirements have to be met before a plan meets the act's minimum participation standards. On the basis of plan sponsors' responses to our questionnaire, we estimated, for 276,499 of the 345,205 continuing revised plans, the extent to which (1) the plans had to be revised to meet the participation standards, (2) the number of employees that became plan participants because of the standards, and (3) the average annual sponsor contribution cost to pay for increased employee pension benefits resulting from the increased participation. We estimate that:

--Of the 276,499 plans, 169,923 (61 percent) did not meet the participation standards.

--Of the 169,923 plans not meeting the standards, 51,334 (30 percent) had increased participation when their plans were revised. The average increase was 8 participants, for a total of 410,672 additional employees becoming pension plan participants. This was a 42-percent increase over the average number of participants these plans had before ERISA.

--Of the 51,334 plans with increased participation, we could estimate, based on plan sponsors' responses to our questionnaire, that sponsors of 46,508 plans had to increase annual plan contributions by an average of $4,869 to pay for the benefits of the added participants.

1/A target benefit plan is a defined contribution plan for which contributions are targeted to pay a specific benefit to participants on retirement.

Of the 169,923 plans not meeting the participation requirements, we estimate that 101,050 (59 percent) did not meet the minimum age and service requirements, 79,937 (47 percent) did not meet the maximum age requirement, and 34,490 (20 percent) did not meet the year of service requirement.

Minimum age and service requirements

Generally, ERISA provides that employees must be allowed to participate in a plan after they are 25 years old and have completed 1 year of service. However, a plan may provide for participation after age 25 and 3 years of service if employees are given a nonforfeitable right to 100 percent of accrued benefits when they begin to participate. In addition, participation may be delayed for up to 6 months after both age and service requirements are met, because participation must begin no later than the earlier of the start of the next plan year or 6 months after the requirements are met. Thus, under the age 25 and 1 year of service requirements, an employee may be required to be 25-1/2 years old and work for 1-1/2 years before being allowed to participate in a plan.

To determine whether the plans met the minimum age and service requirements, we compared the greatest age and years of service required under the pre-ERISA plan provisions with those required under ERISA's general requirements. Plans that allowed employees to participate at age 25-1/2 and 1-1/2 years of service and plans that gave participants a nonforfeitable right to 100 percent of earned benefits at age 25-1/2 and 3-1/2 years of service were considered to meet ERISA's minimum age and service requirements.

Of the estimated 169,923 plans not meeting the ERISA participation standards, 101,050 (59 percent) did not meet the minimum age and service requirements. The following table shows the number and percentage of the 101,050 plans that did not meet those requirements, individually and in total.

Requirement	Number of plans not meeting requirements of		Total	
	Age	Service	Number	Percent
Minimum age only	965	-	965	1
Minimum service only	-	92,753	92,753	92
Both age and service	7,332	7,332	7,332	7
Total	8,297	100,085	101,050	100

The 100,085 plans that did not meet the ERISA years of service requirement required employees to work from 2 to 7 years before participating. About 64 percent of these plans required an employee to work 3 years or more before participating.

The age required by the 8,297 pre-ERISA plans not meeting the ERISA minimum age requirement ranged from 27 to 35 and averaged 30. About 87 percent of these plans required employees to be at least 30 before participating.

Maximum age requirement

ERISA specifies that older employees cannot be excluded from participation in a pension plan because of age, unless the plan is a defined benefit or target benefit plan. For these plans, employees may be excluded from participation if their age at the time they begin employment is within 5 years of the plan's normal retirement age. Thus, if a defined benefit or target benefit plan's normal retirement age is 65, an employee hired before age 60 must be allowed to participate in the plan, but an employee hired at age 60 or older may be denied participation.

Of the estimated 169,923 plans not meeting the ERISA participation standards, 79,937 (47 percent) did not meet the maximum age requirement. Of the 79,937 plans, 59,223 (about 74 percent) were not defined benefit or target benefit plans and had a maximum age beyond which an employee was not able to join the plan for the first time. Because ERISA prohibits such plans from having a maximum age participation requirement, these plans had to be revised to comply with ERISA.

Most of the other 20,714 (26 percent) of the 79,937 plans not meeting ERISA's maximum age requirement were defined benefit plans that denied employees' participation in the plans even though an employee's age when hired was more than 5 years from the plan's normal retirement age. The plans that did not meet the maximum age requirement required that workers, to participate in the plans, begin employment an average of about 10 years before reaching the plan's normal retirement age, rather than the maximum of 5 years required by ERISA.

