The reference date for the data in Table 1 of this article is incorrectly shown. The data are for 1974, not 1984.

How has vesting changed since passage of Employee Retirement Income Security Act?

Since the enactment of ERISA in 1974, vesting status is attained sooner for most workers and is more easily obtained for mobile workers

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Provisions of employer-financed retirement plans have been changed to reflect the statutory requirements of the Employee Retirement Income Security Act (ERISA), enacted in 1974, and several other laws passed since that time. These plans will experience further revisions as terms of the Tax Reform Act of 1986 become effective. The laws largely affect a retirement plan's vesting schedule—the rate at which a participant's future retirement benefits become guaranteed. Vesting provisions are very important in an economy with a mobile labor force; once specific requirements are met, these provisions essentially guarantee a worker the right to future benefits. These provisions allow a worker to terminate service before he or she is eligible for retirement without losing accrued benefits. In addition, vesting provisions can guarantee benefits to the spouse of an employee who dies before retiring. However, vesting increases the likelihood of eventual pension payments, thereby raising the cost to employers of providing employee benefits.

This article discusses the vesting provisions of two types of plans—defined benefit pension plans and defined contribution plans. A defined benefit pension plan contains a formula for determining retiree benefits (for example, the formula may designate a dollar amount or a percentage of annual salary times years of service). A defined contribution plan specifies the employer's contribution to a retirement or savings fund (for example, a percentage of annual salary), but not the eventual benefit amount. Instead, benefits depend on amounts contributed to the fund plus the fund's investment earnings. The two major forms of defined contribution plans discussed in this article are savings and thrift plans (in which employees typically contribute a portion of their earnings to a fund, which is matched in whole or in part by the employer) and deferred profit-sharing plans (in which employers typically contribute a portion of profits to a fund, regardless of the level of employee contribution). Defined contribution plans often have more liberal vesting schedules, compared with defined benefit plans.

Changes in vesting provisions in defined benefit pension plans are traced in this article using results from two Bureau of Labor Statistics surveys, one conducted in 1974 before enactment of ERISA, and the other in early 1986, just before passage of the Tax Reform Act. Essentially, ERISA made vesting a universal feature of the plans studied here. For many plans which already had vesting provisions, ERISA called for revising the timing schedules to guarantee benefits after fewer years of service with the employer. The Tax Reform Act will likewise have a large impact on pension plans; most of the plans studied in the 1986 Employee Benefits Survey will have to be revised to conform to the vesting standards spelled out in that act.

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Vesting provisions

Vesting schedules specify the rate at which employees earn rights to the employer contributions to a plan. Employees are always fully and immediately vested in their own contributions to the plan.[1] The four standard types of vesting schedules are:

- Immediate full—participants have immediate rights to all accrued benefits. This schedule may be found in either defined benefit or defined contribution plans.
- Deferred full (also known as "cliff vesting")—participants are granted full (100-percent) rights to all accumulated benefits only after completing the necessary service period (such as 10 years). However, if employment is terminated before the required service is completed, the benefits are forfeited. This schedule may be found in either defined benefit or defined contribution plans.
- Deferred graded—participants gradually become vested, until 100-percent status is achieved. To illustrate: A schedule may call for 50-percent vesting after 5 years of service and then 10 additional percentage points in each of the next 5 years. An employee leaving the company after 5 years of service would have a guaranteed right to 50 percent of his or her accumulated benefits. This schedule may be found in either defined benefit or defined contribution plans.
- Class year—employer contributions for a particular year (or class) are vested after a certain time, say, 2 or 3 years. For example, if the class-year schedule calls for vesting after 2 years, contributions made in 1986 may become nonforfeitable in 1988. This schedule is found only in defined contribution plans.

