Pensions
(1967 folder)

VESTING

AND

PORTABILITY

IN

PENSION PLANS

A Panel Discussion

NATIONAL SOCIETY OF PROFESSIONAL ENGINEERS
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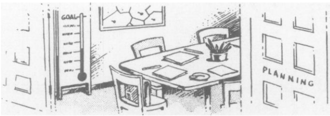
WHAT YOU ARE about to read are comments from three distinct authorities on the general subject of pensions and their provisions or lack of provisions for vesting and portability made during an Annual Meeting of the National Society of Professional Engineers in Hartford, Connecticut on July 6, 1967.

The panelists were: Mr. Frank Cummings, former minority labor counsel to the Senate Labor and Public Welfare Committee and prime author of S. 1103 introduced in the 90th session of Congress; Mr. Andrew Melgard, of the Human Resources Development Group, Chamber of Commerce of the United States; and Mr. Charles E. Tosch, formerly a consultant in employee benefits with the General Electric Company in New York and now vice president of Johnson & Higgins of Wall Street, New York.

At the same meeting, the National Society of Professional Engineers adopted a policy statement regarding pensions which reads:

The growth of private pension plans has been a major factor in the development of the high economic standards of the United States. Such private pension plans should be expanded and fostered by favorable laws and regulations and employers should be encouraged to adopt and improve their plans to the fullest extent possible consistent with sound economic policies. Private pension plans should vest the rights of employees at the earliest practicable time, but not more than 10 years.

NSPE will make a continuing study of methods to permit the economical transfer of pension credits through group arrangements or other means.



ANDREW A. MELGARD

Chamber of Commerce of the United States

THE SEARCH FOR security is as old as man. It began on the day Adam was banished from the Garden of Eden and will continue as long as one human heart beats in this universe.

Paradoxically, as our economic affluence increases, our search for economic security intensifies. Future historians will have to decide whether to call this age we live in the "space age" or the "age of the search for security." We are, in this panel discussion, participating in that quest and joining what is becoming an expanding and in depth national dialogue on this nation's retirement goals and programs.

Let us begin by looking at the broad background of these issues.

Private pensions involve an entire spectrum of issues. These items are but a part of a much larger issue that must be answered in the years 20 or 30 years ahead. *How will responsibility for the economic security of the individual be shared by government, the employer, and the individual himself?*

The average 20th century American survives on income — earned income. The economic value of the individual's life — his ability to earn income and save — is subject to certain hazards. The major ones are death, disability, old age, and unemployment.

Until the 1930's, the responsibility for meeting these hazards was largely left to the individual. With the economic breakdown that came with the great depression, government and the business community assumed more responsibility in these areas through collective approaches. Social Security is a mandatory collective approach to provide a "floor-of-protection" to help the individual find economic security. Fringe benefits, of which pensions are a part, is the collective approach used by an employer for all his employees.

Fringe benefits now cost American businessmen a staggering $75 billion plus each year — four times as much as the dividends paid to stockholders. Furthermore, the most recent Chamber of Commerce survey shows that fringe benefits costs are shooting up almost twice as fast as wage rates. In the area of pensions alone, employers have put almost $100 billion in assets in trust to help guarantee income and financial independence to employees in retirement. Currently, about three million persons are receiving monthly checks that amount to $3 billion a year from these private retirement plans. These plans continue to grow each year in the number of employees covered, the benefits offered and the assets placed in trust.

So, today, in his quest for economic security, the average American enjoys three layers of protection. The bottom layer is provided by Social Security. The middle layer is the fringe benefits provided by his employer. The top layer is what he does for himself — insurance, annuities, savings accounts in banks and building and loan associations, mutual funds, common stocks, corporate and government bonds, property or business ownership, and other forms of savings and investment.

The threat to this uniquely American system comes from the exponents of total security for the individual provided by government through social insurance based on pay-as-you-go tax redistribution. This great welfare society would offer one layer of protection. There would be no employer-provided layer and no individually-provided layer. The government would provide for all the economic hazards faced by the individual. In doing this, taxes on corporations could be so heavy that little in the way of fringe benefits could be offered. Furthermore, withholding taxes would be so heavy on the individual, he would tend to consume all take-home pay and have little, if anything, left for savings.

Beginning in 1962, the federal government began special studies of public policy and private pension plans. Since then we have had at least half a dozen Congressional hearings and over 30 bills introduced into the present 90th Congress, of which six or more relate to pension vesting and portability. The Administration has taken no position on these matters and legislation is unlikely in the near future. However, there will be further hearings and discussions.

During the course of discussions held by administration officials in Washington so far, there appears to be a lack of comprehensive approach to retirement income problems. The President's committee sidetracked the study of welfare plans and concentrated on pensions. This presents problems. It is necessary to look at the entire picture. From the employer or the employee of the union standpoint, it is virtually impossible to pick out one economic security need or one employee benefit and disregard the others.