Year of service requirement

ERISA specifies that, to earn a year of service, an employee generally has to work 1,000 hours for the plan

sponsor within a 12-month period. Of the estimated 169,923 plans not meeting the ERISA participation standards, 34,490 (20 percent) did not meet the year of service requirement. The 34,490 plans required employees to work on the average 1,854 hours a year to earn a year of service, rather than the maximum of 1,000 hours required by ERISA. In fact, 16,694 (about 48 percent) of the 34,490 plans required employees to work 2,080 hours a year--equivalent to 40 hours a week for 52 weeks--to participate in the plans.

Revisions by plan types and sizes

We estimate that about 81 percent of the defined benefit plans, 58 percent of the defined contribution plans, and 25 percent of the Keogh plans did not meet the ERISA participation standards. By plan size, the percentage of plans not meeting the participation standards ranged from 70 percent of plans with 26 to 99 participants to 60 percent of the plans with 1 to 10 participants.

The following table summarizes our estimates of the types and sizes of plans that did not meet the ERISA participation standards.

		Plans not meeting requirements	
Plan type	Total plans	Number	Percent
Defined benefit	72,875	59,206	81
Defined contribution	182,506	105,332	58
Keogh	21,118	5,385	25
Total	276,499	169,923	61
Plan size (participants)			
1 to 10	203,649	121,693	60
11 to 25	46,271	29,597	64
26 to 99	26,579	18,633	70
Total	276,499	169,923	61

MANY PLANS REVISED TO MEET ERISA VESTING STANDARDS

Before ERISA, some employees lost pension benefits because they did not meet requirements to receive benefits even though they may have worked 30 or 40 years for an employer. ERISA established minimum vesting standards to ensure that employees do not have to work an unreasonable number of years and reach an unreasonable age before having a nonforfeitable (vested) right to pension benefits.

Plan sponsors responding to our questionnaire provided sufficient information for us to estimate that about 15 percent of their plans needing revisions had to be revised to meet the ERISA vesting standards.

Revisions for ERISA vesting standards

ERISA provides that participants in a pension plan have a nonforfeitable right to retirement benefits upon reaching the plan's normal retirement age. ERISA also provides that participants have a full, immediate vested right to accrued benefits resulting from their own contributions to a plan even if they terminate employment before retirement. Regarding accrued benefits resulting from employer contributions, ERISA provides three minimum vesting schedules that are generally governed by years of service. Under any of the schedules, participants must be at least 50 percent vested in their accrued benefits after 10 years of service and 100 percent vested after 15 years of service, regardless of age. Generally, every year a participant works for the plan sponsor for at least 1,000 hours after age 22 must be counted as a year of service.

Further, ERISA provides other vesting-related standards on such matters as (1) the effect on vesting rights of working less than 1,000 hours in a year, (2) the way accrued benefits are to be determined, and (3) the right of a surviving spouse to benefits.

To ascertain the degree to which plans met ERISA's minimum vesting standards, we compared the ERISA requirements with the length of time required and ages that had to be obtained for 50 and 100 percent vesting under the pre-ERISA plans. In making the comparison, we used the ERISA general requirement that all years of service after age 22 be counted in determining vesting rights.

Sponsors responding to the questionnaire provided sufficient information for us to estimate whether 305,606 of the 345,205 continuing revised pension plans met these two requirements. We estimate that 47,050 (about 15 percent) of the 305,606 plans had to be revised to meet ERISA vesting standards. We also estimate that 17,939 (about 38 percent) of the 47,050 plans had an average of 11, or a total of 197,329, participants who immediately had increased vested rights in accrued benefits as a result of their plans being revised to meet the ERISA vesting requirements.

Minimum ages and service required

The 47,050 plans did not meet the vesting standards because of either years of service required for vesting, the minimum ages that had to be obtained, or both. The following table shows the number and percentage of the 47,050 plans that did not meet the vesting standards.

