Portability of pension benefits among jobs

A worker's ability to maintain and transfer accumulated pension benefits when changing jobs is not widespread among defined benefit pension plans, although portability provisions vary a great deal

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American workers hold numerous jobs over their working lives.[1] These workers often receive lower retirement benefits from employer-sponsored retirement plans than do workers who remain with one employer because of the way such plans determine benefits.[2] A "portable" pension, which ties a pension to a worker instead of a job, may provide an alternative solution to this pattern.

A worker's ability to maintain and transfer accumulated pension benefits when changing jobs is generally less of a problem in defined contribution plans than in defined benefit plans. An account is established in defined contribution plans for each participating employee. The employer and, in some cases, the employee, make fixed (or defined) contributions to the account. Benefits are not predetermined, but depend on contributed amounts and investment earnings. With comparable contributions and rates of return, a worker who switches jobs (and leaves his or her funds in the plan of each organization) could have the same benefit amount upon retirement as a worker with an identical salary history who worked for only one employer.[3]

In contrast, defined benefit plans use predetermined formulas to calculate retirement benefits. Benefits generally are based on salary and years of service with the employer sponsoring the plan. If a "vested"[4] employee leaves a job before retirement, the final salary at the time of leaving is used to determine retirement benefits. For the employee who stays at the same job until retirement, benefit calculations are based on preretirement salary levels, most often the highest salary. In addition, these high earnings are multiplied over more years of employment.

The following illustrates the financial consequences of changing employers when covered by defined benefit plans that are not portable. Individual A and Individual B work for 30 years and have the same salary pattern. Their pension benefits are calculated using the formula; annual benefit = 1 percent x final average salary x years of service. The only difference is in their employment histories: B changed employers after 15 years, while A remained with the same company for 30 years.

	Individual A	*Individual B*
Starting salary	$10,000	$10,000
Salary after 15 years	20,000	20,000
		(Changed jobs)
Salary after 30 years	40,000	40,000
Annual pension benefit:		
First employer	12,000 (30 percent of $40,000)	3,000 (15 percent of $20,000)
Second employer	...	6,000 (15 percent of $40,000)
Total	$12,000	$ 9,000

As shown, changing jobs yields only 75 percent of the retirement income for B as A received,

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although both had the same earnings throughout their work lives. Individual B's retirement income is lower because much of the pension is based on the $20,000 final salary with the first employer.

Portability provisions

Portability provisions in defined benefit plans generally cover assets, credited service, or both. Portability of assets allows workers to withdraw accumulated pension benefits or transfer them to another retirement arrangement,[5] or both.

Because few defined benefit plans are available with portability or reciprocity agreements, most lump-sum withdrawals are transferred directly to the worker. According to one study, if lump-sum withdrawals were put into an individual retirement account, a worker could have a retirement amount larger than what would have been available from the defined benefit plan.[6] However, research indicates that most workers spend their preretirement distributions.[7]

Portability of credited service allows years of service with a previous employer to be included when determining pension benefits from a subsequent employer. For example, it allows a worker to keep years of service credited to one plan when changing jobs, even if he or she has not met the vesting requirements of that plan. Service credit portability is often found in multiemployer plans. A multiemployer pension plan is a trust fund established in collective bargaining between one or more labor unions and employers of covered union members. These plans allow workers who leave one participating employer to continue their credited service if they work for another participating employer. In 1990, 4.95 million active participants were covered by multiemployer defined benefit pension plans.[8]

A multiemployer pension plan can be a defined benefit or a defined contribution plan. It provides benefits to workers in unionized industries, such as transportation and trucking, where workers tend to be highly mobile and work for several employers a year. Multiemployer plans are arranged by industry on a local, regional, or national level; without these plans, workers would be required to switch pension plans as often as they switch employers, resulting in reduced or incomplete pension coverage.[9]

Although workers covered under a multiemployer plan continue to earn benefits if they switch to another participating employer, they could lose benefits or not gain additional benefits if they subsequently work for an employer participating in another fund. Loss of pension benefits can be reduced or prevented if a worker participates in a plan with a reciprocity agreement with other multiemployer plans. A reciprocity agreement is a mutual exchange of privileges or rights designed to prevent the loss of pension credits for participants who switch employers. In 1987, nearly half of all multiemployer funds included reciprocity agreements.[10]

Reciprocity agreements

The two reciprocity systems most widely used in multiemployer defined benefit pension plans are pro rata reciprocity and "money follows the man." In a pro rata arrangement, money is not transferred between funds; instead, pension credits are maintained by each fund. Upon retirement, a partial, or pro rata, benefit is paid by each fund in which the worker participated, based on the pension credits earned in that fund. Vested status or pension eligibility, or both, are based on the credits earned in all funds.