Employers must consider all the economic security needs of all their employees. Different "generations" of employees are interested in different benefits. The average employer's problem is to have the freedom necessary to allocate a reasonable percentage of payroll for each specific fringe benefit out of the total fringe payment he can afford. In doing this, the employer has to keep a careful eye on take-home pay particularly during inflationary times when taxes are increasing. It would be easy to increase any one benefit if the employer, at the same time, could decrease the costs of another benefit or arbitrarily reduce take-home pay. But this cannot be done.

Another disturbing feature of the Washington discussions on pensions is the idea that complete retirement income must be provided by government — or by government and employers. No room is left for individual savings. This idea seems to be based on a completely erroneous theory that the average American does not have enough sense to save and provide for his own retirement. This does not square with the facts. Savings are at an all time high. Furthermore, recent studies show clearly that coverage by private pension plans actually stimulate individual savings.

The ultimate question is whether the federal government should completely control both public and private plans for retirement. If it does, then after a lifetime of work, the average retired American may find his financial income and freedom dependent on year-to-year decisions made in Washington. This government do-it-all approach is what some call "federal momism" — a tying of every citizen to the apron strings of the federal government from crib to coffin. We think that if the idea of being completely cared for by the federal government was directly presented to the average American, he would politely say "please mother I'd rather do it myself."

In all this pension controversy, where does the Chamber of Commerce of the United States stand?

The purpose of our federation is plainly stated, and is to the point. It is: *to strengthen, improve and preserve the free-market economy.*

In this particular respect, we are old-fashioned — we still believe, in this day and age of automation, there is a place for individual initiative and personal decision-making — and for human and economic freedom.

We have a clear understanding of the social and economic problems facing the nation today.

And the business community, as represented by the National Chamber, is astute enough — smart enough — to know that if the businessmen of the country do not face up to these problems and resolve them by private-enterprise means and methods, the government will step in and fill the vacuum with its own brand of solutions.

Government solutions, state-welfare solutions, if permitted to multiply and continue, could mean the end of the incentive system — the end of the free-market economy, as we know it — and even the end of self-government.

The National Chamber works to prevent that from happening.

We work in a positive, vigorous, determined, forward-looking manner to develop and apply — and to help businessmen in all parts of the country to develop and apply — private-enterprise solutions to the nation's economic and social problems.

That is the reason for our federation's existence.

Therefore, the National Chamber follows a positive, clear-cut approach on private pension plans. Chamber policy colls for maximum encouragement for the continued growth and expansion of private pension plans. At the same time, every effort is made to ease or prevent any needless governmental restrictions which will hamper the growth of pensions. In short, the business community wants to see private pension plans improved and their benefits spread to more employers and employees.

To accomplish this goal, there are a number of steps we have taken.

First, we encourage all employers to review their pension and fringe benefit plans and keep them up-to-date. At the same time, we encourage all employers who do not have such plans to consider the benefits they would derive from establishing one.

Second, because the need for pensions is so great among the self-employed and their employees, we pushed for liberalization of our tax laws on H.R. 10 on self-employed plans last year. Although the Treasury Department opposed this measure, Congress passed the law and gave more pension tax equity to the self-employed.

Third, our research shows that there is another great area of need, among smaller corporate employers. We have been suggesting the adoption by the Internal Revenue Service of a procedure for using master or prototype pension plans. Such a procedure would make it easier and less time consuming for smaller employers to start such plans.

Fourth, we encourage all employers to improve and increase their employee communications that explain the company's pension and fringe benefits. Employers are often amazed after a survey to discover how little their employees know about the employee benefits they already have.

Fifth, we ask employers to make certain that their congressman understand the values of pensions in their home states — what pensions do to provide income and financial independence for the retired, to provide new capital, and create new jobs, and to increase the economic growth of your country.

Finally, we ask government to encourage individuals to build retirement income with their earnings during their working years. At the same time, we look for federal fiscal and monetary policy that will control inflation which can be so destructive of pension values.

Against this broad background, we come to the pros and cons, the feasibility of this professional society establishing a portable pension plan. The subject is difficult, confusing and controversial. There will be no quick and easy answers. It is not commonplace to approach employee pensions from a functional rather than a company or industry viewpoint. The matter would seem to require in-depth research, broad study, alternative approaches and certainly full discussion.

I am entirely sympathetic to the burdens this study places on your chairman and his committee members. However, I am reminded that the two major public affairs programs of the National Chamber are directed at increasing the business and professional man's understanding of economics and politics. Your subject should do both, quickly.

The two distinguished panelists who follow will get into the nuts and bolts of this issue.

At this time, I would like to raise two points.