Requirement	Number of plans not meeting vesting standards because of: Age requirement	Service requirement	Total: Number of plans	Percent
Age only	23,317	-	23,317	50
Service only	-	13,245	13,245	28
Both age and service	10,488	10,488	10,488	22
Total	33,805	23,733	47,050	100

Of the estimated 23,733 plans not meeting the years of service requirement, 10,482 did not meet ERISA's requirement that participants be at least 50 percent vested after 10 years of service and 17,945 did not meet the requirement that participants be 100 percent vested after 15 years of service--4,694 plans did not meet either requirement. Before ERISA, participants in the 17,945 plans had to work from 16 to 30 years, or an average of about 20 years, before becoming 100 percent vested--5 years longer than required by ERISA.

For the estimated 33,805 plans not meeting the vesting standards because of the age required, the minimum age required for employees to become 100 percent vested ranged from age 40 to 65 and averaged age 55. Almost a third of these plans provided

no vesting until a participant earned 100 percent vesting. Participants in these plans could not accrue a right to a pension regardless of their years of service if they terminated employment before reaching the specified age. For example, a participant starting to work at age 22 for a plan sponsor requiring an employee to reach age 55 before becoming entitled to any accrued benefits would have had to work 33 years for the sponsor before having a vested right to any pension benefits. The following table shows the minimum age required by the 33,805 plans before participants were 100 percent vested.

Age required	Number of plans
40 to 45	8,416
46 to 55	14,901
56 to 65	10,488
Total	33,805

Revisions by plan types and sizes

We estimate that about 38 percent of the defined benefit plans and about 8 percent of the defined contribution plans did not meet the ERISA vesting standards. On the other hand, all the Keogh plans met the standards. The Keogh plans all complied with the vesting standards apparently because the Self-Employed Individuals Tax Retirement Act of 1962 (Public Law 87-792) generally required sponsors of Keogh plans to provide 100 percent vesting immediately upon participation.

We estimate also that about 31 percent of the plans with 26 to 99 participants and about 11 percent of the plans with 1 to 10 participants did not meet ERISA's vesting standards. The following table summarizes our estimates of the types and sizes of plans that did not meet those standards.

Plan type	Total plans	Plans not meeting standards Number	Percent
Defined benefit	81,422	31,315	38
Defined contribution	190,648	15,735	8
Keogh	33,536	-	-
Total	305,606	47,050	15
Plan size (participants)			
1 to 10	216,067	24,835	11
11 to 25	54,191	11,255	21
26 to 99	35,348	10,960	31
Total	305,606	47,050	15

MANY PLANS REVISED TO MEET OTHER ERISA PROVISIONS

Before ERISA, employees or their beneficiaries could lose vested benefits in several ways, including (1) denial of vested benefits for employees terminated for acts of misconduct, (2) lack of knowledge of rights to, or employers' requirements for receiving, deferred vested benefits, (3) plans not offering a joint and survivor annuity, and (4) inadequate funding of plans because employers were not having periodic actuarial valuations made of their plans.

As a result of these problems, ERISA established safeguards to increase the likelihood that employees or their beneficiaries would receive vested benefits. With ERISA, vested employer contributions are nonforfeitable, with few exceptions, and employee contributions are always vested and nonforfeitable.

Denial of vested benefits for misconduct

Before ERISA, many plans provided that pension benefits could be denied or suspended for acts of misconduct 1/ against

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1/In estimating the number of pre-ERISA plans having a misconduct provision, we excluded respondents that indicated suspension of benefits for employees going to work for a competitor because ERISA also permits suspension of benefits for such actions under certain circumstances.

the employer. ERISA prohibits such provisions, mainly because of the basic principle behind the vesting provisions--that once employees earn pension benefits, they are entitled to those benefits. There was also the concern that employers could subjectively apply misconduct provisions.

We estimate that 53,024 of the 345,205 plans that had to be revised to comply with ERISA permitted vested benefits to be denied or suspended for misconduct.

Deferred vested benefits

Before ERISA, vested benefits may have been lost because of the plans' procedures in paying the benefits at termination. Some employers did not notify terminated employees at the time of termination of their vested benefits, did not return vested benefits until retirement age (which could have been many years after working for an employer), and returned vested benefits at retirement age only if the employee or beneficiary applied for them. These procedures may have resulted in lost benefits. For example, if a person started with a company at age 20, worked there 10 years (until age 30), then left the company, and normal retirement was age 65, that person would have to wait 35 years before becoming eligible for the benefits and then would receive the benefits only if he/she or the beneficiary filed a claim for them. If the person died, forgot, or did not know about the benefits, they could have been lost.

