YOU CAN’T TAKE IT WITH YOU: AN EXAMINATION OF EMPLOYEE BENEFIT PORTABILITY AND ITS RELATIONSHIP TO JOB LOCK AND THE NEW PSYCHOLOGICAL CONTRACT

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PART I: INTRODUCTION

A. Overview

Increasingly, scholars have been calling for new employment policies and benefit delivery systems that are more in sync with our modern economy and employment relationships. This article explores the regime of employer-sponsored benefits and investigates those areas where benefit portability stands as a barrier to worker mobility, thus leading many workers to become “job-locked.”

Beginning with an explanation of the changing terms of the psychological contract in the American workplace, this article explores its implications for employee benefit portability and the problem of job lock. Partly in response to, and partly independent of the job lock problem, legislators and employers have implemented changes over the last several decades that have had the overall effect of increasing employee benefit portability. This article probes the extent of those accomplishments, and identifies those areas that still remain to be adequately addressed. Finally, this article discusses possible solutions to the job lock problem, along with their associated costs and implications for the broader system of benefits.

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While employers provide various types of benefits, this article focuses on the two benefits most associated with job lock: pensions and health insurance. The article addresses only full-time private sector employees whose employer plans are governed by the Employee Retirement Income Security Act of 1974 (ERISA). The discussion does not address plans sponsored by governmental employers, churches, or retirement savings arrangements connected with employers that are nonprofit organizations, such as educational institutions.

B. Psychological Contract and Portability

“It is yesterday’s news that the terms and conditions under which people work are changing.” For more than sixty years, American employment policies have been predicated on a view that work arrangements are long-term relationships between large firms and their employees. Today’s labor force and employment practices, however, vary considerably from this traditional picture.

“‘[F]orces of change have had a profound impact on the nature of the employment relationship and have caused a shift in the expectations and responsibilities for both employers and employees—a change in the psychological contract.’” The psychological contract is a term used to characterize the mutual expectations and obligations that employees, employers, and society have for work relationships. Psychological contracts are formed because employment contracts are typically incomplete; bounded rationality limits individual information seeking and a changing organizational environment makes it impossible to specify all conditions of employment contracts in advance.


4. Id.


6. Sometimes referred to as the social contract.


8. BARRINGER & MILKOVICH, supra note 2, at 4.
Consequently, employees form expectations about a bundle of returns (such as pay, benefits, and job security) that they will receive in exchange for a bundle of expected contributions (such as performance levels, flexibility, and attendance).

The old psychological contract, under duress today, grew up over the decades following World War II, when an expanding economy produced rising expectations in society and at the workplace. That contract included the expectation that earnings would rise in tandem with increasing productivity and that hard work, good performance, and loyalty would be rewarded with security, fair treatment, and dignity. Increased firm tenure was accompanied by an expectation of certain “property rights” to a job; employees expected job and income security to accumulate with tenure and produce “an upward sloping age-earning profile, rising standards of living, and savings for retirement.”

Organization restructuring, however, has profoundly affected the nature of work and the relationship between employer and employee. In traditional, paternalistic work arrangements, companies could reward employees’ hard work and loyalty with lifetime employment. “In today’s more market-oriented climate, a company cannot promise to take care of its employees from cradle to grave.”

Likewise, employees no longer plan to stay with one employer throughout their careers. According to a recent study by the Bureau of Labor Statistics, the average worker holds 9.2 jobs from ages eighteen to thirty-four. In an attempt to measure employee loyalty, Walker Information and Hudson Institute recently polled approximately two thousand workers nationwide. Their survey concludes that only one-fourth of employees consider themselves to be loyal and committed to their organization, while fully one-third of employees are neither committed to their organization nor planning to stay. Another survey

9. Id.
11. Id.
12. Id. (citation omitted).
14. Id.
15. Id.
17. Dave Murphy, Take a Bite Out of Your Job Turnover, S.F. EXAMINER, Apr. 16, 2000, at J-1.
18. Id.
revealed that 15% of employees in the year 2000 expected to leave their jobs voluntarily to join another company by the end of that year.¹⁹

In response to these changes, scholars are calling for new labor and employment policies that will “reconstruct the social contract between the American workforce and employers in ways that address the needs and realities of a modern economy and society.” Thomas Kochan, for example, believes that an integral part of this reconstruction will be for the country “to modernize the labor and employment policies carried over from the New Deal era,” and to “foster innovations in labor unions, labor market institutions, corporations, and in their relationships.” He believes the starting premise for these changes is to replace the standard employment model with a more accurate view of employment arrangements in today’s economy. Accordingly, in Kochan’s view, employment policies should be modified to anticipate and support mobility across employers. He calls for new policies with the twin goals of reducing the costs to employees of changing jobs and lowering the costs for employers of hiring and developing new employees.²⁻²²

C. From Employment Security to Employability Security

One emerging component of the new psychological contract is the idea that long-term “employment security” with a single firm is being replaced by “employability security” across firms. In writing about the new psychological contract, Rosabeth Moss Kanter proposes a model “employability” contract, by which the firm promises to upgrade workers’ skills and to help provide new job opportunities if those at the firm disappear. Some large companies have adopted this phrase, representing the notion that the firm will use “measures that increase a person’s probability of making a successful job transition.” General

²⁰. Kochan, supra note 3, at 137.
²¹. Id.
²². Id. at 140.
²₃. Id.
²₄. Id.
²₇. WHITMAN, supra note 25, at 62.
Electric, for example, has a policy of offering “employability, rather than the security implied by a career.”

Companies have been slow to adopt “employability security,” based on the traditional view that teaching workers marketable skills only leads them to leave the company for jobs at other firms. Ironically, however, failure to teach marketable skills can actually increase the employer’s turnover in the long-run. As companies have come to the realization that employees are leaving regardless, they have started to embrace the idea of “employability security,” because if an employer can provide employees training, job skills, and opportunities, employees will stay longer.

With employability security becoming the norm, Katherine Stone believes that this new system of employment relationships is threatening to undermine the private welfare state. She notes that with “boundaryless careers” replacing job security, those workers with employer-provided insurance often lose health insurance and unvested pension benefits “each time they move from one employing establishment to another.”

A critical component of employability security is the portability of key employee benefits. Rosabeth Moss Kanter urges firms to develop standard benefits policies that ensure portability, to enable workers to function in the new employment setting.

D. Job Lock

A 2000 survey measuring employee loyalty concluded that as many as 39% of employees are “trapped” in their current organizations, meaning that they plan to stay, although they are not committed to the organization. Employees may feel trapped for various reasons, such as

28. BARRINGER & MILKOVICH, supra note 2, at 5 (emphasis added) (internal quotation marks omitted).
29. Murphy, supra note 17, at J-1.
31. Murphy, supra note 17, at J-1.
32. Stone, supra note 26, at 616.
33. Id.
34. WHITMAN, supra note 25, at 173.
35. Stone, supra note 26, at 569 (citing KANTER, supra note 26, at 192).
36. See supra note 17 and accompanying text.
37. Murphy, supra note 17, at J-1.
limited education or skills, or because they are tied to the organization by “golden handcuffs,” such as stock options. For many workers, however, the greatest barrier to job change is the loss of employer-based benefits, such as pensions and health insurance. This reduction in job mobility due to the non-portability of benefits is the phenomenon known as “job lock.”

Job lock can be undesirable, both for employers that want employees to leave, and for employees who would prefer to change jobs. Employers have traditionally designed benefit plans to cut turnover costs and promote retention. Some human resources professionals argue that this practice may not be wise, because it is more crucial for companies to keep committed employees than trapped employees who display less desirable behaviors. Another challenge in developing the new employment policies will therefore be to define a career concept that strikes a balance between making long service attractive for top contributors and allowing sufficient portability and choice for those not interested in long service.

Job lock also has implications for the economy-wide efficiency of labor markets. "Free labor market mobility enables workers to obtain employment where they are most productive . . . ." Job lock may cause employees to forgo job opportunities in which a better match between the worker and the employer would enable the worker to perform his or her job more effectively. "[I]mmobility due to disparities in the availability or scope of health insurance across employers can eliminate potential gains in productivity and income, adversely affect worker satisfaction, and alter the volume and quality of goods and services produced. The efficiency of the economy may suffer if individuals

38. Id.
39. WHITMAN, supra note 25, at 173.
42. Murphy, supra note 17, at J-1.
45. Id.
46. Fronstin Statement, supra note 41, at 41.
47. Monheit & Cooper, supra note 44, at 68.
remain in their current positions solely to maintain their employer-provided benefits.

Scholars have debated the actual incidence of job lock, and a precise measurement is unknown. While at least one study found that "job lock is small and statistically insignificant," most studies that support the job lock hypothesis report a 20% to 40% reduction in mobility rates attributable to the phenomenon.

Almost fifteen years ago a report, called Work and Change: Labor Market Adjustment Policies in a Competitive World, identified these very problems we are faced with today. This report concluded that displaced workers suffer a loss of benefits due to plan design orientation toward career-long employment with the same firm, which in turn discourages mobility outside the firm. In response, the report called for a fundamental re-examination of pension portability and medical insurance continuation. This article takes on that examination in the forthcoming discussion, beginning with a description of the origin of the current benefits system, and then an examination of the movements that have been made in the direction of portability, the shortfalls of those movements, and some possibilities for the future.

E. A Brief History of Employer-Provided Benefits

Today the provision of employee benefits has become standard fare in employment arrangements. Most employment-based benefits, such as pensions and health insurance, are provided voluntarily by employers with government support in the form of favorable tax treatment. The fact that more than 80% of all private insurance in the United States is currently provided through employers, however, is "at least partly a historical accident."
A few companies initially introduced most of the benefits with which we are familiar near the turn of the last century. In 1898, welfare capitalists introduced profit sharing and employee services, and “[p]ensions, guaranteed income plans, life insurance and savings plans . . . introduced in varying degrees in the early 1900’s.” The federal government began using its taxing power to encourage the provision of employee benefits in the early 1900’s, providing incentives for employment-based pension plans in 1921, for sickness and accident benefits in 1939, and for health plans in 1942.

In 1929, 5% of large firms provided profit sharing plans, 15% provided health and accident insurance, and 2% provided a group pension plan. In the same year, Blue Cross created its first medical insurance plan providing for prepaid medical costs at a Dallas, Texas, hospital. The Great Depression that soon followed, however, was a turbulent time in employee benefits. Many employer-sponsored benefit programs were discontinued or became insolvent; at the same time, economic and social legislation encouraged other companies to start or reinstate welfare benefits.

Employee benefits became more prevalent after the 1942 passage of the Wage Stabilization Act, which froze pay levels to control inflation and boost production of war materials. A concurrent increase in union activity caused a resurgent interest in benefits, and unions played a role in convincing the War Labor Board to permit increases in “fringe” benefits, although wages were frozen. Consequently, the provision of benefits increased dramatically in order to mitigate the effects of the wage freeze and “[t]he number of firms providing these benefits doubled from 1940 to 1946.” Unions continued to play an important role in promoting employer-sponsored benefits after the war.

58. Id. at 13.
59. Id. at 12.
60. EBRI, supra note 54, at 5.
61. MILKOVICH & STEVENS, supra note 57, at 12.
63. MILKOVICH & STEVENS, supra note 57, at 12.
65. MILKOVICH & STEVENS, supra note 57, at 15.
66. Id. at 12.
67. Id.
A 1949 court decision solidified benefits’ role in total compensation, declaring that fringe benefits were a mandatory subject of collective bargaining.