Determining vesting rights. Also important is how pension plans count years of service toward satisfying vesting requirements. ERISA required all service accrued after age 22 to count for vesting purposes; the "vesting" age was reduced to 18 by the 1984 Retirement Equity Act.[2]

Regardless of how vesting rights are determined, they apply solely to benefits accumulated at termination of employment. If an employee leaves a job prior to retirement, the eventual benefits are, of course, usually much less than they would be if the employee had continued working until retirement. Also, vested benefits are not payable until a terminated employee has reached a pension plan's early retirement age, at the least. For example, an employee who is vested in a plan permitting retirement at age 55, and who leaves the employer at age 35 after meeting the necessary service requirement, will have to wait 20 years for the benefits.

Other pension plan provisions may also affect how vested benefits are received. These provisions, such as rules governing breaks in service (when employees temporarily leave employment) and survivors' right to annuities, are not examined in this article.

Table 1. Earliest age and associated service requirement for vesting in defined benefit pension plans, private industry, early 1984.

Vesting provision	Percent of participants
Total participants	100
Plans with vesting provisions	87
Cliff vesting	69
Vesting at any age	39
Service requirement:	
Fewer than 10 years	2
10 years	24
11–14 years	([1])
15–19 years	9
20 years or more	4
Vesting at age 40 or younger	16
Service requirement:	
5–9 years	([1])
10–14 years	5
15–19 years	10
20 years or more	([1])
Vesting at age 41–45	8
Service requirement:	
5–9 years	([1])
10–14 years	2
15–19 years	5
20 years or more	([1])
Vesting at age 50 or older	6
Service requirement:	
10–14 years	2
15–19 years	2
20 years or more	2
No specified service	([1])
Other cliff vesting schedule	([1])
Graduated vesting	18
Full vesting at any age	12
Service requirement:	
5–9 years	1
10–14 years	2
15–19 years	4
20 years or more	5
Full vesting after specified age	5
Service requirement:	
No specified service	([1])
Fewer than 15 years	([1])
15–19 years	4
20 years or more	1
Age and service requirement not determinable	([1])
Full vesting not achieved	1
Immediate vesting	1
Plans without vesting provisions	13

[1]Less than 0.5 percent.
NOTE: Because of rounding and the existence of multiple vesting schedules in a plan, sums of individual items may not equal totals.

Vesting provisions in 1974

Before passage of ERISA 14 years ago, there were no statutory requirements for vesting.[3] An employer who provided a pension plan determined if, when, and under what conditions employees obtained vested rights to the accrued benefits.

The 1974 survey of defined benefit pension plans with 100 or more active workers provides information on vesting practices before the passage of ERISA.[4] This survey covered plans with approximately 23 million private sector plan participants.

According to the survey, 13 percent of participants were in defined benefit plans without vesting provisions; 11 percent were in plans requiring 20 years or more of service before becoming eligible for full vesting; and 34 percent were in plans requiring 15 to 19 years. (See table 1.) Age restrictions also were common; for example, 1 of 5 participants under cliff vesting schedules was required to be 41 or older.

Impact of legislation

Employee Retirement Income Security Act (ERISA). Restrictive vesting provisions, such as those reported in the 1974 survey, were among the major concerns addressed in the Employee Retirement Income Security Act of 1974,[5] which established comprehensive requirements for employee benefit plans, including minimum standards for vesting provisions. (See exhibit 1.) ERISA prescribed several minimum vesting schedules, including a 10-year cliff vesting standard and two graduated vesting alternatives. (See table 2.) In addition, a 5-year minimum class-year schedule was established for defined contribution plans.

Nearly three-fourths of the workers in the 1974 defined benefit pension survey were in plans that did not meet ERISA standards, either because the plans did not provide vesting or the vesting schedules were more restrictive than the ERISA standards, as shown in the following tabulation:

	Percent
All participants	100
Vesting provisions:	
Meeting ERISA standards	27
Cliff vesting	25
Graduated vesting	2
Not meeting ERISA standards	72
With vesting	60
Cliff vesting	44
Graduated vesting	15
Without vesting	12
Not determinable whether vesting schedule met ERISA standards	1

Slightly more than one-fourth of the workers were in plans that met ERISA's vesting schedule requirements. One of three workers under cliff vesting schedules was in a plan that met or exceeded the standards, compared to 1 of 8 workers under graduated schedules.