To help prevent such inequities, ERISA requires pension plan administrators to furnish to each plan participant, upon termination of employment, a statement of total vested benefits earned. Employers can defer paying vested benefits until a participant reaches retirement age. However, to increase the possibility that plan participants will receive the deferred vested benefits, ERISA requires plan sponsors to (1) pay pension benefits automatically once the plan's age and service requirements are met and (2) notify the Internal Revenue Service annually of terminated employees with deferred vested benefits. IRS in turn sends the Social Security Administration information on deferred vested benefits of plan participants who, during the year, terminated employment before retirement. The Social Security Administration keeps the information on deferred vested benefits to provide to employees and their beneficiaries upon request and automatically when they apply for social security benefits.

We estimated that 66,227 of the 345,205 plans that had to be revised to comply with ERISA deferred until retirement vested employer and/or employee contributions. Of the 66,227 sponsors, 29,123 (44 percent) required employees or

their beneficiaries to apply for their benefits instead of returning them automatically. In addition, 7,606 (11 percent) of these sponsors did not give plan participants written notice of their vested benefits when they terminated employment.

Joint and survivors' benefits

Before ERISA, many spouses did not receive a pension after the spouse's death because their plans had no survivor provision. Other plans that did provide survivors' pension benefits required the employee, before retiring, to take certain steps, such as electing this option in writing, in order to provide for the surviving spouses. With these plans, if the employee neglected to meet, or was unaware of, such requirements, the spouse would not receive the survivor's pension benefits.

ERISA has increased the potential for many spouses to receive a pension after the retiree's death. The act requires that most retirement plans which provide for a participant to take retirement benefits in the form of an annuity must also provide for a qualified joint and survivor annuity. A qualified joint and survivor annuity is automatic unless the employee rejects it in writing.

We estimate that 104,349 of the 345,205 revised plans did not offer a joint and survivor annuity before ERISA. Of the 104,349 plans, 37,420 (36 percent) 1/ adopted a joint and survivor annuity provision when their plans were revised to comply with ERISA.

Actuarial valuations

Before ERISA, plan sponsors were not required to fund plans in an attempt to reduce their unfunded liabilities or to periodically evaluate how their plans were funded. As a result, there was a great possibility for plans to terminate with insufficient assets to pay promised benefits.

To help them accumulate enough pension fund assets to pay the promised pension benefits to employees when they retire, ERISA requires sponsors of defined benefit plans 2/

1/We can only assume that the other 66,929 plans did not pay benefits in the form of an annuity and, therefore, did not have to adopt a joint and survivor provision.

2/ERISA also established minimum funding standards for certain defined contribution plans, but we limited this analysis to defined benefit plans because these plans are required to have periodic actuarial valuations.

to accumulate pension funds through regular periodic contributions. The amount of contributions is calculated from assumptions based on past experience and future expectations. Generally, the employer has to contribute annually to a defined benefit plan the annual cost of future pension benefits and administrative expenses computed using acceptable actuarial cost methods. A set of assumptions is used to apply the cost methods. These assumptions may address such matters as the plan's probable future investment performance, increases in benefits due to inflation and salary increases, mortality rates, and plan operational expenses.

Since the actuarial assumptions must be accurate to assure that a plan is adequately funded, they must be closely monitored. ERISA requires plan sponsors of defined benefit plans to have actuarial valuations made at least every 3 years.

Based on the response to our questionnaire, we estimated, for 73,822 of the 87,079 plan sponsors with defined benefit plans that had to be revised to comply with ERISA, how often before ERISA they had an actuarial valuation made. Of the 73,822 sponsors, 54,490 (74 percent) had an actuarial valuation at least every 3 years, and 19,332 (26 percent) had a valuation less frequently than every 3 years. The following table shows our estimates of how often the 73,822 plan sponsors of defined benefit plans had an actuarial valuation made before ERISA.

Actuarial valuation performed	Plans	
	Number	Percent
Annually	49,666	67
Every 2 years	3,037	4
Every 3 years	1,787	2
Every 4 years	417	1
Between 5 and 10 years	-	-
Over 10 years	11,459	16
One or more performed but not periodically	7,456	10
Total	73,822	100

CHAPTER 4

PENSION PLAN ADMINISTRATIVE COSTS

INCREASED SIGNIFICANTLY AFTER ERISA

The Employee Retirement Income Security Act established minimum standards and requirements governing the design and operation of private pension plans. The act also required substantial plan financial and other information to be provided to plan participants and Federal agencies. Many complaints have been made about the burden and cost of administering plans under these requirements.