The next revolution in employee benefits occurred in the 1970’s. Firms again expanded benefit offerings in efforts to get around the wage-price controls imposed by the Nixon administration in the early part of that decade. In 1974, Congress passed a law to regulate the expanding employee pension and welfare plans, known as the Employee Retirement Income Security Act of 1974 (ERISA). ERISA established standards with which employee benefit plans must comply in order to maintain their tax-favored status, such as standards for reporting and disclosure, funding, fiscal responsibility, and employee eligibility and vesting.

It was also in 1974 that employee benefit plans first introduced the element of choice. TRW implemented the country’s first flexible or “cafeteria-style” benefits program, which included three medical plans, eight life insurance plans, dependent life insurance, and supplemental death and dismemberment benefits. In response to this private innovation, Congress passed the Revenue Act of 1978, which permitted the choice between taxable and non-taxable forms of compensation and lessened the burden for companies that wanted to offer flexible benefits. Following these and other tax law changes, the adoption of flexible benefit plans increased. In addition to creating tax preferences for cafeteria-style benefits, the 1978 Revenue Act created the 401(k) defined contribution retirement savings plan.

Sometime in the mid–1980’s, the term “fringe” was dropped and benefits were considered part of a total compensation package. By
1995, benefits costs came to comprise 28% of total compensation. Today, roughly half of the private sector workforce is covered by an employer-sponsored pension plan and 62% of the civilian population under age sixty-five is covered by employment-based health insurance.

Naturally, employee benefit programs are not limited to income security and health insurance. Benefit programs help provide access to a wide range of services, including ongoing education and training, childcare, long-term care, and legal assistance. Other benefits provide convenience and cost savings for employees, such as subsidized parking, product discounts, and relocation expense reimbursement. While these secondary benefits likely affect employee mobility and job lock, the focus of the ensuing discussion is on employer-based pension and health insurance benefits.

PART II: ARE BENEFITS BECOMING MORE PORTABLE?

This section of the article examines the changes that employee benefit plans have undergone in recent decades and explores whether benefit portability has been on the rise. The focus is on the passage of portability-enabling legislation and on changes in the offerings of voluntary employer-sponsored benefits.

A. Pension Portability

One of the assumptions behind security systems in the United States is that individuals can neither manage life risks nor save enough money for retirement. The development of the modern retirement security system occurred after the Great Depression proved that thrift and good work were insufficient to provide security in a capitalist economy. The American retirement security system was designed to

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80. Id. at 15.
82. EBRI, supra note 54, at 5.
83. Id.
85. Id.
split the job of managing risk and increasing retirement savings among government, employers, and individuals.

The resulting system is said to resemble a three-legged stool. The first leg of the stool is Social Security, a government-provided social insurance system. Social Security is funded by payroll taxes, and the system operates by transferring payments from current workers to current recipients, with limited reserves to cover fluctuations in the number of workers or recipients. Benefits are universal and distributed via formulas designed to be adequate to prevent poverty. Cost-of-living adjustments keep these payments in step with inflation.

The second leg of the retirement security stool is a system of voluntary employer-sponsored retirement plans. Employers are encouraged to provide benefits for employees with tax deductions that are afforded to nondiscriminatory or “qualified” plans. Contributions to a “qualified” plan are immediately deductible from the employer’s taxes, and “are generally not treated as wages subject to Social Security (FICA) and unemployment (FUTA) taxes.” Contributions and investment returns become taxable to employees only at the time of subsequent distribution from the plan, which allows benefits to accrue more quickly over the employee’s lifetime.

The third leg of the retirement stool consists of individual savings, which are generally unregulated and handled on an after-tax basis. To complement these individual savings, Congress has developed a regulated system of Individual Retirement Arrangements (IRAs). These arrangements allow certain individuals to make contributions (or in some cases only to earn interest on contributions) on a tax-deferred

86. Id.
87. Id.
88. Id.
89. EBRI NOTES 1996, supra note 84, at 1.
90. Id.
91. Id.
92. Id.
93. Id.
94. EBRI, supra note 54, at 55.
95. John H. Langbein & Bruce A. Wolk, Pension and Employee Benefit Law 270 (2000) (citing I.R.C. §§ 3121(a)(5), (v)(1); 3306(b)(5)(t)(1)). “However, this exemption from employment taxes does not apply to elective deferrals under such plans.” Id.
96. EBRI, supra note 54, at 55.
97. EBRI NOTES 1996, supra note 84, at 1.
98. EBRI, supra note 54, at 163.
This third leg of the stool is “not precise,” but is “expected to exist for most workers.”

Employees tend to rely heavily on employer-sponsored retirement plans. One reason is the generous tax treatment granted to qualified employer plans. Whereas individuals can contribute only $3000 annually to an IRA, employees may save up to $11,000 per year in an employer-sponsored 401(k) plan, and employers may contribute up to $40,000 per year (less employee elective contributions) in tax-deferred compensation. Employees who receive benefits under defined benefit retirement plans may receive up to $160,000 per year, or 100% of the participant’s average compensation for his or her high-three-years’ salary. By granting greater tax advantages to employer-sponsored plans than to individual plans, the government has provided incentive both for employers to establish such plans and for employees to participate in them.

1. Employer-Sponsored Pension Basics

While pension plans are complicated and come in numerous designs, there are a few basic principles of plan design that are important to the following portability discussion. Specifically, it is important to understand the difference between defined contribution and defined

99. Id.
100. EBRI NOTES 1996, supra note 84, at 1.
101. Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, 115 Stat. 38 (2001). The maximum amount is $3000 for the years 2002 through 2004; $4000 for the years 2005 through 2007; $5000 for the years 2008 and thereafter, with future indexing for inflation. Id. Employees age fifty and older may also make “catch-up” contributions of $500 for the years 2002 through 2005, and “catch-up” contributions of $1000 for the years 2006 and thereafter, with future indexing for inflation. Id.
102. Id. Employees may save the following amounts for the specified years: 2003 - $12,000; 2004 - $13,000; 2005 - $14,000; 2006 - $15,000, and thereafter indexed to inflation. Id. at § 611. Employees age fifty and older may also make “catch-up” contributions of the following amounts: 2002 - $500; 2003 - $1000; 2004 - $1500; 2005 - $2000; 2006 - $2500, and thereafter indexed to inflation. Id. at
103. Id.
104. I.R.C. § 415(b)(1)(A) (2001); see also EBRI, supra note 54, at 57-58 (stating that these dollar limits are imposed by I.R.C. § 415 and are indexed to inflation by adjusting for changes in the Consumer Price Index).
105. I.R.C. § 415(b)(1)(A) (2001). The $160,000 limit comes from I.R.C. § 415(b)(1)(A) and is often referred to as the DB “dollar limitation,” while the percentage limitation comes from I.R.C. § 415(b)(1)(B) and is often called the DB “percentage of compensation limitation” or the DB “compensation limitation.”
106. EBRI, supra note 54, at 55.
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benefit plans, and the types of vesting requirements that employers may impose. A brief description of these characteristics follows.

a. Defined Contribution Versus Defined Benefit Plans

There are two fundamental types of pension plans: defined benefit and defined contribution. A defined benefit plan promises a specified monthly benefit at retirement. The plan may state the promised benefit as an exact dollar amount, such as $100 per month at retirement, but plans more commonly calculate benefits through a plan formula. Plan formulas typically consider such factors as salary and service—for example, 1% of the employee’s average salary, during the last five years of employment, for every year of service with the employer. Reflecting employers’ desires to retain workers who have acquired valuable skills, employers often design defined benefit plan formulas to be “back loaded.” As such, employers often provide disproportionately more generous benefits to workers following traditional patterns—spending many years with a single company and retiring at a specified time—than to workers following other career patterns. Defined benefit pensions also reflect the traditional view that investment management and financial risk are better handled by employers than by workers. In defined benefit plans, the employer alone bears the investment risk. If the pension fund’s investments do poorly, the employer is liable for the shortfall and must bring the fund up to the promised benefit level.

A defined contribution plan, in contrast, does not promise a specific amount of benefits at retirement. In these plans, the employee, the employer, or both, contribute to an individual account under the plan. Contributions may be variable or at a set rate, such as 5% of earnings annually. Contributions are then invested and the employee ultimately receives the account balance, which is based on contributions and

108. Id.
109. FUTUREWORK, supra note 79, at 16.
110. Id.
111. Id.
113. Id.
114. CASH BALANCE Q & A, supra note 107.
115. Id.
investment gains or losses. Thus, employees in defined contribution plans bear the investment risk—if the investment experience is poor, the amounts received at retirement will go down; if the investment experience is good, employees will receive more in retirement than initially expected.

Defined contribution pensions are said to reflect an employer’s desire to limit long-term financial exposure, and a shift in employers’ priorities away from retaining workers with eroding industrial skills to attracting new workers with up-to-the-minute skills. Defined contribution arrangements tend to attract mobile workers because they are more adaptable to the needs of workers who change jobs or follow varied career paths. Small employers favor defined contribution plans to avoid the financial commitment and administrative complexities associated with a defined benefit plan. Defined contribution plans come in numerous designs. Examples of defined contribution plans include 401(k) plans, 403(b) plans, money purchase plans, employee stock ownership plans, deferred profit-sharing plans, Simplified Employee Pensions plans (SEPs), savings and thrift plans, and Individual Retirement Arrangements (IRAs).

b. Vesting Requirements

Participants in qualified retirement plans generally attain non-revocable or “vested” rights to keep the employer’s contributions after satisfying a firm’s specified service requirements. While an employee’s own contributions to an employer-sponsored plan vest immediately, employers may impose a vesting period on any benefits that they contribute to the plan on the employee’s behalf. Plan sponsors are not obligated to impose any vesting requirements, but if they do, ERISA places restrictions on the maximum amount of service that may be required. ERISA offers plan sponsors the choice of two different vesting schedules. The first option is cliff vesting, in which no benefits are vested until three years of service are attained, but 100% of

116. Id.
117. Willborn, supra note 112, at 347.
118. FUTUREWORK, supra note 79, at 16.
119. Id. at 17.
120. Id. at 16.
121. Id. at 17.
122. CASH BALANCE Q & A, supra note 107.
123. EBRI, supra note 54, at 42.
124. Id. at 43.
benefits become vested when the employee meets the service requirement. The second option is graded vesting, where employees earn 20% of the benefit after three years of service, and an additional 20% for each subsequent year of service, until 100% of the benefit is vested at the end of the seventh year. Employers are free to impose lesser vesting requirements, but cannot require more than these maximum service provisions.