First, what is the exact extent of the need among professional engineers for pension portability? For what proportion of your membership is such a system important? I believe it would be helpful to have a study of the financial circumstances of those professional engineers who retired recently, say in 1965 or 1966. Possibly, this could be compared with the retirement income of those who retired 5, 10 or 15 years earlier and it could be seen if there has been improvement in retirement income. At the same time, a study could be made of professional engineers age 55 and over to see exactly what prospects they have for retirement income and where their problems lie. Factual studies such as these would be most valuable.

Second, as a matter of priority, how high on the professional engineer's list is pension portability as compared to other matters in the compensation and employee benefit area? Is larger take-home pay more attractive? Would a profit-sharing or thrift plan that vested in six to twenty-four months be of more value to short-term employees than improvement in the vesting or portability of pensions? In other words, for a given sum of money available from the employer, would the professional engineer who moves often, whether from choice or necessity, prefer more portability in profit-sharing or in pensions? The answer might prove interesting.

Finally, I will close with these general observations. The economic life value of the professional man has reached an impressive height. By any standard, professional engineers earn a small fortune in their lifetimes. But, our various levels of government are taking in taxes close to 30 cents of every dollar. In addition the Chamber's latest survey shows that close to 25% of payroll is going to provide fringe benefits. At what point should professional men in their search for economic security cease to look to government and employers? It is imperative in a free society that the citizen retain the freedom to manage the economic value of his own life beyond the floor of protection offered by the federal government and the employee benefits provided by his employer. There is a point of no return beyond which the values and comforts of collective security are outweighed by the advantages and opportunities of free individual choice in the management of the money one earns in a lifetime.

CHARLES E. TOSCH

General Electric Company

ALTHOUGH THIS morning's session is listed as a discussion of "Portable Pensions," I feel from reading the article "Will Your Pension Plan Move With You?" by Sigrid Marczoch as well as Howard D. Engel's comments on a master pension plan for professional engineers which appeared in the March issue of *The American Engineer,* that you are interested in a much broader subject than "portable pensions." Accordingly, I would like to explore with you two subjects, namely: (1) should a job change mean loss of pension rights? — and that's a lot broader, in my opinion, than "portable pensions," and (2) a master pension plan for professional engineers. Both of these topics are related, at least in the context of these articles since the master pension plan would contain provisions which provide for "portability."

Retention of Pension Rights

Unfortunately, there is much confusion about the expression "portable pensions." I should say at this point that whenever I use the expression "portable pensions," I think of it as being in quotations since it has, in my opinion, a special meaning. I think it is important that we understand that meaning. A good deal of the misunderstanding which exists arises from the confusion surrounding the expression "portable pensions." This expression has, incidentally, a rather happy connotation since it implies that, unlike some other things "which you can't take with you," you can take pensions with you. It is used interchangeably with "vested pensions," which, on the other hand, sounds bad — something like some vested interests which, although unfair and unjust, nevertheless cannot be changed.

Although I make my living by working in the pension field, I must confess that I am not sure what people *really* mean when they use the expression "portable pensions." Webster's New International Dictionary defines portable as "Capable of being borne or carried; easily or conveniently transported; not stationary, fixed, or cumbersome to be moved." If we apply the definition to "portable pensions," I think we would assume that a "portable pension" is one which moves with the employee from job to job, or even from a job to the state of unemployment. The crux of the confusion, I believe, lies in the term "move."

Does this mean that if an employee leaves employer A to take a job with B that:

1. He somehow picks up his pension from employer A and carries it to employer B who will be responsible for paying him a pension based on service with both employers, or
2. He has a claim on employer A for a pension based on service with him, or
3. He has a claim on some central fund (probably run by the Federal government) for the pension earned while with employer A.

Method two, i.e., a claim on employer A is easy to implement (it only involves money) and in fact has been done for years — its called "vesting."

Method one — which is what I mean when I use the expression "portable pensions" — involves many practical problems which I will discuss briefly in a moment. The third method — a central fund — introduces needless complications, since the same end result can be accomplished by having employer A, if he doesn't want to be bothered with keeping records on someone who has left him, purchase an annuity from a life insurance company. This private enterprise mechanism is in existence today and would not require the establishment of a new governmental agency.

Although method one sounds simple, there are many problems which make its use impracticable. For example, some pension plans provide for a payment of 100 times the anticipated monthly pension if an employee dies before retirement, i.e., a death benefit of $10,000 for a pension of $100 per month. What do you do if an employee with such a death benefit takes his pension to another employer who has no death benefit in his pension plan? Let us suppose employer B's plan provides a pension of $5 per month per year of service — how does he handle an employee who comes to him from employer A with 10 years of service and a pension at a rate of $3.50 per month per year of service? Just one more example, suppose employer B's plan provides for a pension regardless of age if an employee is totally and permanently disabled — what does he pay a disabled employee who brought to him a pension which had no disability benefit?