As stated on page 8, we estimate that 345,205 of the 388,813 continuing plans covered by our study had to be revised to comply with ERISA's requirements. The one-time cost to revise the plans and the increases in annual costs to administer the plans resulted in a large increase in administrative costs--from at least $157 million the year before ERISA to at least $710 million the year after, an increase of $553 million (352 percent).

Of the estimated $553 million increase in administrative costs, $369 million (or 67 percent) was spent to revise the plans to meet the employee protection requirements of ERISA. The other $184 million (33 percent) was for increased annual administrative costs. The average administrative cost increase was $1,753 per plan--$1,167 to revise a plan and $586 to annually administer it.

Further, although many plan sponsors considered the increase in administrative costs to be substantial or very great, most considered it to be moderate or less. Responses to our questionnaire indicate that 44 percent and 30 percent of the sponsors believed the revision cost and the increased annual administrative cost, respectively, to be substantial or very great.

REVISION COSTS

The sponsors providing cost data indicated an average cost of $1,167 to revise their plans to meet ERISA requirements. The cost, which varied significantly by plan type and size, totaled at least $368.9 million. By plan type, the average projected revision cost ranged from $231 for Keogh plans to $1,833 for defined benefit plans. By plan size, the average projected revision cost ranged from $832 for plans with 1 to 10 participants to $3,236 for plans with

26 to 99 participants. Based on plan sponsors' responses to our questionnaire, the following table shows, for an estimated 316,075 of the 345,205 revised plans, the projected total and average revision cost by plan type and size.

Plan type	Number of plans	Average cost per plan	Total costs
			(millions)
Defined benefit	77,551	$1,833	$142.2
Defined contribution	201,956	1,081	218.3
Keogh	36,568	231	8.4
Total	316,075	$1,167	$368.9
Plan size			
(participants)			
1 to 10	235,935	$ 832	$196.3
11 to 25	48,355	1,442	69.7
26 to 99	31,785	3,236	102.9
Total	316,075	$1,167	$368.9

Although many sponsors considered the revision costs to be substantial or very great, most considered them to be moderate or less. Based on responses to our questionnaire, the following table shows, for an estimated 334,699 of the 345,205 revised plans, the plan sponsors' opinions on revision costs.

Opinion on revision costs	Sponsors	
	Number	Percent
Substantial or very great	148,345	44
Moderate	85,858	26
None, little, or some	100,496	30
Total	334,699	100

ANNUAL ADMINISTRATIVE COSTS

Total annual administrative costs increased for plan sponsors from at least $157 million the year before ERISA to at least $341 million the year after--an increase of $184 million (117 percent). The average cost increased by $586--from $502 to $1,088.

Based on responses to our questionnaire, we estimated, for 313,729 of the 345,205 revised plans, the average increase in annual administrative costs. By plan type, the increase ranged from $212 for Keogh plans to $1,092 for defined benefit plans. The average percentage increase ranged from 93 percent for defined contribution plans to 161 percent for defined benefit plans.

We estimate that the average cost increase by plan size for the 313,729 plans ranged from $290 for plans with 1 to 10 participants to $2,219 for plans with 26 to 99 participants. The average percentage increase ranged from 89 percent for plans with 1 to 10 participants to 151 percent for plans with 11 to 25 participants.

Our estimates of the total, average dollar, and percentage increases of annual administrative costs by plan type and size are provided in the following table.

Plan type	Number of plans	Average cost: Before ERISA	Average cost: After ERISA	Increase: Amount	Increase: Percent	Total cost increase (millions)
Defined benefit	78,521	$677	$1,769	$1,092	161	$ 85.7
Defined contribution	206,092	482	928	446	93	91.9
Keogh	29,118	173	385	212	123	6.2
Total	313,729	$502	$1,088	$ 586	117	$183.8
Plan size (participants)						
1 to 10	235,935	$ 326	$ 616	$ 290	89	$ 68.4
11 to 25	47,105	667	1,671	1,004	151	47.3
26 to 99	30,689	1,602	3,821	2,219	139	68.1
Total	313,729	$ 502	$1,088	$ 586	117	$183.8

As with the revision costs, although many sponsors considered the annual administrative costs to be substantial or very great, most considered them to be moderate or less. Based on responses to our questionnaire, the following table shows, for an estimated 326,285 of the 345,205 revised plans, the plan sponsors' opinions on annual administrative costs.