2. Legislative Efforts to Increase Pension Portability

Pension portability has been an important issue for the federal government since the 1960’s. The last several decades have seen numerous actions by Congress that have increased employee benefit portability. This section discusses several of those legal changes, including changes in vesting and rollover rules. It also discusses the creation of new retirement plans, such as the 401(k), the Savings Incentive Match Plan for Employees (SIMPLE), and Individual Retirement Arrangements (IRAs).

a. Vesting

With the passage of ERISA, Congress established the first minimum vesting rules for retirement plans in 1974. Before that time, approximately 40% of pension plans had no vesting provisions at all, which meant that most employees entirely forfeited pensions at job change. Legislative and regulatory changes during the 1980s and 1990s increased vesting rates by shortening the duration of service that a company can require before an individual’s pension rights vest. The Tax Reform Act of 1986, for example, amended ERISA to establish faster vesting schedules. Further vesting changes went into effect on January 1, 1999, when the maximum vesting requirement for multi-employer pension plans was reduced from ten-year cliff vesting to the

126. Id.; see also I.R.C. § 411(a)(2)(B) (2001). There is a separate vesting schedule for employer matching contributions. See infra note 133 and accompanying text.
127. Whitman, supra note 25, at 176.
128. Id.
129. Id.
same vesting rules associated with other qualified plans. With the implementation of the Economic Growth and Tax Relief Reconciliation Act of 2001, additional, faster vesting changes went into effect for employer matching contributions to a 401(k) plan. For matching contributions, vesting now must occur either: (1) 100% after three years of service; or, (2) 20% after two years of service, and an additional 20% for each year of service thereafter, with the total amount vesting after six years.

b. The 401(k) Plan

The Revenue Act of 1978 amended the Internal Revenue Code, adding to it § 401(k). This section provided for a new type of pension, commonly referred to as the “401(k)” plan, which is a popular retirement savings vehicle. Employers prefer these arrangements because they offer some flexibility in pension plan design and contribution levels. Employees like these arrangements because income taxation on plan contributions and investment returns is deferred until the time of withdrawal, which is presumed to be a time when the employees’ income, and thus their marginal tax rate, might be lower.

There are several ways in which contributions can be made to these retirement accounts. Section 401(k) arrangements can be designed to accept contributions through salary reduction, through profit-sharing distributions, or a combination of both methods. In a salary reduction arrangement, employees are given the option to contribute a portion of their income to a qualified retirement plan via pre-tax deductions in salary, which the employer then pays into the plan on behalf of the employees. By electing to have a percentage of salary contributed to the plan, employees reduce their salary and the base on which current federal income (and some state taxes) are calculated. These arrangements can be designed to include employee contributions only.

132. Id. at 3.
135. EBRI, supra note 54, at 93.
136. Id.
137. Id.
138. Id.
139. Id. at 94.
140. EBRI, supra note 54, at 93.
141. Id. at 94.
employer contributions only, or both employee and employer contributions. In cash or deferred profit sharing arrangements, employees are offered the option of deferring a profit sharing distribution, or some portion of it, to the trust account or taking the distribution in cash. In both arrangements, the deferral, and any income thereon, accrues tax-free until distribution. Distributions taken in cash are taxed.

Like other qualified retirement plans, sponsors of 401(k) arrangements must ensure that the plan does not discriminate in favor of highly compensated employees in terms of coverage, participation in the plan, or contributions provided. While the rules governing coverage and participation are identical to those for other qualified retirement plans, 401(k)s have a special test for ensuring non-discrimination in contributions and benefits. This test, known as the Actual Deferral Percentage Test, limits elective contributions of highly compensated employees, and employers must run the test annually.

Section 401(k) arrangements appear to be gaining popularity with each passing year, perhaps because many employers do not mind sponsoring a retirement plan as long as the employees, rather than the employer, fund the plan’s benefits. The percentage of employees whose employer sponsored a 401(k) plan increased from 27% in 1988 to 37% in 1993. Those numbers continued to increase in the late 1990's, with 55% of full-time employees in medium and large establishments participating in such plans by 1997.

142. Id.
143. Id.
144. Id.
145. EBRI, supra note 54, at 94.
146. Id. at 96.
147. Id.
148. Id.
150. WHITMAN, supra note 25, at 176-77.
151. Medium to large establishments are those establishments with one hundred or more employees.
152. BUREAU OF LABOR STATISTICS, U.S. DEP’T OF LABOR, EMPLOYEE BENEFITS IN MEDIUM AND LARGE PRIVATE ESTABLISHMENTS (1997), at http://stats.bls.gov/eshome.htm [hereinafter BENEFITS 1997]. These numbers are not as high for small establishments with under one hundred employees, however, as only three out of ten employees of these establishments participate in such plans. BUREAU OF LABOR STATISTICS, U.S. DEP’T OF LABOR, EMPLOYEE BENEFITS IN SMALL PRIVATE INDUSTRY ESTABLISHMENTS (1996), at http://stats.bls.gov/eshome.htm [hereinafter BENEFITS 1996].
c. Rollovers

Legislative efforts to enhance retirement portability have typically focused on making it easier for participants to transfer money between retirement accounts, especially between defined contribution accounts. In 1992 and 2001, Congress relaxed the rollover rules to clarify and expand the situations in which distributions from qualified plans could be rolled over into other retirement accounts, including Individual Retirement Accounts (IRAs), without subjecting the worker to current taxation and penalties. For example, the 2001 changes stipulate that distributions from qualified retirement plans may be rolled into any other qualified plan or into an IRA; these changes allow, for the first time, rollovers between different types of non-IRA plans, such as between a 401(k) and a non-profit employer’s § 403(b) plan. Further, the changes provide that after-tax contributions may be rolled over to an IRA or a qualified plan. The changes also provide that distributions from an IRA, into which a taxpayer has made deductible contributions, may be rolled over into a qualified workplace retirement plan.

There are a number of reasons why participants may be interested in rolling over assets, held on their behalf, by a former employer, to their new employer. For example, the participant may think that the new employer’s fund is more stable or has better investment advisors, the transfer may permit the participant to buy years of service credit in the new plan, or the transfer may simply make it easier for the participant to keep track of his or her money.

d. SIMPLE

In order to generate incentives for the creation of employer-sponsored plans, the Small Business Job Protection Act of 1996 created a simplified retirement plan for small businesses. Called the Savings Incentive Match Plan for Employees (SIMPLE), only those employers with less than one hundred employees, who do not maintain...
another retirement plan, are eligible to participate. To ease administration, contributions made through this type of plan may be made to either an IRA or a 401(k) account. Under this plan, the employee may contribute up to $7000 in 2002, increasing by $1000 increments to $10,000 in 2005. Employers have two contribution options to choose from. Employers may either provide a 3% match on employee contributions (i.e., employees making voluntary contributions receive a dollar-for-dollar match for the first 3% of income they save), or they may contribute 2% of each employee’s pay regardless of whether the employee made elective contributions. The main advantages of the SIMPLE plan include simplified reporting requirements and a waiver of the complicated non-discrimination requirements applicable to other qualified plans.

e. IRA Expansion

Individual Retirement Arrangements (IRAs), originally established by Congress as part of ERISA in 1974, have undergone many changes since their creation. These arrangements were originally instituted as a vehicle to provide workers without employment-based pensions an opportunity to save for retirement on a tax-deferred basis. Subsequent legislation has changed, and generally expanded, eligibility to participate in these arrangements. The Economic Recovery Tax Act of 1981 (ERTA) extended the availability of IRAs to all workers, including those with pension coverage. The Tax Reform Act of 1986 (TRA ‘86) took a step backwards, retaining tax-deductible IRAs for families in which neither spouse was covered by an employment-based pension, but restricting tax deductibility for those with pension coverage to families with incomes below specified levels. To accommodate the new limitations, the Act added two new categories of IRA contributions:

160. Id.
161. Id.
163. EBRI, supra note 54, at 485
164. Id.
165. Id. at 163.
166. Id.
168. EBRI, supra note 54, at 163.
170. EBRI, supra note 54, at 163.
nondeductible contributions that accumulate tax-free until distributed, and partially deductible contributions. Although the 1986 Act made IRAs less advantageous for some individuals, most individuals may still contribute the maximum amount on a tax-deductible basis.

Congress expanded the purview of the IRA with the passage of the Health Insurance Portability and Accountability Act of 1996 (HIPAA). One of the most controversial features of HIPAA was the creation of the Medical Savings Account (MSA) program. The MSA, commonly referred to as a "medical IRA," is a savings program for financing health care expenses that is designed to supplement traditional indemnity and medical insurance programs. Unlike traditional IRAs, the use of tax-preferred MSA funds is not limited to retirement savings purposes, and account holders may use their savings without penalty for either retirement savings or current medical expenses. The MSA permits funds not used for medical expenses in the current tax year to accumulate tax-free for use in future years, effectively enabling account holders to use their MSAs as tax-preferred retirement savings vehicles.

The Taxpayer Relief Act of 1997 established another type of IRA, referred to as the "Roth IRA," named after its principal sponsor, Senator William Roth (R-Md.). In contrast to the traditional IRA, where "contributions are deductible but withdrawals on retirement are taxable," Roth IRA "contributions are not deductible, but withdrawals

171. Id.
172. Id.
175. Id. at 687-88.
176. I.R.C. § 220(f)(4)(C) (2001) (providing that any distributions made after an account holder reaches age sixty-five are not subject to the 15% excise penalty that typically applies to distributions used for purposes other than qualified medical expenses); see also Benjamin C. Ayers & Elizabeth Plummer, New MSA and Health Insurance Rules Create Opportunities, 58 TAX’N FOR ACCT. 260, 263 (1997) (suggesting that Congress authorized, perhaps unintentionally, the use of MSAs as an alternative means of securing retirement savings).
177. Ayers & Plummer, supra note 176, at 260-61 (explaining that because MSAs allow the taxpayer to accumulate unused funds, they closely resemble IRAs). With IRAs, there is a 10% penalty for distributions taken prior to age sixty-five. I.R.C. § 72(t)(1) (2001). There is an exception to the penalty, however, if the distribution is used for medical expenses or health insurance premiums for unemployed individuals, to the extent that they exceed the amount designated by I.R.C. § 213(d)(1)(D). I.R.C. §§ 72(t)(2)(B), (D) (2001).
180. Jefferson, supra note 173, at 699 n.84.
181. Id. (citing I.R.C. §§ 219(a), 408(d) (2001)).
on retirement are tax exempt.\footnote{Like the traditional IRA, the maximum amount that individuals may contribute is limited to $3000 annually.} Like the traditional IRA, the maximum amount that individuals may contribute is limited to $3000 annually.\footnote{“[W]hen a taxpayer’s marginal tax rate remains constant, the traditional and Roth IRA provide identical benefits.”}

The Economic Growth and Tax Relief Reconciliation Act of 2001 further affected the IRA by allowing employers to permit voluntary employee contributions to deemed traditional IRA accounts and deemed Roth IRA accounts under qualified plans.\footnote{The Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, 115 Stat. 38 (2001).} It also enacted a “catch-up” provision for individuals age fifty or over, permitting them to make an additional annual contribution of $500 in 2002 through 2005, and an additional annual contribution of $1000 each year thereafter.\footnote{Id.}

3. Employer Efforts to Increase Pension Portability

At the same time Congress has been trying to increase portability via legislation, employers have been making innovations in pension plan design that have also resulted in increased portability. The most influential change has been the shift away from defined benefit plans toward more portable defined contribution plans and similar hybrids.

a. The Move from Defined Benefit to Defined Contribution

From the time of its inception and into the 1980’s, the American “pension system was dominated by . . . ‘defined benefit’ arrangements.”\footnote{Id. (citing I.R.C. §§ 408A(c)(1), (d)(1)(A) (West Supp. 1998)).} Defined contribution pensions began to challenge this leading role in the 1980’s, however, and today they dominate the retirement scene.\footnote{Defined contribution pensions began to challenge this leading role in the 1980’s, however, and today they dominate the retirement scene.} When measured in terms of participants in private sector qualified plans, the percentage of participants in defined contribution plans increased from 26% to 55% between 1975 and 1995.\footnote{When measured in terms of participants in private sector qualified plans, the percentage of participants in defined contribution plans increased from 26% to 55% between 1975 and 1995. During that same period, the count of defined contribution plans as a percentage of all qualified plans increased from 67% to 90%.} During that same period, the count of defined contribution plans as a percentage of all qualified plans increased from 67% to 90%.\footnote{During that same period, the count of defined contribution plans as a percentage of all qualified plans increased from 67% to 90%.}

\begin{footnotes}
\item[182] Id. (citing I.R.C. §§ 408A(c)(1), (d)(1)(A) (West Supp. 1998)).
\item[184] Jefferson, supra note 173, at 699 n.84 (citing I.R.C. § 408A(c)(2) (West Supp. 1998)).
\item[186] Id.
\item[187] FUTUREWORK, supra note 79, at 16.
\item[188] Id. at 16, 18.
\item[189] Yakoboski, supra note 71, at 9.
\item[190] Id.
\end{footnotes}
scholar proclaimed that this shift on the part of employers from defined benefit to defined contribution arrangements “has done the most” to enhance portability of pension plans.  