Information from the Current Population Survey (CPS)[6] suggests that the proportion of retirement plan participants who were fully or partly vested in their plan increased after the passage of ERISA. According to the

Exhibit 1. Minimum vesting requirements prescribed by the Employee Retirement Income Security Act (ERISA) and the Tax Reform Act

Type of schedule	ERISA (1974)	Tax Reform Act (1986)
Cliff vesting	100 percent after 10 years.	100 percent after 5 years (10 years for multiemployer plans).
Graduated	100 percent after 15 years. 25 percent after 5 years, 5 percent additional in each of the next 5 years, 10 percent additional in each of the next 5 years.	100 percent after 7 years. 20 percent after 3 years, 20 percent additional in each of the next 4 years.
	Alternative graded vesting:[1] 50 percent if age and service total 45 with minimum 5 years' service, or after 10 years' service; 10 percent additional in each of the next 5 years.	Eliminated alternative grading vesting.
Class-year vesting	Each class must vest after 5 years.	Eliminated class year vesting.
Special vesting	(2)	(2)

[1]This is known as the "rule of 45." The ERISA requirement that all service from age 22 be included in meeting vesting requirements did notapply to this form of graduated vesting.

[2]After the passage of ERISA, a specialvesting schedule was added by the Internal RevenueService for plans in professional service corporations. This "4-40" schedule requires full vestingafter 11 years (40 percent after 4 years, 5 percent each in years 5 and 6, and 10 percent ineach of years 7 through 11). Later, the Tax Equity and Fiscal Responsibility Act of 1982 added two additional stringent rules for plans that primarily benefited highly paid employees. The first was a 3-year cliff vesting schedule; the second was a 6-year graduated schedule (calling for 20 percent after 2 years, and 20 percent in each of years 3 to 6). The Tax Reform Act of 1986 lowered the cliff vesting requirement from 3 years to 2 years.

Table 2. Full-time workers participating in defined benefit pension plans in medium and large private sector firms, by vesting schedules and selected occupations, 1986

[In percent]

Type of schedule	All workers	Professional and administrative workers	Technical and clerical workers	Production workers
Total participants	100	100	100	100
Cliff vesting	89	85	85	91
ERISA standards:				
Full vesting after 10 years' service	87	84	84	89
Other standards:				
Full vesting after less than 10 years' service	2	1	1	2
Graduated vesting	13	17	17	9
ERISA standards:				
Full vesting after 15 years' service	3	3	4	2
"Rule of 45"[1]	3	4	3	2
"4-40" rule[2]	1	1	1	1
Other standards:				
6-9 years' service	(3)	1	(3)	(3)
10 years' service	6	7	7	4
11-14 years' service	(3)	1	1	(3)
Immediate full vesting	(3)	(3)	(3)	(3)
Not determinable	(3)	(3)	(3)	(3)

[1] Fifty percent if age and service total 45 with minimum 5 years service, or after 10 years service; 10 percent additional in each of the next 5 years.

[2] The "4-40" schedule requires full vesting after 11 years (40 percent after 4 years, 5 percent each in years 5 and 6, and 10 percent in each of the next 5 years).

[3] Less than 0.5 percent.

NOTE: Because of rounding and the existence of multiple vesting schedules in a plan, sums of individual items may not equal totals.

CPS, the proportion of retirement plan participants who said they were vested rose from 32 percent in 1972 (before ERISA) to 48 percent in 1979, and to 51 percent in 1983.[7]

More dramatic is the growth of vesting among covered workers with 5 to 9 years of service with their current employer. The 1972 CPS reported that 25 percent of these respondents said they had vested status; 59 percent were not vested. In 1979, 42 percent said they were vested, and 41 percent were not. (Among workers with 5 to 9 years of employment in both the 1972 and 1979 CPS, approximately one-sixth did not know if they were vested.)