An example of such an arrangement is among the provisions of a multiemployer pension plan covering members of an International Brotherhood of Teamsters local in the New York City area.[11] The plan's partial reciprocal pension arrangement is for participants whose years of service are divided between the local plan and related plans, and who also are ineligible for a regular pension from any of the plans.[12] For these participants, credited service under the local plan and related plans are counted for eligibility purposes.[13]

The partial reciprocal pension amount is determined by the following formula:

$$\text{Monthly pro rata pension} = \text{total pension amount} \times A/A + B$$

where: A = the number of years of local pension credit; and
B = the number of years of pension credit earned under related funds.

As an example, local and related pension plan credits entitle the worker to a total pension amount of $1,200. The employee has 8 years of service under the local plan, plus 7 years of service with local Y, and 9 years with local Z. The monthly pro rata pension from the local plan would be $\$1,200 \times 8/24 = \$400$. The employee also will receive a pro rata pension from the local Y and local Z plans.

Another example is a construction trades pension fund. In this plan, a reciprocal pension is available to participants who would be ineligible for a pension or whose pensions would be less than the full amount because their working years were divided between employment in the plan and employment in related pension plans.

The related plans include signatories to a national pro rata pension agreement or an international re-

ciprocal agreement, or any other pension plan authorized by the board of trustees as a related plan.

As in the previous example, a participant is eligible for a pro rata pension if all pension credits earned in related funds and the local plan were enough to allow the participant to be eligible for a full pension in the local plan. The participant must have at least 1 year of pension credit in the plan and 1 year of pension credit in each related plan to qualify for a reciprocal pension. Although pension credits of a related plan are required for eligibility, they are not used when determining the monthly pro rata pension. For example, a participant retires at age 65 with 9 years of pension credit in the plan and 6 years of credit in a related plan. The monthly amount of a regular pension is $30 multiplied by years of pension credit. The participant's reciprocal pension would be $270 ($30 × 9). The related plan would determine and pay any benefits for the 6 years of related pension credit.

The "money follows the man" arrangement assigns each worker to a "home" fund. If a worker is employed outside the home fund's jurisdiction, monetary contributions to the local area fund are transferred to the home fund. When the worker retires, the home fund pays the entire pension, according to the fund's benefit formula. If participating funds have different contribution levels, the home fund may have gains or losses, depending on its contribution rate relative to the other funds. The worker's benefit remains at the level it would have been had all his employment been within the home fund's jurisdiction.

An example of a "money follows the man" arrangement is a construction trades pension fund. If a participant works for an employer covered by the union's collective bargaining agreement, the employer is required to contribute monthly to the plan. These contributions equal the number of hours the participant worked multiplied by the rate per hour specified in the agreement. The plan has reciprocity agreements that allow participants to increase retirement benefits while working in certain other jurisdictions. Unlike the previous examples, contributions made on the participant's behalf may be transferred to the fund. The participant, however, must request transfers of contributions. If hours and contributions are transferred, they are treated as if they had resulted from work in the fund's jurisdiction.

Multiple employer trusts also can provide portability. These trusts are not the same as multiemployer plans established in collective bargaining agreements. While more than one employer contributes to a multiple employer trust, a collective bargaining agreement is not involved.

An example of a multiple employer trust involves a group of financial institutions, such as savings and loan associations and Federal home loan banks. The participating employers provide a defined benefit pension plan for employees. A participant who leaves employment before becoming vested in 5 years, but is reemployed by the same institution or another participating institution, is immediately reenrolled in the plan. If the employee's break in service was 60 months or fewer, the vesting service is reinstated; if the break is 12 months or fewer, vesting service credit for the break period also will be reinstated.

A single-employer portability plan

Portability provisions are not commonly found in single employer defined benefit pension plans. One exception is the mandatory portability arrangement for employees of the former Bell System, a telecommunications firm.

Before the AT&T divestiture in January 1984, employees who transferred from one Bell System company to another carried with them their credited service and any accrued benefits. Many of the companies had previously participated in the Bell System pension plans, one for management employees, and another for nonmanagement employees. The plans provided automatic portability when changing employment in the Bell System. But after divestiture, these companies were no longer affiliated.