There are several reasons why the move to defined contribution plans has increased benefit portability. First, “[v]esting provisions in these plans are generally more liberal than those for defined benefit plans.” The employee contributions vest immediately, and “[m]any defined contribution plans provide at least partial vesting of employer contribution after two or three years of service.” Defined benefit plans, in contrast, often adopt a cliff vesting rule. Second, defined contribution plans typically pay benefits in a lump sum at the time of employment termination, whereas defined benefit plans typically pay benefits as an annuity that is not distributed until the employee reaches retirement age. Third, since defined contribution plans can be rolled over into another investment account, they continue to accrue value over the employee’s lifetime, whereas defined benefit plans typically freeze the benefit amount at termination, leaving the employee exposed to future inflation. Fourth, defined contribution plans create a steady stream of benefits to an employee regardless of service. Under defined benefit plans, the size of the pension benefit generally “rises disproportionately to the number of years of service, creating a premium or reward for longevity with a single employer.” This back-loaded defined benefit design has the effect of discouraging older employees from changing employers.

b. Hybrid Plans

Even those employers who still choose to provide a defined benefit plan have been adopting plans with more portability-enhancing characteristics. An increasing number of employers have been offering these hybrid retirement plans, which combine features of both defined benefit and defined contribution plans. While there are a variety of

191. Whitman, supra note 25, at 176.
192. EBRI, supra note 54, at 74.
193. Id. at 74-75. As of January 1, 2002, employer matching contributions must vest on a faster schedule than for defined benefit plans. See supra note 133 and accompanying text.
194. EBRI, supra note 54, at 75; see also Section II.A.1.b for explanation of cliff vesting.
195. EBRI, supra note 54, at 75.
196. Id.
197. Whitman, supra note 25, at 176.
198. EBRI, supra note 54, at 111.
these plans in existence, this section addresses only the best known of these designs: the cash balance plan.

The cash balance plan first became well-known in the mid-1980s, when Bank of America adopted such a plan with the goal of combining the best features of both defined benefit and defined contribution designs. The outward characteristics of cash balance plans closely resemble a defined contribution plan and capture portability as an advantage of the plan design. Like a defined contribution plan, each participant has an account that is credited annually with a dollar amount resembling an employer contribution, typically expressed as a percentage of pay. Likewise, each participant’s account is also credited annually with interest. The option to receive benefits in the form of a lump-sum is another shared characteristic, and these lump-sum distributions are popular with participants, because they can be rolled over into an IRA or another employer’s retirement plan. Because the benefit accrual of a cash balance plan also follows the defined contribution pattern, these plans are attractive to younger, shorter-service employees who can accrue benefits more quickly and who find the account concept attractive.

Despite the apparent similarities to defined contribution plans, however, cash balance plans are actually defined benefit arrangements. The plan has an account-based nature, but plan assets are not specifically allocated to participant accounts. There are no actual employee accounts; instead, a participant’s benefit is based on a hypothetical account used as a bookkeeping device. Employers contribute to the plan generally, based on actuarial valuations, and contributions may actually be less than the sum of the additions to participants’ accounts. The individual account balances are credited with hypothetical

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199. Other hybrid plan designs include the pension equity, life cycle, floor-offset, age-weighted profit-sharing, new comparability profit-sharing, and target benefit plans. Id.
200. Id.
201. Id.
202. Id.
204. EBRI, supra note 54, at 111.
205. Id.
206. Id. at 111, 114.
207. Id. at 116.
208. Id. at 112.
209. Drigotas, supra note 203, at 40.
210. Id. at 39.
211. EBRI, supra note 54, at 112.
contribution and interest credits, but that interest is not tied to actual plan investment earnings over the period. The interest component is defined in the plan either as a specified rate or a rate related to some index (such as the consumer price index or the rate on U.S. Treasury bills) and is completely unrelated to the actual investment earnings of the pension trust.

Although the design is not new, cash balance plans have received a great deal of attention recently due, in part, to an increase in the number of employers who are converting their traditional defined benefit plans into cash balance plans. Despite the recent attention, hybrid plans remain relatively rare. In 1998, only 4% of employers with two hundred or more employees sponsored a cash balance plan.

**B. Health Insurance Portability**

The majority of Americans under age sixty-five are covered by employer-provided health insurance, and one result of this link between employment and health insurance is that insurance is not portable across jobs. A U.S. Census Bureau report revealed that roughly 44% of workers with a job interruption experienced one or more months without health insurance due to that interruption. One of the major concerns listed in that report was the length of time that Americans remain without coverage after losing it—a median period of 5.3 months.

Most job lock studies have focused on the effect of employer-provided health insurance. Thirty percent of respondents to a 1991 *New York Times*/CBS News poll and 20% of respondents to a June 1991 Gallup poll cited the risk of losing health insurance benefits as an important reason for remaining at a job. Similarly, in the 1998 Health Confidence Survey, 27% of Americans “reported that they or an

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213. *Id.* at 40.
214. EBRI, *supra* note 54, at 112.
219. *Id.*
immediate family member had experienced some form of job lock.” As such, improving health insurance portability may play a key role in supporting the terms of the new psychological contract.

1. Health Insurance Basics

Like the three-legged stool concept in retirement security, health insurance can be provided by the government, by employers, or by the individual. Unlike the retirement system, however, these three possible sources of coverage tend to be mutually exclusive, and individuals rarely obtain coverage from more than one source. Another difference from the retirement system is that there is no universal governmental health insurance coverage. As of 1998, 24.3% of individuals had a form of government insurance, 62% of individuals obtained health insurance from an employer-sponsored plan, and 8.2% of individuals had an individually purchased health insurance plan. Approximately 16.3% of individuals had no health insurance at all.

a. Health Insurance Plan Types

Employer-sponsored health insurance plans, the dominant source of health insurance coverage, can be divided into two primary types of coverage. The first type, the pre-paid plan, allows individuals to pay periodic fees in exchange for the provision of services at the time they are needed. An example of a pre-paid plan is a Health Maintenance Organization (HMO). “HMOs both finance and deliver health care services,” and “[e]ach HMO develops its own rates and benefits.” “HMOs’ basic functions are to provide comprehensive health care services to subscribers, contract with or employ... health care professionals who will provide the covered medical services, and

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222. There are some exceptions to this concept. For example, 7.6% of Medicare recipients also have private insurance coverage. CAMPBELL, supra note 81 at 2.
223. Medicare, Medicaid, or military health care program.
224. CAMPBELL, supra note 81, at 1.
225. Id.
226. EBRI, supra note 54, at 211.
227. Id. at 235-36.
228. Id. at 211.
229. Id. at 235.
230. Id. at 236.
contract with one or more hospitals to provide covered hospital care . . . .” HMO participants are therefore limited in their choice of doctors to those who contract with the HMO as part of its network. This may serve as a disincentive to mobility since changing jobs may mean switching HMOs and, therefore, switching doctors.

The second type of plan is the traditional fee-for-service indemnity plan. In this arrangement, insured individuals are reimbursed (for covered charges they incur) after a service has been provided. Unlike HMOs, which contract directly with health care professionals, fee-for-service plans do not impose restrictions on insured individuals’ choice of physicians. Fee-for-service plans may be better suited than HMOs to the needs of mobile employees, since changing plans does not also require a change in physicians.

A hybrid arrangement has also emerged in the health insurance scene, known as the Preferred Provider Organization (PPO). PPOs “are not actually organizations but rather are contractual arrangements, generally between health care providers and an employer or insurance company, to provide fee-for-service health care, usually at a discount.” Under PPO arrangements, health care providers agree to pre-negotiated rates for those with whom they have contracted for service; in return these providers enjoy an increased pool of patients and/or faster claims processing. In most cases, PPO members may choose any health care provider they wish. However, the PPO arrangement uses financial incentives, such as expanded benefits or lower costs, to induce individuals to use preferred providers. The mobile employee would therefore be able to continue seeing his own doctor if changing plans, but may have financial incentive to switch.

b. Health Insurance Plan Operators

Employer-sponsored health plans not only differ according to the type of fee arrangement, but they are generally furnished by one of three types of plan operators: commercial insurance plans, Blue Cross and Blue Shield plans, or self-insured plans.

231. EBRI, supra note 54, at 236.
232. Id. at 211.
233. Id. at 214.
234. Id. at 243.
235. Id.
236. EBRI, supra note 54, at 245.
237. Id.
238. Id. at 212.
The first type of operator, the commercial insurance company, is a major source of health insurance. Insurance companies generally charge premiums that are calculated to cover the benefits paid, administrative costs, sales commissions, state premium taxes, and profit.

The second type of operator, the Blue Cross and Blue Shield plan, is a group of localized non-profit plans that operate independently but comply with standards set by the Blue Cross and Blue Shield Administration. Because each plan is independent, they vary by geographic region in terms of benefit structures.

The third type of operator is the self-insured plan, whereby “the employer essentially acts as its own insurance company and bears the financial risk of making payments to providers.” Some employers both self-insure and self-administer their plans, while others purchase administrative services. Employers who self-insure are exempt from any state-mandated-coverage. As such, self-insured plans may have distinctive design features not otherwise available in the market, and each of these plans may be unique.

c. Federal Health Insurance Regulation

Title I of ERISA is the statute primarily responsible for regulating health care coverage through its monitoring of employment-based health plans. Its requirements for private health plans were initially limited to select areas, such as informational disclosures, fiduciary conduct, and remedies for plan participants, and did not establish substantive federal requirements for private health plan coverage and benefits. This lack of regulation has resulted in insurance offerings varying widely across employers, with some employers designing medical plans specifically for their own employee populations. As a result, portability of plans

239. Id.
240. Id.
241. EBRI, supra note 54, at 212.
242. Id.
243. Id.
244. Id.
245. Id. at 38.
247. Id. at 488.
across employers is often impossible. Several amendments to ERISA, however, have been aimed at addressing this problem. A discussion of these laws follows.

