Effects of Eligibility and Vesting Policies on Workers’ Retirement Savings

Why GAO Did This Study

ERISA allows sponsors to opt to set up 401(k) plans—which are the predominant type of plan offered by many employers to promote workers’ retirement savings—and to set eligibility and vesting policies for the plans. GAO was asked to examine 401(k) plans’ use of these policies. Among other objectives, this report examines 1) what is known about the prevalence of these policies and why plans use them, and 2) the potential effects of these policies on workers’ retirement savings.

GAO conducted a nongeneralizable survey of 80 plan sponsors and plan professionals regarding plans’ use of eligibility and vesting policies and the reasons for using them; reviewed industry data on plans’ use of eligibility and vesting policies; and projected potential effects on retirement savings based on hypothetical scenarios. GAO also interviewed federal officials and 21 retirement professionals and academic researchers.

What GAO Found

GAO’s nongeneralizable survey of 80 401(k) plans ranging in size from fewer than 100 participants to more than 5,000 and its review of industry data found that many plans have policies that affect workers’ ability to (1) save in plans (eligibility policies), (2) receive employer contributions, and (3) keep those employer contributions if they leave their job (vesting policies). Thirty-three of 80 plans surveyed had policies that did not allow workers younger than age 21 to participate in the plan. In addition, 19 plans required participants to be employed on the last day of the year to receive any employer contribution for that year. Fifty-seven plans had vesting policies requiring employees to work for a certain period of time before employer contributions to their accounts are vested. Plan sponsors and plan professionals GAO surveyed identified lowering costs and reducing employee turnover as the primary reasons that plans use these policies.

The Employee Retirement Income Security Act of 1974 (ERISA) allows plan sponsors to set eligibility and vesting policies. Specifically, federal law permits 401(k) plan sponsors to require that workers be at least age 21 to be eligible to join the plan. The law also permits plans to use rules affecting 401(k) plan participants’ receipt of employer contributions and the vesting of contributions already received. However, over time workers have come to rely less on traditional pensions and more on their 401(k) plan savings for retirement security. Further, while the rules were designed, in part, to help sponsors provide profit sharing contributions, today 401(k) plan sponsors are more likely to provide matching contributions and today’s workers may be likely to change jobs frequently. GAO’s projections for hypothetical scenarios suggest that these policies could potentially reduce workers’ retirement savings. For example, assuming a minimum age policy of 21, GAO projections estimate that a medium-level earner who does not save in a plan or receive a 3 percent employer matching contribution from age 18 to 20 could have $134,456 less savings by their retirement at age 67 ($36,422 in 2016 dollars). Saving early for retirement is consistent with Department of Labor guidance as well as previous legislation and allows workers to benefit from compound interest, which can grow their savings over decades. In addition, the law permits plans to require that participants be employed on the last day of the year to receive employer contributions each year, which could reduce savings for today’s mobile workforce. For example, GAO’s projections suggest that if a medium-level earner did not meet a last day policy when leaving a job at age 30, the employer’s 3 percent matching contribution from age 18 to 20 could have been worth $29,297 by the worker’s retirement at age 67 ($8,150 in 2016 dollars). GAO’s projections also suggest that vesting policies may also potentially reduce retirement savings. For example, if a worker leaves two jobs after 2 years, at ages 20 and 40, where the plan requires 3 years for full vesting, the employer contributions forfeited could be worth $81,743 at retirement ($22,143 in 2016 dollars). The Department of Treasury (Treasury) is responsible for evaluating and developing proposals for legislative changes for 401(k) plan policies, but has not recently done so for vesting policies. Vesting caps for employer matching contributions in 401(k) plans are 15 years old. A re-evaluation of these caps would help to assess whether they unduly reduce the retirement savings of today’s mobile workers.

What GAO Recommends

GAO suggests Congress consider a number of changes to ERISA, including changes to the minimum age for plan eligibility and plans’ use of a last-day policy. GAO is also making two recommendations, including that Treasury reevaluate existing vesting policies to assess if current policies are appropriate for today’s mobile workforce. Treasury had no comment on the recommendation. GAO believes that such an evaluation would be beneficial, given the potential for vesting policies to reduce retirement savings.

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