United States General Accounting Office 134222

GAO

Testimony

For Release
on Delivery
Expected at
10:00a.m. EDT
Friday
October 23, 1987

Vesting Status of Selected Participants in Top-Heavy Pension Plans

Statement for the Record of
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Before the
Subcommittee on Private Retirement Plans
and Oversight of the Internal Revenue
Service
Committee on Finance
United States Senate

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GAO/T-HRD-88-3

Mr. Chairman and Members of the Committee:

A pension plan is determined to be top-heavy if more than 60 percent of the present value of the total accrued benefits are provided to company owners and others who are defined as key employees. The Congress added rules for top-heavy plans to the requirements pension plans must meet to qualify for tax benefits under the Internal Revenue Code as part of the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA). Among other things, these rules reduce the length of time required for workers in top-heavy plans to vest in (i.e., have a nonforfeitable right to) their employer-provided pension benefits.

As part of the Tax Reform Act of 1986 (TRA 1986), the Congress changed the rules for most pension plans to require quicker vesting. The 1982 minimum vesting periods, which still apply to top-heavy plans, are shorter than those required by the 1986 rules.

In August 1987, Congressman Charles B. Rangel asked us to assess the effect of replacing the 1982 top-heavy vesting rules with the TRA 1986 rules. The following is a summary of the results of our work for your consideration in deliberating the repeal of top-heavy provisions, as provided for in the Small Business Retirement Benefit Extension Act (S. 1426).

We examined data from an ongoing review of pension plans of small businesses (less than 100 employees). This review surveys a national sample of 887 small employers to satisfy the 1984 Retirement Equity Act requirement that GAO examine the effect of pension rules on women. At the time of the request, we had received usable responses from 367 employers which included 202 top-heavy plans.

We analyzed 1985 data on 859 active participants (437 men and 422 women) in 128 top-heavy plans. These plans used a 2-to-6-year graded vesting schedule, that is, participants begin vesting in their pension benefits at the end of the 2nd year of credited service, increasing 20 percent per year until they are fully vested at the end of the 6th year. Top-heavy plans are also permitted to use 3-year cliff vesting. With a cliff schedule, participants move from nonvested to fully vested status after a specified length of service. We did not analyze data on plans using 3-year cliff vesting because the number of such plans was relatively small (20 plans). The remaining 54 plans, which used more rapid vesting schedules than the top-heavy rules require, were not included in the analysis.

Most of the 128 plans we analyzed were from the legal, medical, and health services industry groups. The plans had an average of 7 participants each. The median job tenure for men in these plans was 7 years, for women 4 years.

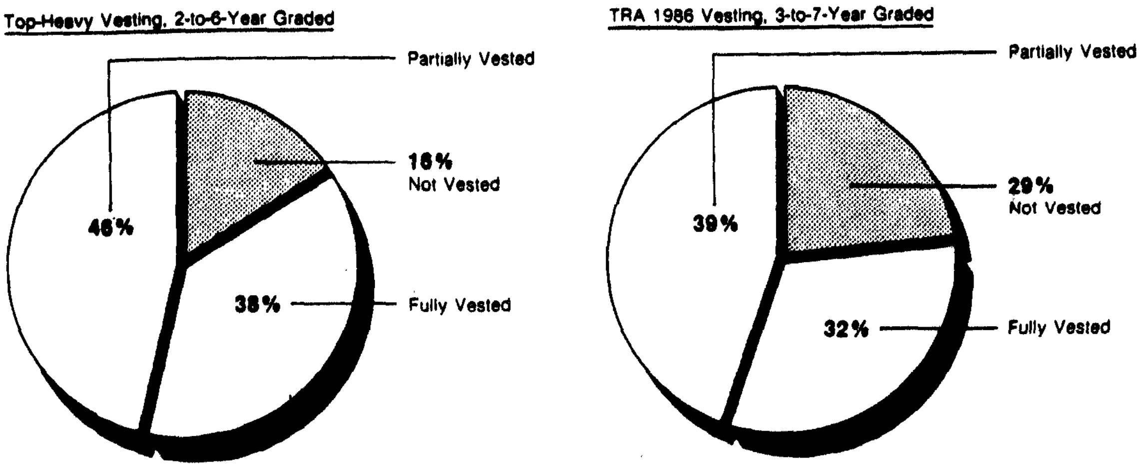
We determined the percentages of men and women who were fully vested, partially vested, and not vested under their top-heavy plans and compared their vesting status with what it would have been under the TRA 1986 minimum vesting schedules (3-to-7-year graded or 5-year cliff). Our results are not projectable to the universe of top-heavy plan participants.