2. Legislative Efforts to Increase Health Insurance Portability

Congress enacted two major laws intended to increase health insurance portability, the first known as the Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA), and the more recent known as the Health Insurance Portability and Accountability Act of 1996 (HIPAA). COBRA focused on addressing one cause of job lock—the lack of health insurance coverage during an unemployed job search or an eligibility waiting period with a new employer. The source of job lock that attracted legislators’ attention in HIPAA is the “pre-existing” health condition exclusion, which often made it difficult for workers with personal or family health problems to get complete health insurance coverage upon job change. The impact of these laws is explored in the following section.

a. COBRA

Until 1985, ERISA’s provisions relating to health care plans were merely procedural. Congress enacted the first substantive federal requirements for private health care plans by amending ERISA as part of COBRA. The Act’s goal was to relieve the hardships that employees and their families experience as a result of the temporary loss of group health insurance. The purpose was to ensure continuous coverage during transitional periods for individuals changing from one job to another, and, therefore, from one health insurance plan to another.

COBRA, as amended in legislation subsequent to its passage in 1985, requires employers with health insurance plans to offer qualified beneficiaries continued access to group health insurance if they lose coverage as a result of a qualifying event. Plan sponsors must offer

251. Medill, supra note 246, at 494.
252. Fronstin Statement, supra note 41, at 40.
254. Fronstin Statement, supra note 41, at 40.
continued insurance access for eighteen months to employees, spouses, and dependent children who lose coverage after a covered employee loses benefits due to termination of employment or a reduction in work hours. COBRA is touted as an Act that improves health insurance portability and reduces job lock. One reason for this is that COBRA allows continuation of the same health insurance policy that an employee had in place at work. COBRA specifies that the quality of the coverage must be “identical to the coverage provided under the plan to similarly situated beneficiaries under the plan with respect to whom a qualifying event has not occurred.” COBRA coverage is advantageous for most workers, because although an employee can be required to pay 102% of the applicable premium, workers can still realize significant savings compared with purchasing the equivalent health insurance policy in the private market. COBRA premiums are typically lower than those for plans purchased directly from an insurance company because the employer plan enjoys administrative economies of scale and a reduced risk of adverse selection. Furthermore, employment-based plans typically cover a larger array of benefits than individually purchased plans for an equivalent premium, so the COBRA participant tends to get more for each insurance dollar. COBRA’s most significant contribution to alleviating job lock may be that it allows employees to continue coverage under one plan while simultaneously enrolling under another, thus “allow[ing] employees to retain coverage while riding out exclusion periods imposed by the new plan.” Thus, COBRA acts as a “safety valve,” eliminating some of the gaps in coverage that would otherwise result from changing jobs.

255. Id.
256. Id. at 41.
257. Id. at 40.
259. “Under COBRA, the ‘applicable premium’ generally equals ‘the cost to the plan . . . for similarly situated beneficiaries . . . (without regard to whether such cost is paid by the employer or employee).’” Lewin, supra note 253, at 517.
260. Fronstin Statement, supra note 41, at 40.
261. Id.
262. Id.
263. Lewin, supra note 253, at 517.
264. Id.
b. HIPAA

Congress passed health insurance portability legislation known as HIPAA in 1996, with overwhelming support in both the House and the Senate. This legislation included several portability-enhancing provisions, but its best known provision is one addressing pre-existing conditions.

Whereas COBRA “guarantees’ portability, as it allows workers to maintain their current health insurance plan,” HIPAA “improves’ portability as it makes it easier [for individuals with pre-existing conditions] to get new health insurance on job change.” Health insurance plans “often restrict[] or exclude[] plan coverage for the treatment of health conditions that existed prior to the time the participant enrolled in the plan.” HIPAA’s core provision for preventing job lock was a limit on the length of time for which pre-existing health condition clauses can restrict coverage. HIPAA requires that group health plans reduce the duration of a pre-existing-condition waiting period by one month for every month that an individual previously had health insurance coverage in another plan. HIPAA uses a broad definition of creditable coverage encompassing almost any type of health plan, including those through private employers, government group health plans, individual health insurance, COBRA coverage, Medicare and Medicaid, the military, the Indian Health Service, and the Peace Corps. This creditable coverage is forfeited, however, if the participant has a lapse in coverage of sixty-three or more days.

HIPAA provides further protections to those individuals with pre-existing conditions by prohibiting group health plans and issuers of group health insurance from charging these individuals more than similarly situated individuals based on health-related factors. Furthermore, if an individual enrolls in COBRA coverage and is unable

265. Kapur, supra note 40, at 283.
266. Fronstin Statement, supra note 41, at 45.
267. Medill, supra note 246, at 496-97 (citing Interim Rules for Health Insurance Portability for Group Health Plans, 62 Fed. Reg. 16, 908). “[F]or 1993-94, 46% of participants in private sector, employer-sponsored health plans were subject to pre-existing condition coverage exclusions.” Id. at 497 n.94.
268. Kapur, supra note 40, at 283.
269. EBRI NOTES Aug. 1998, supra note 221, at 5.
270. Medill, supra note 246, at 499.
271. Id.
272. Id. at 500.
to join another group health plan before exhausting COBRA benefits, HIPAA guarantees that the individual will have access to health insurance coverage in the individual market.\footnote{273} COBRA and HIPAA have been designed to work hand-in-hand, and COBRA can play an important role in maintaining protections under HIPAA. For example, COBRA coverage can be used to avoid the sixty-three day break in coverage, and employees are required to exhaust COBRA coverage before they are guaranteed access to a plan in the individual market under HIPAA.\footnote{274} Recognizing the important role that COBRA plays in portability, Congress also took steps to alleviate the financial hardship that an unemployed person may face in paying for the cost of COBRA. HIPAA amended the Internal Revenue Code to eliminate the 10% penalty on distributions from an IRA before age fifty-nine and one-half for those persons who had received unemployment compensation for twelve consecutive weeks, and who used the distribution to pay health insurance premiums.\footnote{275}

HIPAA also addressed the concern that some small employers, defined as those with between two and fifty employees, were unable to obtain insurance contracts due to their employees’ claims experience.\footnote{276} The Act requires any insurer that offers general coverage in a state’s small group market to offer coverage to every small employer that applies for it,\footnote{277} and to accept every individual beneficiary within that employer’s group.

Furthermore, HIPAA took steps to decrease job lock for those individuals who might want to leave an employer to pursue self-employment. The Act raised the tax-deductibility of self-employed individuals’ health insurance premiums from 30% to 80% over a ten-year period.\footnote{278} Today, self-employed individuals can deduct 70% of their health care insurance expenses, and such individuals will be able to deduct 100% in 2003 and thereafter.\footnote{279}

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\begin{itemize}
  \item \footnote{273} Fronstin Statement, supra note 41, at 41.
  \item \footnote{274} Id.
  \item \footnote{275} Medill, supra note 246, at 495 n.77.
  \item \footnote{276} Solomon & Asaro, supra note 62, at 254-55.
  \item \footnote{277} Id.
  \item \footnote{278} Donald J. McNerney, Health Insurance Reform, 73 HR FOCUS 1, Dec. 1, 1996, at 1, available at 1996 WL 8888949.
  \item \footnote{280} Id.
  \item \footnote{281} I.R.C. § 162(h)(1) (2001).
\end{itemize}
Finally, the Medical Savings Account (MSA) provision of HIPAA took progressive steps toward vesting health care plans in the individual worker. This provision was set up as a limited pilot project to allow Congress time to assess the impact of these tax-favored individual accounts. In order to qualify for participation in the pilot, the sponsoring employer must have fewer than fifty employees and must couple the account with a high-deductible or “catastrophic” health insurance plan.

The pilot was intended to stimulate provision of health insurance by small employers. Employers save money by purchasing low-cost, high-deductible policies for employees instead of more expensive comprehensive plans, and they can defray employees’ out-of-pocket deductible costs by depositing the remaining cash designated for health insurance premiums into the MSA. This design shifts more responsibility to employees by requiring them to make deductible payments out of their MSAs. Employees also benefit, however, because any money left in the account at the end of the year belongs to the employee and rolls over to the next year without being taxed.

“MSAs give individuals more control over their health insurance dollars while simultaneously attenuating the relationship between health insurance and the job market. The balance of the MSA can travel with employees as they change jobs, and catastrophic indemnity (fee-for-service) plans can be more unified across employers than other health care arrangements that are geographically limited or that limit access to physicians. Thus, expanding the use of MSAs has the potential to alleviate job lock, because changing jobs would not necessarily require workers to change health plans or doctors.”

PART III: BARRIERS TO PORTABILITY

Although employee benefits have come far along the path to portability, they still have a long way to travel before reaching full portability. This section of the article identifies the shortfalls of existing

282. Whitman, supra note 25, at 175.
283. Id.
286. Lewin, supra note 253, at 539.
287. Id.
288. Id.
289. Id.
290. Id. at 539-40.
portability legislation, and discusses those portability barriers that are inherent in employers’ pension and health plan design and offerings.

A. Barriers to Pension Plan Portability

While pension portability has steadily improved, several barriers remain. Pension legislation allows employers to impose vesting requirements, requires employers to comply with complicated administrative requirements, and discriminates against IRAs and SIMPLE plans in terms of maximum contribution levels. Employers continue to perpetuate portability loss through their pension plan design, and those employers who are trying to convert to more portable pension designs are met with resistance from employees and the government. The following section explains those obstacles.

1. Inadequacy of Pension Legislation

While legislators have made strides in promoting employer-sponsored retirement savings plans, those efforts have been neither progressive nor widespread enough to achieve true mobility. The following discussion addresses the shortcomings of each of the improvements in pension law described in the previous section.

a. Vesting

Although ERISA and subsequent amendments have decreased the maximum service requirements for pension plan vesting, these requirements still stand as an impediment to worker mobility. Since most pension plans require several years of service before employees vest, employees who change jobs frequently may be left without retirement benefits and short-service employees may find themselves job-locked. As long as vesting requirements continue to be imposed, they will continue to be an impediment to mobility.

b. The 401(k) Plan

Despite Congressional efforts, many employers decline to sponsor retirement plans due to the associated administrative complexity and

expense. An employer that has no obligation to implement a tax-favored retirement plan, upon deciding nonetheless to sponsor a 401(k) plan, must incur substantial funding and administrative costs determined under vague rules of the Internal Revenue Code. Even 401(k) plans consisting solely of employee contributions involve administrative cost and a certain amount of risk in the implementation of a qualified retirement plan. For example, employer funding costs can be unexpectedly incurred because non-discrimination provisions may require employers to provide matching contributions in order to maintain qualified tax status. To the extent the employer must make matching employer contributions to sustain plan viability, it will hesitate to implement or continue a § 401(k) plan.

c. Rollovers

Although Congress increased the ability to rollover funds from an employer plan to another qualified plan or IRA, enhanced asset portability is not likely to have a significant financial benefit for mobile employees. Although employees would have greater control over who holds their money, the amount of money held would be the same. The ability to rollover alone does nothing to address the “portability loss” that is built into the design of many retirement arrangements, in the form of “back-loaded” defined benefit formulas (discussed infra, section III.A.2.a.) or forfeitures due to vesting requirements.

d. SIMPLE and IRAs

In spite of efforts to promote small employer plans and individual savings, employer plans remain expensive to sponsor, and savings limits for both types of plans are small in comparison with those plans

292. Kovach, supra note 149, at 435 n.166.
293. Id. at 407.
294. Id. at 407 & n.42.
295. Id. at 407.
296. Willborn, supra note 112, at 349.
297. The most recent effort took place in the Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, 115 Stat. 38 (2001). Congress added a small-employer tax credit of 50% of the qualified start-up costs of adopting a new defined benefit, defined contribution, SIMPLE, or simplified employee pension. Id. Up to a $500 total credit is available for the first three years of operation, and qualified costs include administration and retirement-related education. Id. The effects of this credit remain to be seen, but the amount of the credit is small in comparison with the risk and expense attendant to plan sponsorship, leading to the conclusion that the credit is unlikely to have broad effect.
typically sponsored by large employers. SIMPLE vastly reduced complexity for small employers, but several of its provisions still inhibit its effectiveness as a retirement savings vehicle. For example, the plan requires matching contributions on the part of the employer. Although SIMPLE arrangements eliminate vague rules characteristic of § 401, they do not eliminate the indeterminacy of funding costs, because the employer has no control over employee elective deferrals and associated matching contributions. SIMPLE also caps employee contributions at $7000 per year and prohibits the sponsoring employer from simultaneously maintaining another tax-favored saving arrangement, further limiting the amount an employee can save. IRA legislation has been similarly restrictive, with a maximum contribution level of $3000 per year. Although Congress recently increased these limits in the Economic Growth and Tax Relief Reconciliation Act of 2001, the new caps still do not begin to approach the savings allowed under plans typically sponsored by large employers.