The Divestiture Interchange Agreement, which was approved as part of the court approved divestiture, continued the predivestiture practice of service credit recognition for employees who moved from one former Bell System company to another in 1984. In addition, Section 559 of the Deficit Reduction Act of 1984, known as the Pension Portability Act, requires that the service credit of covered employees who move from one former Bell System company to another on or after January 1, 1985, be recognized by the hiring company under the same terms as the Divestiture Interchange Agreement. Those covered are primarily nonmanagement employees who were on the Bell System payroll on December 31, 1983, and management employees who earned less than $50,000 a year and were on the Bell System payroll on December 31, 1983. Unless covered by one of these agreements, employees who leave one former Bell System company and are later hired by another former Bell System company, are considered new employees for benefits related purposes.[14]

The Bell System companies affected by the Portability Act have signed a Mandatory Portability Agreement that spells out their obligations. At the time of divestiture, each affected company sponsored defined benefit plans with identical provisions, including benefit computa-

tion and rules for crediting service. Former Bell System companies also had common pension administration and actuarial methods. Nonmanagement employees were represented primarily by two unions and, until divestiture, pension negotiations were conducted nationally. Despite these common features, it took nearly 1 year for the 11 companies that are part of the Mandatory Portability Agreement to resolve most of the issues regarding crediting of service, asset transfer, and eligibility for other benefits.[15]

The Mandatory Portability Agreement outlines the actuarial determination of the amount of pension fund assets to be transferred when a covered employee changes to another former Bell System company and sets forth other relevant terms and conditions for administering portability.[16] The agreement also protects the employee's accrued pension benefit given that it cannot be reduced if the worker changes to a company with lower pension benefit levels.

The transfer of fund assets is not automatic. A covered employee who changes to another former Bell System company must notify the new company's employment office before the transfer can occur. Once notified, the new companies and those they succeeded verify portability eligibility and provide for the appropriate fund transfer.

Public employee plans

Defined benefit plans remain the dominant retirement plan for State and local government employees. In 1992, 87 percent of full-time State and local government employees participated in defined benefit plans, compared with 9 percent in defined contribution plans.[17]

Sometimes plan information booklets will state that membership is "portable" among employers. This is not entirely accurate; benefits usually remain intact only if the participant's job change is to another branch or agency of the same government employer that also participates in the same pension plan. The participant is not working for a different employer as in the case of a multiemployer plan.

Many State and local governments maintain separate funds for teachers, firefighters, police officers, and general employees. State and local governments often have reciprocity where, for example, a participant in a teachers retirement fund who later works in a position covered by the general employees fund may have contributions or credited service, or both, taken into account in the new job.

How this is taken into account varies among government jurisdictions. In one State system, the State's teachers retirement system maintains reciprocity with the State's general employees retirement system. A participant in one system who later works in a position covered by the other system can request "multiple service," which allows the employee's previous credited service and contributions to be taken into account at retirement. The system from which the person retires will calculate the retirement benefit based on the average of the highest 3 years of salary in either system and the combined contributions, interest, and years of credited service.

Another example is a county system that maintains reciprocity with the State employees retirement system and several other county systems. This reciprocity, however, involves a direct transfer of credited service to the other systems.

One State system provides reciprocity among the teachers, general employees, and the police and firefighters retirement systems. Each requires an employee contribution based on age at the time of system enrollment, with younger entrants making smaller contributions. At any given age, however, the employee contribution varies with each system.

A participant in one system who later takes a position covered by another system may request a transfer of previous credits to the new system. This transfer involves credited service and the reserves the participant has accumulated. If the reserves are not enough to cover the benefits provided by the new system, "public employers" make up the difference. A participant entering a new system will make the same contribution he or she made in the previous system, not one based on age at enrollment in the new system.

While not considered a portability provision, many public employee plans allow participants who have worked for public employers in other States to purchase service credit based on these previous jobs. These provisions allow participants with previous job changes to increase their pension benefits. Participants are often limited to the purchase of 1 year of credit for previous employment per 12-month period in the current job. A limit is often placed on the total amount of credit (for example, up to 10 years of comparable service) that can be purchased. In addition, a stipulation is usually included that the participant not be eligible for, or currently receiving, pension benefits based on this service. Some plans also allow participants to purchase credit for military service if they are not eligible for retirement benefits based on this service.[18]

Improving portability data

The issue of pension portability is often confusing, partially due to the varying definitions of portability. Even if a definition has been agreed upon, illustrations may not conform to the given definition.