Opinion on annual administrative costs	Sponsors	
	Number	Percent
Substantial or very great	96,734	30
Moderate	94,284	29
None, little, or some	135,267	41
Total	326,285	100

REASONS FOR INCREASE IN ANNUAL ADMINISTRATIVE COSTS

ERISA could have contributed to increased annual administrative costs in many ways. For example, additional annual administrative expenses could result from (1) changed recordkeeping practices, (2) the need to report and provide extensive information to three Government agencies--Labor, IRS, and PBGC--and plan participants, and (3) consulting fees for services and advice. Costs could also be incurred for bonding fiduciaries 1/ of smaller plans as required by ERISA 2/ and the purchase of insurance to protect fiduciaries from personal liability for plan administration.

In the questionnaire sent to plan sponsors, we asked whether particular types of costs, such as those mentioned above, were incurred the year before and after ERISA and how large these costs were. Sponsors provided sufficient information to indicate the average of particular types of costs. For example, the information provided indicates that:

1/A fiduciary is anyone who exercises discretionary control or authority over pension plan management or assets. A fiduciary may be the plan sponsor or administrator, or anyone with authority or responsibility in administering a plan.

2/ERISA generally requires that fiduciaries of plans be bonded, whereas the Welfare and Pension Plans Disclosure Act (the principal legislation regulating pension plans which was repealed by ERISA) did not require bonding of fiduciaries of plans with fewer than 25 participants.

--The average cost of reports to Government agencies increased from $62 to $312 (or 403 percent).

--The average cost for reporting to employees increased from $72 to $338 (or 369 percent).

--The average cost of fiduciary insurance increased from $18 to $332 (or 1,744 percent).

It should be noted that, although ERISA permits the purchase of insurance to protect the plan and/or fiduciary against the breach of fiduciary duties, the purchase of insurance was optional.

The following table summarizes the average increase in various categories of annual administrative costs based on information provided in responses to our questionnaire.

Costs	Average cost: Before ERISA	Average cost: After ERISA	Average increase: Amount	Average increase: Percent
Fees to:				
Insurance company	$442	$ 722	$280	63
Accountants	254	395	141	56
Attorneys	202	532	330	163
Actuaries	309	692	383	124
Consultants	269	550	281	104
Reports to:				
Government agencies	62	312	250	403
Employees	72	338	266	369
Fiduciary:				
Bonding	34	103	69	203
Insurance	18	332	314	1,744
Premium payments to PBGC (note a)	-	22	22	-
Other costs, such as trustee fees	484	826	342	71
Total	$502	$1,088	$586	117

a/ERISA requires defined benefit plans to pay premiums to PBGC to guarantee payment of certain participant benefits under insurance programs established by ERISA.

ACTIONS TO REDUCE ANNUAL ADMINISTRATIVE COSTS

Actions, such as eliminating certain annual reporting requirements, have been taken to reduce the administrative and paperwork burden and the cost to administer pension plans. For example, the requirement for an independent public accountant's certification of the financial statements of pension plans with fewer than 100 participants was eliminated. Also, beginning with the 1977 annual report on plan operations, plans had to file only one report with IRS, rather than individual reports with IRS, Labor, and PBGC.

Other actions are being considered or taken to reduce the burden of ERISA on businesses, especially smaller businesses. On August 10, 1978, the President, in submitting his plan for reorganizing the jurisdictional authority over ERISA, pointed out that the act's administrative provisions have caused bureaucratic confusion, delayed many important rulings, and produced bureaucratic runarounds and burdensome reporting requirements.

He said that the biggest problem has been the overlap in jurisdiction authority of the Departments of Labor and the Treasury in issuing regulations and decisions. According to the President, the reorganization plan, which became effective December 31, 1978, would significantly reduce these problems by eliminating most of the jurisdictional overlap.

On August 10, 1978, the White House announced additional steps the Departments of Labor and the Treasury and PBGC would take to relieve small businesses from the paperwork burden. According to the White House, the steps included eliminating the Plan Description Report (EBS-1 Form) and requiring that plans with fewer than 100 participants file a full annual report only every 3 years rather than every year. An abbreviated annual report will be required the other 2 years.

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