2. Employers’ Pension Plan Designs Cause Portability Losses

Even if all legislative barriers to pension portability were removed, several pension plan design characteristics that lead to portability losses would remain. Portability losses are principally experienced by shorter-service workers who are covered under defined benefit plans, with at least 75% of all portability losses the result of plan design characteristics. Approximately 59% of covered workers experience some portability loss, with the average pension loss equal to 25% of the single career benefit.

a. Back-Loaded Defined Benefit Formulas

One defined benefit design characteristic that leads to portability loss is what is known as a back-loaded benefit formula, meaning that these plans provide disproportionately higher benefits to older and

298. Kovach, supra note 149, at 436.
299. See supra note 162 and accompanying text.
300. Kovach, supra note 149, at 414.
301. See supra note 101.
303. See supra notes 101-105 and accompanying text.
304. Labor Dep’t Study, supra note 291, at 1152.
305. Id.
306. Id.
longer-service employees. In addition to rewarding long service, these plans may be designed to anticipate late-age hiring and to provide adequate retirement benefits to older employees with fewer years of service. Under defined contribution plans, in contrast, employees earn a steady pattern of benefits over a career. Defined contribution plans do not exhibit back-loaded features rewarding long service, nor do they generally make special accommodations for employees hired later in life.

As a result of these differences, long-service employees covered by defined benefit plans stand to lose a greater portion of benefits on job change than do shorter-service employees, thereby making them less likely to change employers. Conversely, long-service employees covered by defined contribution plans will never achieve the same long-service bonus that their counterparts enjoy under a defined benefit regime. Older employees considering a job change will likely be hesitant to take a job with an employer who utilizes only a defined contribution plan or similar hybrid, since these plans do not make special accommodations for older workers. Taken together, these characteristics of defined benefit plans will tend to decrease mobility of older and longer-service employees, and to increase their pension losses in the event that they do decide to change jobs.

b. Failure to Index for Inflation

Another defined benefit design feature leading to portability loss is the failure to index the vested benefits of separated workers to inflation. Defined benefit plans index for inflation only so long as an employee remains employed with the plan sponsor. As long as an

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307. FUTUREWORK, supra note 79, at 16.
308. EBRI, supra note 54, at 75.
309. But see id., at 72 (stating benefits that defined contribution plan might yield on older employees). Under the Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, 115 Stat. 38 (2001), participants over fifty may make additional elective “catch-up” contributions each year beginning in 2002. See supra note 102. Elective contributions are those made by the employee, however, and not the employer.
310. However, fewer and fewer employees can attain the minimum age and service combination to attain a full pension under a defined benefit formula. The cash balance plan’s smoother accrual pattern over the employee’s period of service renders it a much more portable plan and thus more in sync with today’s mobile workforce. Harold W. Burlingame & Michael J. Gulotta, Case Study: Cash Balance Pension Plan Facilitates Restructuring the Workforce at AT&T, 30 COMPENSATION & BENEFITS REV., Nov. 1, 1998, at 25, available at 1998 WL 16141205.
311. Id.; see also supra note 309.
312. Labor Dep’t Study, supra note 291, at 1152.
employee continues to work for the same employer, the “final salary”
element of the pension formula serves to index the employee’s pension
to wage inflation. When an employee leaves an employer, however,
the “final salary” element of the formula is frozen at the amount the
employee was paid at the time of separation.

In contrast to defined contribution plans, which allow employees to
take the benefit as a lump-sum and reinvest it, defined benefit plans
typically do not allow participants to collect their benefit until they
become eligible for retirement under the plan. Between the time when
employees leave the employer and when they begin distributions,
however, increasing price levels erode the value of benefits. It is
estimated that the failure to index to inflation, the vested benefits of
separated employees, accounts for up to two-thirds of all portability
losses. Regardless of whether vested pension assets remain in the plans
or are rolled over to an IRA, workers in a series of defined contribution
plans will not experience a portability loss. In either case, the
contributions continue to earn interest or investment returns until the
time of retirement.

3. Barriers to Conversion

Defined contribution plans do not display most of the
characteristics that lead to portability loss under defined benefit
arrangements. Instead, the key barrier to portability associated with
defined contribution plans (or similar hybrids) is the difficulty that
employers experience when trying to convert from a defined benefit plan
to this type of arrangement. The most illustrative example of this
difficulty is the current debate that is associated with the movement to
convert to cash balance retirement plans.

a. Cash Balance Retirement Plan Conversions

Cash balance retirement plans have been receiving a great deal of
attention recently as the pace of conversions to this type of plan has

313. Willborn, supra note 112, at 348.
314. Id.
315. Id. at 362.
316. Labor Dep’t Study, supra note 291, at 1152.
317. Id.
318. Id.
319. See generally Drigotas, supra note 203.
increased. Cash balance plans have many portability-enhancing features that make them popular among younger and/or mobile employees. They provide larger benefit accruals earlier in a career, allow employees to take the benefits as a lump sum, and allow benefits to accrue investment income to keep pace with inflation.

On the other hand, older and/or long-tenured employees can suffer financial injury if they continue their entire careers under a cash balance plan or if they migrate from a typical defined benefit to a cash balance design. The latter is often the case, because employers typically have not started out with cash balance plans, but have converted to them from traditional defined benefit plans. Depending on how this conversion is implemented, the process can penalize an employee who began service under a traditional design and, who therefore, does not get the advantage of the relatively high accruals of later service. This has been the complaint of numerous employees whose employers converted to cash balance plans.

Attention has been drawn by recent conversions where the employees complained loudly to the company, the Internal Revenue Service (IRS), the Department of Labor (DOL), the Equal Employment Opportunity Commission (EEOC), and to Congress. One of the best known examples is the IBM conversion to a cash balance plan. When IBM announced its cash balance conversion, the company was planning to let workers within five years of retirement choose whether they wanted to remain in the old defined benefit plan or transfer to the new cash balance plan. In response to the continued uproar from younger employees, IBM extended this option to all employees with forty years

320. Id. at 40.
321. Id. at 41.
323. See generally Drigotas, supra note 203, at 41.
324. See generally Drigotas, supra note 203, at 41.
325. TOWERS PERRIN, supra note 318.
326. TOWERS PERRIN, supra note 318.
327. Id. at 40.
328. Theresa Dixon Murray, Pension Plan Shutdown; How IBM Solves Retirement Fund Dispute Could Affect the Plans of Workers All Over, PLAIN DEALER, Apr. 24, 2000, at 1C.
of age and ten years of service. The conversion received even more publicity when the Securities and Exchange Commission (SEC) ruled that the company had to allow a vote on a shareholder proposal that would extend this option to all employees.

Employers are not prohibited from changing retirement plans, and there are few legal restrictions or guidelines on how plan conversions should take place. The most prominent requirement is imposed by the Internal Revenue Code and ERISA, and requires employers to amend qualified retirement plans in a way that does not reduce the level of benefits below that which has already accrued to employees. Therefore, in converting a plan, employers must keep track of the amount of an employee’s accrued benefit at the time of conversion, and ensure that employees who subsequently retire receive at least that benefit.

Although ERISA protects accrued benefits, it does not prevent plan sponsors from changing benefit formulas for future accruals or from discontinuing future accruals altogether. This issue is controversial and surfaces most often as a result of the method the employer uses to calculate the beginning account balance as part of a cash balance conversion. Some conversion methods lead to a period of “wear-away,” which occurs when companies convert the plan in a manner that leaves employees with no accruals for a period after the conversion.

There are three basic methods for converting from a traditional defined benefit plan to a cash balance plan. The first method preserves the participant’s accrued benefit under the defined benefit plan as of the conversion date, and starts a new cash balance account with a zero balance that begins accruing benefits as of that date. At the time of retirement, the benefit equals the sum of the defined benefit account and the amount in the cash balance account. Under this approach, participants continue to accrue benefits at all times and suffer no wear-away.

329. Id.
331. Drigotas, supra note 203, at 44.
332. Id.
333. Id.
334. Id.
335. Id.
336. Drigotas, supra note 203, at 44.
337. Id.
In the second approach, the cash balance account does not start with a zero balance. Instead, the value of the defined benefit plan is converted to a lump sum in accordance with I.R.C. § 417(e) as of the conversion date, and that amount becomes the opening account balance. The wear-away in this case, which is particularly difficult to understand, is a problem driven by the fact that the interest rate required by § 417(e) may change between the time of the conversion and the actual retirement. If the § 417(e) interest rate changes, employees may experience a period in which they do not accrue any additional benefits. The possibility of a change in interest rate is the source of the wear-away.

For example, if the § 417(e) interest rate decreases between the conversion date and retirement, the value of the accrued benefit will be greater than it was calculated to be as of the conversion date. In this case, the starting balance of the Cash Balance Retirement Account (CBRA) was actually lower than it should have been; the participant has no more benefits at retirement than she or he had accrued as of the date of the conversion, and any contributions to the account after the conversion only kept the account at the statutorily-mandated level. If the § 417(e) interest rate increases during this period, however, the effect can work to the advantage of the participant. In that case, the present value of the pre-conversion accrued benefit will fall (meaning that the starting CBRA balance was higher than it should have been), and the relative value of the participant’s cash value account will increase.

The third conversion approach is the most controversial because it generally provides for longer periods of wear-away. Although § 417(e) must be used to keep track of the employee’s accrued benefit as of the date of conversion, the law does not require that employers use § 417(e).
to determine the opening account balance. Instead, employers are free to convert the defined benefit annuity to an opening account balance using any interest and mortality assumptions they think appropriate, even if they are different than those found in § 417(e). Depending on the assumptions used, the opening account balance may actually be lower than the present value of the participant’s benefit in accordance with the Internal Revenue Code. Any additions to the cash balance plan, therefore, are initially used only to bring the account up to the level required by § 417(e), resulting in a longer period of wear-away.