The Bureau of Labor Statistics Employee Benefits Survey first requested information on portability in 1991.[19] The 1991 survey defined portability as the ability to transfer years of credited service or accumulated benefits from one employer to another. In 1991–92, about 13 percent of full-time workers participating in defined benefit pension plans were covered by portability provisions. The incidence of portability varied by industrial sector and occupation, as shown in the following tabulation:

	All	*White collar*	*Blue collar*
Total	13	11	16
Private sector	12	9	15
Medium and large firms	9	9	9
Small firms	19	9	31
State and local government	16	16	18

The Employee Benefits Survey also categorized portability provisions by type of provision:

- transfer years of service credits in limited groups of employers (multiemployer plans);
- transfer years of service credits to another employer's plan (single-employer plans with portability or reciprocity agreements);
- transfer pension benefits or assets to another employer's plan; and
- option to cash out vested benefits with a current value greater than $3,500 (portability of assets).

A study of these data indicated that these categories were incomplete and, in some instances, not mutually exclusive. For this reason, BLS has not published data by type of portability provision. For example, the 1991 and 1992 surveys showed that while multiemployer plans allow participants to work for several employers and continue to accrue benefits, employers make contributions to the plan on the participant's behalf. No transfer is ever made between employers and no transfer is made if a subsequent employer contributes to the same plan. Even with a reciprocity agreement, there may be no transfer if there is a pro rata pension involved. Thus, while multiemployer plans usually were included in "transfer years of service credits within limited groups of employers," such plans used a variety of portability and reciprocity arrangements.

Another problem was that the categories were set up for transfers to be reported as only assets or only service credits. As earlier noted, many plans with portability provisions provide for the transfer of both.

State government plans were particularly difficult to categorize. While plan information may have used the term portable, the intent is only to allow participants to retain benefits if they change to jobs covered by the same plan or to switch between related plans. One example is a participant in a State teachers retirement fund who later works for another school district that also participates in the plan; another example would be a teacher being able to transfer to the State general employees fund if he or she later takes a job with a State agency. Portability is not provided for participants who work for a private employer or for a government agency in another State.

For the 1994 Employee Benefits Survey, changes have been made to improve the usefulness of pension portability data. The categories used to measure portability are:

- transfer of service credits;
- transfer of assets;
- transfer of service credits and assets;
- lump sum of more than $3,500 paid to separated employee; and
- multiemployer plan.

For multiemployer plans, the Employee Benefits Survey also indicates whether reciprocity agreements have been made with other plans or jurisdictions and, if so, whether contributions are sent to a home fund; or a pro rata pension is paid by several funds.

An additional question asks if State government plans allow employees to purchase credit for previous government service in another State.

Footnotes

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[1] Workers typically hold 10 or 11 jobs during their working lives. See Robert E. Hall, "The importance of lifetime jobs in the U.S. economy," *American Economic Review*, September 1982, pp. 716–24.

[2] See William J. Wiatrowski, "Factors affecting retirement income," *Monthly Labor Review*, March 1993, pp. 25–35; and Emily S. Andrews, "Pension Portability and What It Can Do for Retirement Income: A Simulation Approach," *EBRI Issue Brief* No. 65, April 1987.

[3] If funds from former employers' plans were rolled over into an Individual Retirement Account, the job switcher would have a larger retirement benefit if the rate of return on IRA funds was greater than that of the employers' plans. Similarly, if the rate of return on IRA funds was lower, the job switcher would have a smaller retirement benefit than the worker with one employer. See Andrews, "Pension Portability."

[4] Pension plan participants usually gain nonforfeitable and nonrevocable (vested) rights to benefits after meeting spe-

cific service or age and service requirements. The Employee Retirement Income Security Act of 1974 requires private single employer plans to provide full vesting (100 percent) after 5 years of plan participation (with no partial vesting before that time) or graded (gradual) vesting of 20 percent after 3 years of service and 20 percent for each subsequent year of service with full vesting reached after 7 years of service. Multiemployer plans also may use a 10-year cliff vesting schedule in which participants have no vested rights to employer contributions until they have completed 10 years of service at which time they become 100 percent vested. See *Fundamentals of Employee Benefit Programs, 4th Edition* (Washington, DC, Employee Benefit Research Institute, 1990), pp. 30–31.