The problems arising from different benefits provided by plans are relatively simple compared to those arising from the differing costs which come about because of differences in interest earnings on the funds; mortality and turnover rates; and expenses.

Although I understand that engineers have in recent years made purses out of sows' ears, I unfortunately cannot make actuaries out of engineers in the time allotted to me this morning. Therefore, I want to point out to you in very simple terms how transferring pension rights would cause problems by using just one of the many factors involved — interest earnings.

As you may know, the one-sum cost of a pension involves interest since the money set aside today can be invested until the employee reaches retirement when pension payments begin. To keep it simple, let us assume that employer A has an obligation to pay an employee now age 40, $1,000 when he reaches age 65. If his pension fund will earn four percent for the next 25 years, he need have only $375.12 set aside at present. On the other hand, if employer B's plan earns three and three quarters percent (only one quarter of a percent less) he would need $398.38 to meet the obligation. If the employee leaves employer A who has set aside only $375.12, and transfers his pension right to B, he certainly would take with him only $375.12. However, on the basis of B's earnings rate this would provide only $942 at age 62. If B's plan earns three and a half percent, the age 65 payment would be still smaller, only $886. I doubt that this employee would be happy to have a "portable" payment at either of these reduced amounts rather than a "vested" payment of $1,000 from employer A.

Of course, all of these problems are easily remedied provided all plans are required to provide identical benefits and to use the same factors for interest, mortality, etc. This would require the benefits and standards to be set by government, i.e., that all plans be required by law to be identical. This would, in my opinion, be a high price to pay for "portability," especially since I doubt that is what is basically wanted.

For example, in Miss Marczoch's article referred to earlier, the author points out that "Fear of loss of pension rights has tied many an engineer to a declining industry or firm longer than the prevailing job market required. Further, the loss of benefits discourages laid-off employees from seeking new fields of employment as long as they can still hope to return to their old jobs with all their accrued pension rights. An engineer's mobility is often severely restricted by his employee pension plan." Her desire, apparently, is to have a system which will permit an engineer to retain his pension rights even though he changes jobs. This does not require a "portable pension" system but can be accomplished by an early vesting provision which would remove these deterrents to mobility and is a workable solution currently used successfully by many plans.

Today, the vast majority of pension plans provide for some vesting. For example, the Department of Labor's recent study of 25,000 plans filed by the end of 1960 under the Federal Disclosure Act revealed that 67 percent of them contained a vesting provision. Of the plans containing a vesting provision, 76 percent covering 86 percent of the employees required 15 years of service or less for full vesting; 43 percent of the plans covering 46 percent of the workers required 10 years or less. These trends toward liberalized vesting are verified by studies made by Bankers Trust Company which traced developments from

1950 through 1959. My Company is one of those which has been improving the conditions under which an employee's pension vests. Last fall we reduced our requirement for full vesting to 10 years of service.

I think that vesting is a two-way street; that the employer, in this highly technical and specialized age, who must invest a considerable amount of money training a new employee, regardless of his technical competence and qualifications, has a right to expect that the employee will stay with him for some reasonable length of time in order to return that investment to the employer and thus earn his vested pension. And so I believe that so-called "immediate vesting," whereby if you work for one week, you would be entitled to a pension based on one week's pay, is quite impractical and really unfair. I think those of you who are employers in your own right will agree with me. It costs money to put a man on the payroll; to teach him how you do business. A pension is used to attract and hold good people. I'm not advocating that pensions be paid only to employees who remain with an employer until they have reached age 65, but I do think that there's some minimum period of time needed. I don't know what it is; I'll leave that to your judgment and to that of your committee.

Those who recommend early vesting do so on the grounds that lack of vesting deters mobility, which is an urgent necessity of rapidly changing technologies. I guess this is particularly true of the engineering profession, where you may be attracted to a particular industry at a particular time because they are expanding only to find that, not only because of changes in technology, but sometimes because of loss of defense contracts, the jobs disappear and you must go elsewhere. However, the Labor Department study I referred to a moment ago points out that "The presumption that pension plans inhibit worker mobility is widely accepted. Indeed, a contrary view would run counter to one of the chief reasons for the establishment of many pension plans. Almost without exception, however, it is agreed that other practices — seniority, for example — are intermeshed with the accumulation of pension rights and may, on balance, be more significant deterrents to worker mobility."

From time to time, I have spoken to union representatives who almost always want immediate vesting. Since the right to a job depends upon seniority, shouldn't the employee also be protected by having his seniority rights transferred from company to company and from union to union? After all, a pension is a contingent right payable only if the employee lives to retirement, but his job, or the loss thereof, is a current right. Isn't the loss of *today's* means of livelihood more important than the loss of the pensioner's contingent income?