Generally, however, cash balance plans “converted from traditional final pay defined benefit plans provide special transitional benefits for employees nearing retirement.” These grandfather provisions prevent the older and/or longer-service employees from losing benefits as a result of the conversion.

b. The Government Response

Because of the above-enumerated concerns, the Internal Revenue Service slowed the conversion process by referring all requests for determination letters regarding cash balance conversions to its National Office. The requirement that IRS personnel request technical advice before making a CBRA determination has delayed employers’ efforts to convert to cash balance retirement plans. This change was announced in September 1999, and as of April 2000 there were fifty requests pending in that office. At one point it was announced that the status of these applications would not be determined until a multi-

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349. Id.
350. Id. However, if the participant actually retires, the employer must still use the section 417(e) rate (in existence as of the date the participant starts distributions from the plan) to determine the lump-sum value of the previously accrued benefit. Id. In some cases, that amount may be greater than the account balance. Id.
351. EBRI, supra note 54, at 112.
352. Id.
353. Determination letters are issued to plan sponsors to indicate whether their plans comply with the Internal Revenue Code. A plan that does not comply with this code may lose its tax qualified status. Therefore, cautious employers will wait for a determination letter before proceeding with a plan conversion.
355. Id.
356. Id.
agency review of cash balance plans and plan conversions was complete.

In the Economic Growth and Tax Reconciliation Act of 2001, Congress created a new notice requirement affecting employers undergoing conversions. The new provision, apparently aimed directly at disclosing the effects of the wear-away problem, requires that “[i]f an applicable pension plan is amended to provide for a significant reduction in the rate of future benefit accrual, the plan administrator shall provide written notice to each such applicable individual (and to each employee organization representing the applicable individuals).” This notice must be given within a reasonable time before the effective date of the plan amendment, and the penalty for failing to provide the notice is an excise tax of $100 per day, per individual, until notice is provided.

B. Barriers to Health Insurance Portability

As in the pension portability framework, improvements in health care portability have left gaps where the system continues to fail job-locked employees. Job change may still entail lack of health insurance during an unemployed job search or a waiting period for coverage with the new employer. Job change typically requires a change in health plans, which can also entail a change in premium contributions, covered benefits, or the employees’ physicians. Workers may want to remain enrolled in a particular health maintenance organization, or may need to do so to stay with their current physicians, and these idiosyncratic

357. *Id.* The multi-agency review referred to is a joint effort by the IRS, Treasury Department, the DOL, EEOC and SEC. There are three areas of particular concern for the regulators:
1. “The use of cash balance plans to disguise benefit reductions.” *Towers Perrin*, supra note 318. While benefit reductions are not illegal nor is there intent to outlaw them, there is concern that reductions should be adequately disclosed;
2. “[A]ge discrimination issues on the conversion from one formula to the other”; *Id.*
3. Benefit accrual issues, especially wear away, “where employees see no additional accruals under the amended plan for a number of years.” *Id.*

The challenge faced by this multi-agency committee is to balance “participant rights and protections, while providing employers with the needed flexibility” and to “maintain an environment in which employers will want to continue sponsoring pension plans.” *IRS Has 50 Requests*, supra note 350.


359. *Id.* The notice must be “written in a manner calculated to be understood by the average plan participant and shall provide sufficient information . . . to allow applicable individuals to understand the effect of the plan amendment.” *Id.*

360. *Id.*

preferences may cause “job lock” as an attempt to maintain the status quo. The following section examines these shortfalls and other barriers to health insurance portability.

1. Legislative Barriers

Congress’s attempts to improve health insurance portability have been well-intentioned. However, neither piece of portability-enhancing legislation was perfect. COBRA’s brand of portability is expensive and of limited duration. HIPAA’s portability is focused primarily on pre-existing health condition exclusions, but many workers experience job lock even if they are not subject to pre-existing condition exclusions with their prospective employers. Equally important is the structure of the current taxing system, which favors employer-sponsored health plans and perpetuates job lock by forcing employees to change health insurance plans when changing jobs. Until these concerns are addressed, full health insurance portability cannot be achieved.

a. Internal Revenue Code

The structure of the Internal Revenue Code is such that it provides greater tax benefits to those individuals who obtain health insurance through an employer plan than from any other source. Section 213 of the Code addresses individual health insurance purchases, and provides that individuals can deduct only the amount of insurance expenses that exceed 7.5% of their adjusted gross income. Self-employed individuals are not subject to the “7.5% rule,” and can deduct 70% of their health insurance premiums in the year 2002 (although the deduction increases to 100% in the year 2003 and thereafter).

Section 106(a) of the Internal Revenue Code (Code), in contrast, gives employees a complete income tax exemption for premiums paid for employer-sponsored health insurance plans. This section has served to entrench our current system of health insurance provision, whereby the employer selects the health insurance policy provided to employees

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362. Id.
363. Id.
366. Cords, supra note 279, at 1226 n.63; see also supra note 281 and accompanying text.
so that the insurance will be considered “employer-provided” in accordance with this section.

Section 125 of the Code built on § 106 to allow limited choice among plans. Before the enactment of this section in 1978, employees were limited to the one health insurance plan provided by employers and were not allowed to select among several different plans within a benefit category. Section 125 allowed employees to choose between taxable forms of compensation and nontaxable benefits, therefore allowing employees to choose among several plans with different prices. Although § 125 plans provide more employee choice, employers are still responsible for selecting the plans among which employees may choose. As long as each individual employer is responsible for plan selection and employees have to obtain insurance through their employers in order to enjoy full tax deductibility, employees will almost certainly have to change health insurance plans when changing employers.

b. COBRA Shortfalls

COBRA’s limited scope and low rate of participation have impaired its effectiveness. One reason is the fact that workers cannot continue indefinitely their old health insurance plan coverage after leaving an employer. If the new employer does not offer a health insurance plan, or offers one more expensive than or inferior to that offered by the previous employer, employees will suffer a benefit loss as part of the job change. After the maximum period of COBRA eligibility has been exhausted, employees may be left with more expensive benefits, inferior benefits, or no benefits at all. Another one of COBRA’s shortfalls is that the law does not protect workers employed by employers with fewer than twenty employees. Consequently, employees who work for these small employers are not afforded any portability options for their current health insurance plan.

369. EBRI, supra note 54, at 354.
370. Id. at 353.
371. Lewin, supra note 253, at 517.
372. Id. at 516, 517.
373. Id. at 521-22.
More disturbing than these shortcomings, however, is that very few individuals eligible for COBRA coverage elect to use it.\textsuperscript{375} Of those individuals eligible in 1994, for example, only 18.2% elected to use it.\textsuperscript{376} One likely explanation for the low utilization rate is the high cost of coverage.\textsuperscript{377} As noted previously, plan sponsors are allowed to charge COBRA participants 102% of the applicable premium. This figure is misleading, however, because first glance yields only a 2% cost increase to employees. In actuality, the employees’ costs may be enormously higher. One reason is that the “applicable premium” generally equals the total cost of providing benefits under the plan, without regard to whether such costs are paid by the employer or employee.\textsuperscript{378} Since sponsoring employers typically cover some or all of the cost of premiums, employees are left to pick up the portion previously paid by the employer and may see a large increase in premium payments. Furthermore, the money paid for health insurance premiums loses its tax-preferred status when the employee pays for COBRA coverage. Whereas employer contributions are tax exempt under § 106, and employee contributions for health insurance premiums are exempt under a § 125 cafeteria plan or premium conversion plan, individual purchases of health insurance are only partially tax-deductible\textsuperscript{379} and only under limited circumstances. Even if the employer was not making any sizable contribution towards the premium, but had allowed the employee to pay for insurance through a § 125 premium conversion plan, the mobile employee will experience a premium increase equal to the amount of the lost tax advantage.

Yet another explanation for the low utilization of COBRA benefits may be the problem of adverse selection.\textsuperscript{380} The Employee Benefits Research Institute offers an example to illustrate this problem:

Under the health plan, the annual premium for a family plan is $10,859. However, the actuarial cost of the plan varies greatly

\textsuperscript{375} Lewin, supra note 253, at 517.
\textsuperscript{376} EBRI, supra note 54, at 454.
\textsuperscript{377} Lewin, supra note 253, at 517.
\textsuperscript{378} Id.
\textsuperscript{379} See supra note 358 and accompanying text.
\textsuperscript{380} Only those individuals who file form 1040 may make deductions for medical expense deductions (those who file 1040A or 1040EZ cannot make such deductions). Publication 502, supra note 365, at 1. The effect of this requirement is to make those individuals who do not itemize (who generally tend to be less wealthy than those who do itemize) or who have no tax liability (because they have little or no income) ineligible for this tax subsidy.
\textsuperscript{381} EBRI, supra note 54, at 455.
across workers. The actuarial cost for workers under age 30 would be $4,524, and the actuarial cost for workers aged 55 and over would be $12,759. If a worker chooses COBRA coverage, the premium would be $11,076, or 102 percent of the annual premium faced by the employer. Young individuals would have an incentive to forgo COBRA coverage, while older workers would have an incentive to accept COBRA coverage. As a result, the COBRA coverage pool of insured workers is adversely selected—meaning only relatively older, relatively unhealthy individuals will choose COBRA coverage . . . .

Therefore, COBRA’s premium pricing rules may lead younger and healthier individuals to forego coverage and pay out-of-pocket as services are rendered, since the expected costs of doing so will be less than the cost of the COBRA premium.

c. HIPAA Shortfalls

Like its counterpart COBRA, HIPAA leaves us far from achieving real health insurance portability. The Act’s name itself is misleading, because “portability” does not entail carrying a specific package of health benefits from one job to another or into periods of unemployment. Portability in HIPAA simply captures the notion that if an individual has maintained health insurance coverage, the next employer plan must waive or limit any pre-existing condition exclusion that would otherwise apply. Unlike the protection COBRA provides, portability under HIPAA does not mean that an insured individual actually retains the same policy. Neither law guarantees that a worker will have access to health insurance coverage on the new job, nor that health insurance on a new job will be affordable. Even with HIPAA protections, workers who change jobs may still have to change health plans or health care providers, or may experience coverage interruptions caused by eligibility waiting periods. Therefore, HIPAA does not achieve total portability, which would be realized if the worker did not have to change health plans on job change.

382. Id. at 455-56.
384. Id.
385. Id. at 522 (footnote omitted).
386. Fronstin Statement, supra note 41, at 45.
387. Id.
388. Lewin, supra note 253, at 522.
389. EBRI NOTES Aug. 1998, supra note 221, at 5.
Given that HIPAA’s primary portability feature is the reduction of pre-existing condition periods, HIPAA actually benefits a small portion of the job-locked population. Only 16% of individuals who reported that they or an immediate family member had experienced job lock were affected by a pre-existing condition. It is those areas that HIPAA ignores that are largely responsible for job lock. Thirty-six percent of individuals reporting job lock attributed it to the prices of health insurance at a new employer, 25% said it occurred because the prospective employer offered a health plan that covered fewer benefits than the current employer, and 15% of respondents reported that they experienced job lock because the prospective employer did not offer health benefits.

Even HIPAA’s pre-existing condition provisions cannot guarantee that an employee or other beneficiary will be covered under the new health insurance plan, and several HIPAA loopholes have the potential to pose problems in the future. For example, HIPAA provides that in order for an individual to be exempt from pre-existing condition exclusions, she or he must demonstrate that there was no break in his or her prior coverage exceeding sixty-three days. There is some evidence, however, that insurers may drag their feet while processing COBRA or insurance applications, thereby causing workers to go without coverage for over sixty-three days and lose HIPAA eligibility.