Our analysis showed:

-- If the top-heavy plans had used the TRA 1986 graded vesting schedule, the proportion of nonvested women would have increased from 16 percent to 29 percent, as shown in fig. 1. The proportion of nonvested men would have increased from 8 percent to 15 percent, as shown in fig. 2.

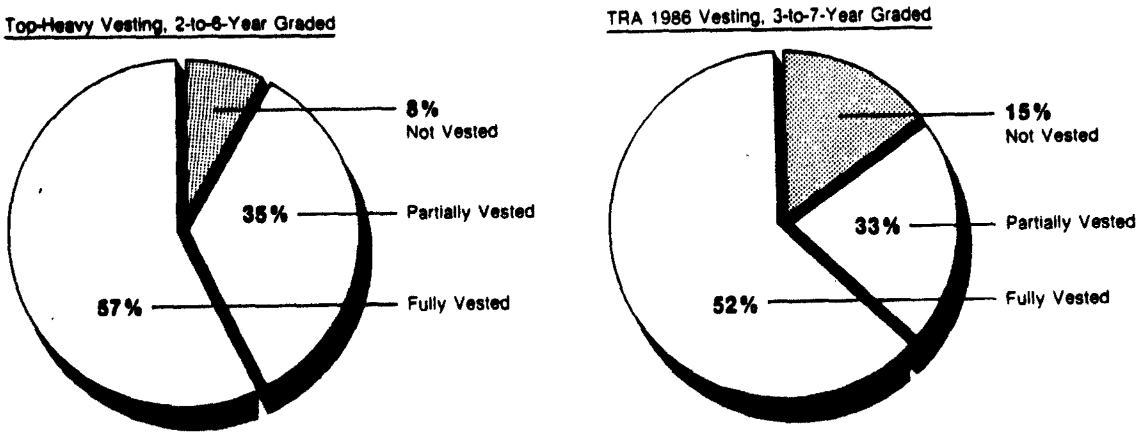
-- In addition, smaller percentages of participants fully vest under TRA 1986. For example, 38 percent of women were fully vested under their top-heavy plans, while 32 percent of women would have been fully vested under the TRA 1986 vesting schedule. Under top-heavy rules, 57 percent of men were fully vested, while 52 percent of men would have been fully vested under the TRA 1986 graded vesting schedule. (See figs. 1 and 2.)

Figure 1: Comparison of Women's Top-Heavy Vesting Status With What Their Status Would Have Been Under TRA 1986 Graded Schedule



Note Based on preliminary 1985 data from 128 top heavy plans using a 2-to-6-year graded vesting schedule, with 859 participants, 422 of whom were women, in 97 companies with fewer than 100 employees

Figure 2: Comparison of Men's Top-Heavy Vesting Status With What Their Status Would Have Been Under TRA 1986 Graded Schedule



Note: Based on preliminary 1985 data from 128 top heavy plans using a 2-to-6-year graded vesting schedule, with 859 participants, 437 of whom were men, in 97 companies with fewer than 100 employees.

-- Considering vesting percentages of each of the 859 participants studied, the average vesting percentage for women would have decreased from 60 percent under top-heavy to 49 percent under the TRA 1986 graded schedule. Similarly, the percentage for men would have decreased from 74 percent to 66 percent.

Finally, if these plans had used the TRA 1986 5-year cliff schedule, the proportion of women with no vested benefits would have increased from 16 percent to 53 percent, while the proportion of women fully vested would have increased from 38 to 47 percent. Similarly, the proportion of men with no vested benefits would have increased from 8 percent to 36 percent, while the proportion of men fully vested would have increased from 57 to 64 percent.

In summary, workers in our plans would have been adversely affected if top-heavy vesting had been replaced by the minimum vesting schedules of TRA 1986. Under the TRA 1986 graded schedule, fewer employees (both men and women) would have been fully vested in their pension benefits; more employees would not have been vested at all. Our results show employees' actual vesting status at a point in time and not necessarily what their vesting status will be when they leave their job.

We expect to complete our work for Congressman Rangel during November and will issue a more detailed report at that time.