Vesting, as I said earlier, is easily obtainable. It only costs money. As one of my sons says, "Dad, money isn't everything. But I don't know what's second-best." If you're running a business, money is something you have to consider — you've got to meet your payroll, pay your suppliers and keep the owners happy. An article in the *Actuarial Journal* gave some estimates of the cost of providing full vesting upon the completion of 10 years of service, regardless of age, and reported that the increase in cost over a plan without vesting ranged from 1 percent to 20 percent depending upon the plan provisions, the employee turnover rates, etc. Obviously, if you are in the teaching profession, where you have relatively little turnover, vesting doesn't cost you very much, because people don't leave. On the other hand, if you run a department store, where your turnover may be very high, vesting can be extremely expensive. So you do get this wide range of cost. If a plan provides vesting, something has to give. You know, it's like punching a balloon; you push your fist in here and it pokes out over there. So if you're going to spend your money on vesting, this may mean that the people who stay with you until 65 will get smaller benefits. Or, instead of having a benefit of two percent of pay per year of service, you may reduce this to one and a half percent per year. Perhaps you will leave out a disability pension as something to add at a later date. For this reason, we have to weigh the rights of the various classes of employee, when we decide what kind of provisions to include within the plan.

I would recommend to your society and to your committee that rather than chase what I think is a will-o-the-wisp, i.e., "portable pensions," you devote your energies to stressing vesting — early vesting — because this is an attainable object which, if realized, would provide the flexibility in job assignments that you feel so highly desirable for engineers.

Master Pension Plan for Professional Engineers

Now just a few comments about the feasibility of a master plan for professional engineers.

I would like to second what our first speaker, Andy Melgard said, and that is, that you go out first, and get yourselves some statistics about the pension arrangements now in effect for your members. I'm a little bit at a loss because I don't have those statistics. You may remember that I was that gad-fly at the Chemical Society session on pensions about two years ago. I told them that I thought that "portability" was not a practical objective and that a universal pension plan for chemical engineers was not practical. One of the reasons for my statement was that they said that only seven percent of their members were not already covered under a pension plan. I don't know what the percentage is among professional engineers — it's probably higher because there are more of you in consulting work in smaller organizations which are less apt to have a pension plan than a large organization. But, I would guess that a high percentage of your members are already covered under a pension plan.

Just think of problems that a Professional Engineers' plan would cause an employer who already has a plan. Put yourself in that spot. Assume you were General Electric, and one group of your employees came to you and said, "We want to have a completely different plan from all the other employees of General Electric, some 300,000 of them. We want a plan designed just for professional engineers." If this demand were granted, what would be done with other classes of employees? If you professional engineers working for General Electric had a special pension plan, shouldn't I have one, even though I'm the only actuary who works for General Electric? Would the chemical engineers, the accountants, the lawyers, the molders in our foundries, the glassblowers in the glass plants — all be entitled to a special plan of their own?

And it would not only be the employers who would complain. How do you think one of your members would react if he found that the benefits of your plan were less than those his employer provided for other employees?

To paraphrase John Guenther who asked in his book *Inside Europe,* "Must every language have a nation of its own?" I ask "Must every profession and every trade have a pension plan of its own?"

I think that your hope for a plan to which all professional engineers would belong is impractical. But I do think that you can provide a real service to a number of your members if you would set up a plan which could be used by the smaller employers who employ members of your organization — those who find it uneconomical or difficult to set up a plan of their own — to cover *all* their employees, secretaries as well as the professional engineers working for them.

Conclusion

In concluding, let me leave two thoughts with you.

First, forget about "portability" as I defined it because it is impractical. Instead, press for early vesting which will provide for the retention of pension rights as you move from job to job.

Second, forget about a universal plan for *all* professional engineers. Instead, devote your efforts to a program which will provide pensions for those of your members who are not now covered by a plan.

FRANK CUMMINGS

Member, New York Bar

"PORTABLE PENSIONS" — like portable radios and portable typewriters — come in attractive packages preceded by even more attractive advertising, and, I suggest, are never quite as substantial as the stationary variety. Certainly they are rarely *more* substantial. The problem of mobility, on the other hand — and the implications of that problem in the pension field — is a very real problem indeed.

Engineers, I suspect, like most professionals, are more mobile than most unskilled or semi-skilled workers. Moving around, you have a very real and important interest in taking your pension credits along with you — or at least an interest in not forfeiting your pension credits every time you move.

The problems of *forfeiture,* on the one hand, and of *portability,* on the other, are not, in my judgment, the same.

I. Vesting and Funding — The Keys to the Problem

In fact, if you really analyze the meaning of "portability" when it is applied to pensions — at least when it is so applied uncritically — you will see that portability is *irrelevant,* or at least unimportant, to the solution of mobility problems.