Retirement Equity Act. Vesting standards were tightened when ERISA was revised 10 years later by the Retirement Equity Act of 1984. Although best known for provisions improving the accessibility of retirement benefits to spouses, this statute also lowered from 22 to 18 the age after which employees must be given credit toward vesting.

The BLS 1986 Employee Benefits Survey, which covered 21 million full-time workers, shows that 81 percent of the participants in defined benefit pension plans in medium and large firms had schedules which counted all years of service toward vesting. The following tabulation shows the percent of the participants in defined benefit plans in medium and large firms providing cliff and graded vesting, and years of service included toward vesting requirements, 1986:

	Total	*Cliff vesting*	*Graded vesting*
All participants	100	100	100
Years of service credited:			
All years	81	80	95
All years after age 18	9	10	0
All years after specified age of 19 or older	10	10	5
Not applicable—immediate vesting	*	—	—
Vesting provision not determinable	*	—	—

*Less than 0.5 percent.

As shown, relatively few participants were in plans that did not follow the new Retirement Equity Act rules. For plans which stipulated an age requirement older than 18, the Retirement Equity Act standards did not become effective until after the date of the 1986 Employee Benefits Survey.[8]

Vesting provisions in 1986

Defined benefit plans. Data from the 1986 Employee Benefits Survey show the influence of ERISA on vesting schedules. According to the survey, 76 percent of full-time employees in medium and large firms were covered by a defined benefit pension plan in 1986. Nearly all of them were in plans that used the minimum time for vesting specified by ERISA. (See table 2.) The vast majority were in plans with cliff vesting schedules, nearly all of which specified the maximum time allowed by ERISA for this type of vesting, 10 years of service. Only 13 percent had graduated schedules; about half of them were in plans with vesting schedules more liberal than those prescribed by ERISA. Overall, 1 of 10 participants was in a plan providing vesting time schedules more liberal than those prescribed by ERISA.

Defined contribution plans. The 1986 Employee Benefits Survey also examined the characteristics of defined contribution plans, including provisions affecting vesting of employer contributions to savings and thrift and deferred profit-sharing plans. The survey found that 28 percent of employees participated in savings and thrift plans, and 21 percent in deferred profit-sharing plans.

The following tabulation compares vesting provisions of defined benefit pension plans with the two types of defined contribution plans studied. The data (in percent) relate to medium and large firms in the first half of 1986:

	Defined benefit pension plans	Defined contribution plans: Savings and thrift	Defined contribution plans: Deferred profit-sharing
All participants	100	100	100
Vesting provision:			
Immediate	*	26	29
Cliff	89	20	2
Graduated	13	25	66
Class-year	0	29	4

*Less than 0.5 percent.

While the majority of the participants in defined benefit pension plans had cliff vesting, only a minority of those in savings and thrift and profit-sharing plans had such provisions. When the defined contribution plans had cliff vesting schedules, the provisions nearly always called for participants to be vested within 5 years. (See table 3.)

Table 3. Full-time workers participating in defined contribution plans in medium and large private sector firms, by vesting requirements, 1986
[In percent]

Type of schedule and service requirement	Savings and thrift plan	Profit-sharing plan
Total participants	100	100
Immediate full vesting	26	29
Cliff vesting	20	2
1–2 years	5	1
3–4 years	7	0
5 years	7	(1)
6–9 years	1	1
Graduated vesting	25	66
Full vesting after:		
4 years or fewer	2	0
5 years	15	3
6 years	2	5
7 years	1	7
8 years	1	1
9 years	(1)	1
10 years	4	24
11 years	(1)	5
12–14 years	(1)	14
15 years	(1)	6
Other	0	(1)
Class vesting	29	4
Each class is fully vested after:		
1 year	1	0
2 years	16	2
3 years	8	1
4 years	3	0
5 years	(1)	1
Not determinable	(1)	0

[1]Less than 0.5 percent.
NOTE: Because of rounding and the existence of multiple schedules in plans, sums of individual items may not equal totals.