[5] The Employee Retirement Income Security Act of 1974 permits sponsors of defined benefit plans to cash out separated participants with accrued benefits of $3,500 or less. In these cases, workers receive a lump sum whether or not they want it. Lump-sum withdrawals of more than $3,500 require approval of the plan and the participant.

[6] As in the case of a defined contribution rollover, a job switcher who rolls over funds from a defined benefit plan into an Individual Retirement Account earning a rate of return greater than that guaranteed by the plan's benefits formula will have a benefit amount greater than what would have been received had the funds remained in the plan. Similarly, the benefit amount would be reduced if IRA funds earn less than what would have been received had the funds remained in the pension plan. Unlike the defined contribution plan, the job switcher who leaves funds in a former employer's defined benefit plan usually receives a benefit amount substantially lower than a worker with an identical salary history who remains with that employer throughout his working life. See Andrews, "Pension Portability."

[7] See Paul Yakoboski, "Retirement Program Lump-Sum Distributions: Hundreds of Billions in Hidden Pension Income," *EBRI Issue Brief No. 146* (Washington, DC, Employee Benefit Research Institute, February 1994); Phyllis A. Fernandez, "Preretirement Lump-Sum Distributions," in John A. Turner and Daniel J. Beller, eds., *Trends in Pensions, 1992* (U.S. Department of Labor, 1992) pp. 285–317; and Joseph S. Piacentini, "Preservation of Pension Benefits." *EBRI Issue Brief No. 98*. Washington, DC: Employee Benefit Research Institute, June 1990.

[8] See U.S. Department of Labor, "Abstract of 1990 Form 5500 Annual Reports." *Private Pension Plan Bulletin*, No. 2, 1993, p. 24. Also included are participants in multiple-employer collective bargaining plans that chose not to be treated as multiemployer plans in the Multiemployer Pension Plan Amendments Act of 1980.

[9] See Cynthia J. Drinkwater, "Multiemployer Plans," in Jerry S. Rosenbloom, ed., *The Handbook of Employee Benefits—Design, Funding and Administration (3rd Edition)*, Vol. II (Brookfield WI, International Foundation of Employee Benefit Plans, 1992), pp. 507–21.

[10] See "Reciprocity and Multiemployer Funds: A Model of Portability," *Employee Benefit Notes*, Vol. 8, No. 2, February 1987, pp. 5–7.

[11] The public may obtain information on this and other pension plans from the U.S. Department of Labor, Pension and Welfare Benefits Administration, Office for Public Disclosure, Washington, DC.

[12] Plan provisions define a related plan as the pension plan of any other Teamster local union that has entered into a reciprocal agreement with the local plan.

[13] To be eligible for a partial reciprocal pension, a participant must meet all of the following requirements: be eligible for a regular pension from the local plan had all pension credit earned in related plans been earned in the local plan; have at least 2 years of pension credit for which contributions were made to the local plan; be entitled to a partial reciprocal pension from the plan in which the employee was covered before retirement; and be ineligible for a regular pension from a related plan.

[14] In certain circumstances the predivestiture vesting service of an employee not covered by one of the agreements may be recognized by the hiring Bell System company. April 7, 1994, telephone interview with Scott J. Macey, executive vice president and general counsel, AT&T Actuarial Sciences Associates, Inc.

[15] A more detailed discussion can be found in Ronald D. Hovis, "Portability: A Case Study of the Bell System Model," *Employee Benefits Notes*, Vol. 7, No. 3, March 1986, pp. 4–7.

[16] Since divestiture occurred, changes have been made in the pension plans of all former Bell System companies. These changes have increased the difficulty of administering the MPA. April 7, 1994, telephone interview with Scott J. Macey, executive vice president and general counsel, AT&T Actuarial Sciences Associates, Inc.

[17] Included are 3 percent of State and local government employees participating in defined benefit and defined contribution plans. See *Employee Benefits in State and Local Governments, 1992*, Bulletin 2444. (Bureau of Labor Statistics, 1994).

[18] See Dan M. McGill, "Public Employee Pension Plans," in Jerry S. Rosenbloom, ed., *The Handbook of Employee Benefits — Design, Funding and Administration (3rd Edition)* Vol. II, (Brookfield, WI, International Foundation of Employee Benefit Plans, 1992), pp. 522–36.

[19] See *Employee Benefits in Medium and Large Private Establishments, 1991*, Bulletin 2422 (Bureau of Labor Statistics, 1993).