I suggest that what you are really interested in — or at least what you ought to be interested in — is vesting and funding.

With early vesting and sound funding, you don't need transferability.

And without adequate vesting and sound funding, transferability won't do you much good at all, because you will have nothing to transfer.

What is at stake can be understood only if the key terms are defined.

A "vested" pension is a right which is nonforfeitable — which you keep even if you quit, or take another job.

A "funded" pension is one which is backed by sufficient assets — usually in the form of trust funds or paid-up insurance contracts — so that, even if no more contributions are made, the money will be there to pay benefits when you reach retirement age.

As you can see, "vesting" and "funding" go hand in hand. If you have a "vested" (nonforfeitable) right to a pension, but the pension is payable only to the extent that the pension trust fund has sufficient assets, and if the trust is poorly funded, then you may have a vested interest in nothing. Conversely, if your pension plan is well funded but unvested, the fund ends up with lots of cash, but you have no right to receive it.

In short, you need *both* vesting and funding before a pension plan does you any good.

Now let us suppose you have worked ten years for an engineering firm, and you decide to take a better job with another firm. *If* you have a plan with ten years vesting and adequate funding, you have a nonforfeitable right to a pension when you reach a specified retirement age. You can't "transfer" the pension, but at 65 you can still go back and get it.

On the other hand, *if you don't have a vested pension right,* there would be nothing to "transfer" to another employer, even if there were such a thing as "transferability."

Assuming you had a vested pension, as a practical matter you may end up with two small pensions instead of one larger one. "Portability" might do you about as much good as having all your money in one bank, as opposed to half your assets in each of two banks: there is something to be said for the *convenience* of it, but not enough to warrant all the fuss we have been hearing lately about the need for portable pensions.

By this I don't mean to suggest for a moment that the problem we are here to discuss is not important. But the problem is really not one of providing for "portability" but rather of doing something about unreasonable *forfeitures.*

II. Some Alternatives

A. *"Portability Agreements"*

Having suggested to you that portability is, in most cases, besides the point, I can imagine the question: Yes, but what about the "portability agreements" we have heard about? As you may know, some labor unions — notably in the building trades — have worked out regional reciprocal agreements. If a carpenter moves from one region to another, he may, indeed, be able to take his "credits" with him. True enough, but if you analyze what is really happening in such cases, I think you will see that these pension plans have merely adopted a modified kind of vesting. Vesting, after all, is nothing but a provision in a plan protecting the participant against forfeiture. Ordinarily an employee who moves away forfeits his pension rights. Under these reciprocity agreements, the move does *not* result in a forfeiture. And absent the forfeiture, there is something "vested" — or at least quasi-vested — to transfer.

B. *Multi-Employer Plans*

These reciprocity agreements are usually, if not always, arranged between regional plans which are established on a multiemployer basis. And you get a kind of "portability" from a multiemployer plan, with or without regional reciprocity agreements. Under a multiemployer plan, a group of employers agree that in effect, for pension purposes, they are all "the same employer." So, of course, when an employee leaves one employer and taks a job with another employer, and if both employers are under the same plan, then, for pension purposes, the employee did not really "change jobs" because both employers are the "same employer." As long as you keep working for *some* employer under the plan, you have "portability."

Once again, however, if you really examine what is happening, you will see that, whatever the legal technicalities may be called, the practical effect of this system is that an employee transferring from one job to another is protected against forfeiture.

C. *Social Security*

The broadest "multiemployer plan," of course, is run by the Government, in the form of Social Security. All employers (except railroaders and government employees) are under the same plan — and there are even provisions for "reciprocity" between the Social Security system, the railroad retirement system, and the retirement system for federal employees.

In point of fact, it has been suggested that the Social Security system be amended to permit the purchase, by employers or other private persons, of additional credits, providing for additional benefits. Thus, an employer would be permitted to take the cash he would otherwise pay into a pension plan and pay it, instead, into the Social Security trust fund, to be credited as an "extra" for the benefit of his employees.

That is one way to solve portability problems. I don't recommend it at all.

III. The Motives & Mechanics of Pension Planning

Why all these different types of plans? If there is a "good" type of plan, why aren't all plans "good"? Why aren't they all the same?

A. *Motives*

1. *"Salable Benefits"*

No pension planner wants to set up a plan which will provide benefits so low as to be laughable. One of the fundamental purposes of having a pension plan, after all, is to provide a kind of compensation — something of value. So most planners will not set up a benefit structure under which benefits will not be high enough to live on in retirement — either alone or combined with Social Security.

Vesting, however, can be expensive.

And forfeitures, on the other hand, can be so built-in to a plan, and so anticipated, that the extra cash can provide a much higher benefit level than would be possible if the plan had early vesting provisions.