Although rare in defined benefit plans, immediate vesting accounted for slightly more than one-quarter of the participants in savings and thrift and deferred profit-sharing plans.

Graduated vesting schedules, ranging from 5 to 15 years, accounted for two-thirds of the workers in profit-sharing plans. In savings and thrift plans, graduated vesting schedules applied to one-fourth of the participants, most of whom achieved full vesting after 5 years of service.

Class-year vesting was a significant provision in savings and thrift plans, with most participants granted full vesting 2 or 3 years after the employers' contributions were made. This form of vesting schedule was rare in deferred profit-sharing plans.

In summary, defined contribution plans required generally shorter vesting periods than did defined benefit plans. In defined contribution plans, vesting schedules varied widely, but the large majority of participants in defined benefit plans were subject to a 10-year cliff vesting schedule. (As discussed later, many of the vesting variations between the two plans will be reduced as provisions of the 1986 Tax Reform Act become effective.)

Future vesting revisions

The 1986 Tax Reform Act provides for changes in vesting schedules created under ERISA. The changes become effective for plan years beginning after December 31, 1988, and apply to all accrued benefits earned before and after the effective date. The effect of the Tax Reform Act on both cliff and graduated schedules is to require fewer years of service for vesting.

Based on the 1986 Employee Benefits Survey, the vesting schedules of nearly all defined benefit plans in medium and large firms will have to be revised to comply with the Tax Reform Act. Many participants in defined contribution plans also will be affected by the more rapid vesting schedules required by the act. The following tabulation shows the proportion of participants in plans which do and do not meet the vesting requirements of the 1986 Tax Reform Act:

	Defined benefit pension plans	Defined contribution plans: Savings and thrift	Defined contribution plans: Deferred profit-sharing
All participants	100	100	100
Vesting provisions:			
Meeting Tax Reform Act standards	5	65	40
Cliff vesting	5	19	1
Graduated vesting	*	20	10
Immediate vesting	*	26	29

Not meeting Tax Reform Act standards	95	35	60
Cliff vesting	82	1	1
Graduated vesting	13	5	55
Class-year vesting	0	29	4

*Less than 0.5 percent.

As shown, 95 percent of defined benefit pension participants were in plans that will have to be revised. This is primarily because of the predominance of 10-year cliff vesting in 1986 plans, and also because of the number of participants who needed 10 years or more of service under graduated schedules.

Sixty percent of participants in deferred profit-sharing plans were under more restrictive schedules than those allowed by the Tax Reform Act. They were primarily participants who had graduated vesting provisions calling for more than 7 years of service before full vesting. In contrast, one-third of the savings and thrift plan participants had vesting requirements not meeting the Tax Act standards; they were primarily under class-year vesting schedules.

VESTED STATUS HAS BECOME EASIER TO OBTAIN over the last 15 years for a growing population of mobile workers. ERISA, in 1974, established years of service requirements specifying the time by which employees were to be vested in both defined benefit and defined contribution plans.

By 1986, nearly all plan participants studied in the BLS Employee Benefits Survey of medium and large private sector firms were in either a defined benefit pension plan or a defined contribution plan that met vesting standards set by ERISA and the Retirement Equity Act. Vesting schedules required fewer years of service than those schedules reported in the BLS 1974 survey, conducted before the enactment of ERISA.

The 1986 Employee Benefits Survey suggests that tax reform will have a substantial impact on vesting provisions. As with the earlier laws, the 1986 Tax Reform Act was intended to ensure that employees with pension plans vest sooner in their benefits.[9] However, it is important to note that the accumulated pension benefits may not be large, particularly for workers who make many job changes during their careers. Also, many workers are not, and will never be, vested in private retirement plans because their employers do not offer one.[10] □

——*FOOTNOTES*——

[1]Employee contributions were required of only 6 percent of defined benefit pension plan participants in 1986, according to the Bureau of Labor Statistics' Employee Benefits Survey. See *Employee Benefits in Medium and Large Firms, 1986*, Bulletin 2281 (Bureau of Labor Statistics, 1987). The survey studied approximately 1,500 private sector establishments with at least 50, 100, or 250 workers, depending on the industry, representing approximately 21 million full-time workers in the United States, excluding Alaska and Hawaii.