So if you have a choice — and every pension planner has this choice, in one form or another — between a plan which will provide $25 per month for half the employees, or $150 per month for half the employees, or $150 per month but only for three percent of the employees, the planner will very opten opt for the bigger benefits, even though he must set the eligibility standards so high that almost everyone will forfeit, and only a tiny fraction of the employees will ever get a pension.

You put the "$150 per month" in big red letters. And you put the eligibility standards in small print.

B. *Collective Bargaining.*

If it is a plan which is set up by a union in collective bargaining, you might think that one side or the other at the bargaining table would keep the plan from being a fraud. Not necessarily. The union's officers, after all, have to run for reelection — and they must make their reelection campaign *before* many of the members will have retired. So what counts is how the plan *looks*, and only secondarily how it *works*. And the employer, ordinarily, is concerned with *costs*. So if his pension costs are lessened because of a high forfeiture rate, so much the better.

In short, the ordinary dynamics of collective bargaining — under which the union looks out for the employees' interests and the employer looks out for the stockholders' — simply do not produce a sound pension plan in many cases.

C. *Anti-Mobility.*

While we are here talking about "portability" as an answer to the problems which accompany the increasing mobility of Americans, it is often said that one of the fundamental objectives of a pension plan is to *resist mobility*, not to accommodate it. A pension plan, under this approach, is designed by the employer as an incentive *not* to be mobile — as a way of keeping for a longer time those employees in whom the employer has invested money, training, and so forth. Early vesting would, it is argued, undermine the very purpose of the plan, because it is the risk of forfeiture which keeps an employee from switching jobs — and that is supposed to be just what the employer wants. Thus, early vesting would destroy the employer's incentive to establish a pension plan in the first place.

I really doubt the authenticity of this theory. I doubt that too many employees will turn down a better job — if it is really better than their present job — just because of the forfeiture of pension rights. As a matter of fact, I suspect that the forfeiture may well freeze-in the more mediocre employees, not the best ones.

And if you look at the typical *executive* deferred compensation plan, early vesting — *very* early vesting — is overwhelmingly the rule. Most key executives *insist* on early vesting, and they get it.

In my judgment, this anti-mobility "motive" is an excuse — a disguise — for what is the real motive behind the resistance to early vesting. What is really at stake, of course, is *costs.*

IV. Cost

In pure *theory,* vesting has no "cost" at all. A vested pension is more "expensive" than a forfeitable one only if the benefit level is constant. But, given a constant pool of cash, you can provide high benefits for few people, or low benefits for lots of people — and the cost will be the same.

In *practice,* however, vesting is *very expensive,* because low benefits — even if coupled with early vesting — are simply not "salable."

As a practical matter, moreover, benefits can never be lowered. So once a high-forfeiture plan is established, it can never be rearranged. Indeed, once a high benefit level plan is built on the foundation of high-forfeitures, "improvements" in the plan tend to come in the form of even *higher* benefits, rather than earlier vesting.

Under a vested plan, on the other hand, *any* increase in benefits is expensive, because *so many people* actually get something out of the increase.

V. Legislation Ahead

There is legislation ahead: not right away, but soon. In 1965, a special committee appointed by President Kennedy recommended minimum federally-established standards for private pension plans. Senator Javits of New York, whom I recently served as labor counsel, has introduced a bill to establish such standards. Indeed, the Javits bill — which I drafted — would require 15-year vesting as a minimum standard, and would also reinsure private pension plans much as the Federal Deposit Insurance Corporation insures bank deposits. The bill would also control funding of pension plans, their administration, and would provide a central portability "clearinghouse" for those plans which might wish to participate on a voluntary basis.

The portability feature, of course, is built on the premise that only *vested* credits would be accepted. What, after all, is the monetary value of an unvested credit? The minute you move, it's worthless.

A number of other Congressmen have paid a good deal of lip service to the portability, or "clearinghouse," idea. I have seen none of them, except Senator Javits, actually propose a bill that will work. The Javits bill is founded on vesting and funding standards, with portability only an ancillary feature. I suggest that the idea of a portability clearinghouse, without control of vesting and funding, will be both worthless and unworkable. And that is why, despite all the talk by so many legislators and others, the Javits bill is the only bill so far.

VI. Private Solutions

Even if legislation like the Javits bill were to become law, however, it would only establish the most general standards. Fifteen year vesting, after all, is really very minimal. A man who has devoted 15 years of his life to working under a single pension plan for a single employer has earned something. He ought not to be told after 15 years that if he changes jobs he forfeits the whole thing.

But there are some industries where even 15 years may be too long. Suppose you have a business where only two percent of the employees stay 15 years with the same employer. Is a plan with only 15-year vesting a hoax on the other 98 percent? I think it is, but that is only one lawyer's opinion.