[2] These requirements are related to legislative standards for plan participation. Under ERISA, employees generally were eligible to participate when they reached age 25 and had 1 year of service. (Plans granting immediate vesting could require 3 years of service.) The Retirement Equity Act reduced the minimum age for participation to 21.

[3]See Harry E. Davis and Arnold Strasser, "Private pension plans 1960–1969: an overview," *Monthly Labor Review*, July 1970, p. 48. For a study of vesting provisions in the early and mid-1960's, see Donald M. Landay and Harry E. Davis, "Growth and vesting changes in private pension plans," *Monthly Labor Review*, May 1968, pp. 29–35.

[4] The 1974 survey, a joint project of two agencies of the U.S. Department of Labor—the Bureau of Labor Statistics and the Labor Management Services Administration—was designed to yield information on pension plan provisions prior to ERISA. Survey findings on benefit levels were used in James H. Schulz, Thomas D. Leavitt, and Leslie Kelly, "Private pensions fall far short of preretirement income levels," *Monthly Labor Review*, February 1979, pp. 28–32; findings concerning mandatory retirement provisions were published in Dorothy R. Kittner, "Forced retirement: how common is it?" *Monthly Labor Review*, December 1977, pp. 60–62.

[5]See, for example, Joint Committee on Finance, *Digest of Testimony on Proposals for Private Pension Plan Reform* (Washington, Government Printing Office, 1973), pp. 7–14; and *Recommendations for Pension Reform: A Message from the President of the United States* (Washington, Government Printing Office, 1973), pp. 2–3.

[6] The Current Population Survey (CPS) is a program of personal interviews conducted monthly by the Bureau of the Census to collect national statistics on employment and unemployment. The CPS data in this article were collected from special supplements to the 1972, 1979, and 1983 surveys.

[7]The 1972 study results are described in Walter W. Kolodrubetz and Donald M. Landay, "Coverage and Vesting of Full-time Employees Under Private Retirement Plans," *Social Security Bulletin*, November 1973, pp. 20–36. The 1979 results are described in Gayle Thompson Rogers, *Pension Coverage and Vesting among Private Wage and Salary Workers: Preliminary Estimates from the 1979 Survey of Pension Plan Coverage*, Working Paper No. 16 (Social Security Administration, Office of Research and Statistics, June 1980). The 1983 results are described in *New Survey Findings on Pension Coverage and Benefit Entitlement*, Issue Brief No. 33 (Washington, Employee Benefits Research Institute, August 1984). Although coverage and definitions were not the same in the 1972, 1979, and 1983 surveys, the differences are not sufficient to obliterate the broad trend. Furthermore, the scope of these surveys differs from the 1974 and 1986 BLS surveys analyzed in this article; the CPS covers a broader range of workers and includes data for deferred profit-sharing and other retirement plans along with data for defined benefit plans.

[8] The survey was conducted in the first half of 1986. Compliance with Retirement Equity Act provisions was required of noncollectively bargained plans by June 30, 1986, and of collectively bargained plans by the earlier of the expiration date of the collective bargaining agreement, or January 1, 1987.

[9]See, for example, Joint Economic Committee, *The Role of Older Women in the Work Force* (Washington, Government Printing Office, 1984), pp. 1–5.

[10] For a discussion of the public policy implications of vesting and related plan provisions, see *Pension Portability and What It Can Do for Retirement Income: A Similation Approach*, EBRI Issue Brief No. 65 (Washington, Employee Benefits Research Institute, 1987).