The key questions can only be answered on an individual basis. But at least you all ought to know enough to *ask them*. When you are asked to evaluate a pension plan, or to devise one, or to consider working for an employer who has one, you ought to ask:

First, how many years must I work before I get a vested interest?

Second, how likely is it that I will work here that long?

Third, is there a trust fund which will have enough cash to pay me?

And Fourth — and this is the last, not the first, question — how high are the benefits?

If you get adequate answers to *all four* questions — answers which satisfy you personally — then you have a pension plan which will present no portability problems. When you leave or move, you will have a nonforfeitable credit which has real value.

If you do *not* get satisfactory answers to these four questions — and particularly the first three — then the plan needs changing, at least as far as *you* are concerned.

And if you are a mobile fellow and you doubt that you will stick with one employer for a long time, then you ought to press, not for a nebulous undefinable "portability," but for earlier vesting, because that is the primary practical precondition of portability.

So I end where I began. *With* adequate vesting, the portability problem is solved. *Without* adequate vesting, the problem is insoluble.

QUESTION AND ANSWER PERIOD

QUESTION: From what I can gather at this point, it seems to be a black and white situation; either forfeiture or full vesting. Isn't there a middleground? Isn't there a compromise possible which would allow a percentage of vesting?

MR. TOSCH —

ANSWER: The answer is yes. There are plans that have such graded vesting. Some have as an example, 50 percent after ten years of service with five percent for each of the next ten years until the employee reaches 100 percent in 20 years. This is a possible solution, but most firms provide all or nothing. Speaking as an employee, I would prefer that the period of full qualification not be so long.

* * * * *

QUESTION: As a teacher, one of the things I am glad to know is that I am covered by a pension plan with a deferred income plan. We have vested interest in our first paycheck. The money goes to a third party who holds it until we retire and it varies from university to university because the percentage and ratio of contribution varies from place to place. Why can't engineers have a plan similar to that?

MR. CUMMINGS —

ANSWER: The motives behind that type of a plan seem to be essentially tax motives. I admit I don't know the plan well, but if you only get your own money back with interest, I would rather invest it myself.

MR. TOSCH —

ANSWER: What we are speaking about here is the TIAA plan for college teachers. It is a pension plan and there is employer money. It does have full immediate vesting, but it isn't quite as good as you think it is. When I was addressing the American Chemical Society, this question came up: "Why can't industry give full and immediate vesting if the poor universities do it?"

For one thing, you can't enter these plans until you are at least 30 years old. If, for example, G.E. had such a plan, an engineer starting with us at age 22 would have to wait eight years before entering the pension plan. Using the same assumptions, if a person left the university at age 32, he would have immediate vesting of two years benefits even though he started working at 22. If he left G.E. at 32 after ten years of service, he would have nine years of pension credits.

As you can see, you must examine these plans carefully and avoid making hasty judgments.

* * * * *

QUESTION: Do you have any comments on the Dingell Bill?

MR. CUMMINGS —

ANSWER: Yes, I think it is a very amusing bill. It doesn't solve or even address itself to the problem of forfeiture at all. Forfeiture is your big problem. What difference does it make to you if your money is transferred to the Secretary of Health, Education and Welfare or if its kept in a trust fund, as long as you can go back and get it when you retire? It is the same amount of money.

I can't find anything in the Dingell Bill which does anything more than provide a central clearinghouse for the money which, by rights, you have earned. The bill does not tell you what those rights are, and does not affect or improve those rights in any way.

* * * * *

QUESTION: The panel did not mention the Internal Revenue clause in the Javits bill. In an actual situation where the worker under the planned system transfers to another company, we have an impression that the IRS can tax the income of each.

MR. CUMMINGS —

ANSWER: All employees know there are ways to get around the Internal Revenue Service. I think this is one of the nicest features of the Javits bill. It takes all control of pension plans away from the Internal Revenue Service and deposits them with a new commission. This is a commission independent of government control and not motivated by the Treasury's motives.

The trouble with the Treasury is that it has two conflicting motives — to encourage pension plans and to collect money. If it wants to encourage plans, it allows the deduction. If the motive is to collect money for the government, it will want to deny deduction or vest the income in the employee where he will have to pay tax on it. But if you really want to foster pension plans, you give the employer his deduction, and give the employee the deferral. So the Treasury has inconsistent motives. The Javits bill takes jurisdiction away from the Treasury.

A further improvement would result if either the Javits bill or the Dingell bill said that the funds passing through the "clearinghouse" were not available to the employee, but merely a transfer from one fund to the central fund or to another employer's fund. This would not give the employee the opportunity to taking cash in lieu of a pension. I think laws could be drafted to accomplish that.

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