Furthermore, because HIPAA does not prohibit restrictive insurance policies, “it effectively allows insurers to structure their benefits to ‘act [] as preexisting condition exclusion[s].’” “By designing the terms of a plan to exempt certain conditions from coverage for a set period of time [under the guise of a waiting period], insurers obtain nearly the same result as if they had implemented pre-existing condition exclusions.” The difference is that the waiting period applies to all employees who join the plan, not just those who come to the plan with a pre-existing condition. Furthermore, while pre-existing condition limitations prevent employers from discriminating against individual employees who have such conditions, there is no protection

390. Id. at 6.
391. Id.
392. Lewin, supra note 253, at 531.
393. Id.
394. Id.
395. Id. at 535.
396. Id.
397. Lewin, supra note 253, at 531.
against employers simply dropping that type of coverage from the plan for all employees.

Despite HIPAA’s advances, job lock persists in the form of reluctance to join small companies that do not offer health insurance. While HIPAA did take steps to ensure that small employers would be guaranteed the right to purchase health insurance plans, it did nothing to address the affordability of those plans. Unless individual states have legislation aimed at price control, insurers could charge small employers exorbitant rates.

“So, even though coverage might be ‘available’ in a technical sense—since it is being offered in the marketplace—it might be too expensive for any small firm to buy.”

The expense of providing health insurance is a big factor for small companies who do not have the purchasing influence of their larger counterparts. Many small companies therefore choose not to offer health benefits at all, or if they do, they do not provide benefits comparable to their larger counterparts. A 2000 study found that only 60% of firms with fewer than ten workers offered benefits, compared to 99% of firms with more than two hundred workers. Those small businesses that do offer insurance are feeling the brunt of increased medical costs and tend to shift this burden to their employees. Finally, there is a great deal of skepticism regarding whether HIPAA’s Medical Savings Accounts will actually solve the portability dilemma. When HIPAA was passed, both proponents and opponents believed that MSAs would be a popular product. Participation in the MSA program, however, has fallen far short of expectations. Furthermore, even if participation were at expected levels, critics claim that the only people who will opt for MSAs are those who are “either healthy enough not to require much health care or

399. McNerney, supra note 278, at 1.
400. Id.
401. Id.
402. Id.
403. Id.
404. Id.
405. Id.
406. Although MSA legislation had allowed for as many as 375,000 accounts to be established by the first interim cap date of April 30, 1997, the IRS reported that only 9720 MSAs were established by this date. Jefferson, supra note 173, at 724. Between January and June of 1997, only 22,051 MSAs had been opened, a number significantly below the interim cap of 525,000 accounts set for June 30, 1997. Id. The number of accounts created through June 30, 1998 was only 50,172, which is significantly below the applicable interim cap of 600,000. Id.
wealthy enough to afford the high-deductible payments of a catastrophic policy. If this happens, there is a fear that adverse selection will bankrupt the health insurance system “by allowing low-risk, wealthy individuals to drop out of mainstream coverage, leaving behind a pool of individuals who will drive up the insurance rates.”

2. Employer Plan Offerings and Employee Health Plan Selection

Barriers to portability also exist in terms of employer health insurance offerings and the types of plans in which employees choose to participate. One type of disparity exists between large employers and small. For example, approximately 75% of employees working for medium and large employers participate in employer-sponsored medical plans, whereas only 64% of employees working for small private establishments have employer-sponsored health insurance coverage. This disparity in health insurance coverage will tend to serve as a barrier for workers moving from larger companies to small, because of the increased likelihood of losing insurance.

Moreover, barriers to portability exist because employees are increasingly participating in nontraditional plans that limit their choice of doctors, making it more likely that employees will have to switch doctors when changing jobs. For example, of those participants in employer-sponsored plans, 73% of employees working for medium and large employers participate in non-traditional plans; 33% of those were in HMOs and 40% were in PPOs (leaving only 27% to participate in the more mobile fee-for-service plans). In contrast, in 1991, 17% of employees were in HMOs, 16% were in PPOs, and 67% were in

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407. Lewin, supra note 253, at 539.
408. The theory behind adverse selection is that the cost of insurance will be driven up if employees are allowed to select plans based on how they foresee their medical needs for the next year. For example, employees who foresee few medical needs during the year are likely to choose a low-cost, less generous health insurance plan. EBRI, supra note 54, at 258. Those employees who enroll in the most generous and most costly health insurance plans are those who think they are likely to have greater health care costs during the year. Id. As a result, the average cost of the most generous plan is likely to rise much faster than the cost of the least generous plan. Id. Therefore, if insurers are to accurately price the more generous plans (in order to cover their costs for the year), they will need to adjust or “reprice” the health plans to reflect the actual expected costs subsequent to the initial offering and enrollment in the plans. Id. To the extent that repricing is not possible, adverse selection may eventually bankrupt the insurer. Id.
409. Lewin, supra note 253, at 539.
410. BENEFITS 1997, supra note 151.
411. BENEFITS 1996, supra note 151.
412. BENEFITS 1997, supra note 151.
traditional fee-for-service. Employees who work for small employers demonstrate a similar pattern. In 1996, of those participating in employer-sponsored plans, 62% had signed up for non-traditional insurance; 27% of those participated in HMOs, and 35% in PPOs (leaving only 36% to participate in fee-for-service plans). In contrast, in 1990, 14% were in HMOs, 13% were in PPOs, and 74% were in fee-for-service plans.

PART IV: POSSIBILITIES FOR INCREASED PORTABILITY

Having identified the shortfalls of portability legislation and those barriers characteristic of employers’ pension and health insurance plan design and offerings, the following section examines possible remedies for the portability dilemma. The discussion highlights the arguments both for and against various proposals, but avoids taking a normative position in the debate.

A. Expanding Pension Plan Portability

Legislative and employer design changes have increased pension portability, especially in terms of workers’ ability to transfer pension assets between employers. While these changes have improved workers’ opportunity to manage their accounts, they have done little to increase the amount in the accounts. To solve the job lock problem, it will be necessary to address the “portability loss” associated with job change. The author’s research has identified four key possibilities for taking on this issue: (1) shortening or eliminating vesting requirements; (2) indexing defined benefit accounts to inflation; (3) allowing employees to carry service credit with them to a new employer; or (4) expanding individual pre-tax retirement savings limits to the same maximums as employer-sponsored plans. The following section discusses these options for increasing portability, as well as the costs and distributional implications accompanying each.

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413. Id.
414. BENEFITS 1996, supra note 151.
415. Id.
1. Shorten or Eliminate Vesting Requirements

Perhaps the simplest proposal for increasing pension portability is to shorten the maximum allowable vesting requirements or to require that employees vest immediately in qualified retirement plans. While one would think that such proposals could reduce job lock by improving pensions for short-tenure employees, empirical data shows that this proposal would actually do little to alleviate job lock overall. Although the change would entitle some additional workers to pension benefits, the changes would have relatively little impact on overall pension losses—immediate vesting would reduce the benefits that the average pension-covered worker loses by only 4%. Critics of this proposal claim that mandated vesting would do little to increase the retirement benefits of its intended beneficiaries and would have the detrimental effect of reducing benefits for other plan participants. Using an economic efficiency argument, they predict that the mix of cash compensation and benefits before a vesting mandate is the efficient one. Therefore, they argue, following a vesting mandate, benefits for short-tenure employees will eventually be driven back down to pre-mandate (efficient) levels. Due to ERISA’s non-discrimination requirements, however, retirement plans would not be able to respond by reducing benefits of only short-tenure employees, but would also have to reduce benefits for those plan participants who highly value them. If the pension plan’s ability to provide retirement benefits to employees who prefer them is diminished, the plan will become a less valuable compensation mechanism. Voluntary retirement plan sponsorship only exists as long as the plans provide value to the employer and the employees. Therefore, critics argue, if legal rules make it impossible to provide retirement benefits to those employees who value pension benefits more highly than alternative forms of compensation, fewer

416. Peter M. van Zante, Mandated Vesting: Suppression of Voluntary Retirement Benefits, 75 NOTRE DAME L. REV. 125, 129 n.10 (1999). The most recent example of this is, of course, the Economic Growth and Tax Relief Reconciliation Act of 2001’s reduction of vesting requirements for employer matching contributions under a 401(k) plan. See supra note 133 and accompanying text.
418. van Zante, supra note 416, at 129 n.10.
419. Id.
420. Id.
421. Id. at 128-29.
422. Id. at 129.
423. van Zante, supra note 416, at 129.
retirement plans will be sponsored and more plans will be terminated. In sum, critics argue that “[m]andated vesting is a destructive policy when measured against its effect on aggregate retirement benefits. The retirement benefits of short-tenure employees are not enhanced, but plan coverage is suppressed, and the benefits of long-tenure employees are reduced.”

2. Index Defined Benefit Accounts to Inflation

A second portability proposal would be aimed at alleviating some of the portability loss associated with defined benefit plans. As previously mentioned, it is estimated that indexing these benefits to inflation could eliminate up to two-thirds of portability loss. Indexing might take such forms as insuring against inflation with government-issued bonds, or allowing deferred vested participants to withdraw their benefits at the time of job change so they could be transferred to another investment vehicle.

However, to promise employees a benefit indexed for inflation is to promise employees a larger benefit, and this increased benefit would mean that the employer has to bear additional funding costs. For example, an indexing scheme that allows the employee to accrue interest on vested benefits will deprive the employer of investment results that would otherwise be retained by the plan to fund other pension benefits. Since this indexing scheme would allow investment results to accrue to the separated employee rather than the pension trust, employers would eventually have to make larger contributions to the plan in order to fund other pension benefits.

The alternative scheme, allowing vested employees to take their entire benefit at the time of separation, so that they may invest it elsewhere, causes similar problems. This scheme naively assumes that the employer has the entire amount of the promised benefit sitting in an account at the time of the employee’s separation. In fact, in defined benefit plans

the employer is responsible for making contributions to a trust adequate to ensure that the promised pensions can be made from the pooled fund. The amount of contributions required will

424. Id. at 129-30.
425. Id. at 218.
426. See supra text accompanying note 317.
427. Labor Dep’t Study, supra note 291, at 1153, 1154.
depend on a complex actuarial analysis which takes into consideration factors such as the age, length of service, and expected attrition of employees, projections of future salary increases, and the rate of return on plan investments.\footnote{428. Willborn, \textit{supra} note 112, at 347 n.7.}

Because they consider employee age and investment results in the funding formula, employers may place fewer dollars in the pension trust today and rely on investment results to achieve a fully funded benefit by the time the employee reaches retirement. If employees can withdraw their pension benefit at the time of separation, which may occur decades before the employees would be eligible to retire under the plan, the employer will have to fund the benefit immediately. Thus, the employer will lose out on the time value of money and forfeit some potential investment results. This requirement could also result in cash flow problems and could force the pension trust to liquidate investments at inopportune times.\footnote{429. \textit{Id.} at 362-63.} Moreover, this requirement could adversely affect other participants. If the plan is underfunded, the early transfer of assets equal to 100% of the present value of the separated employee’s benefits would increase the level of the plan’s underfunding and reduce security for the remaining participants.\footnote{430. \textit{Id.} at 363.}

3. Allow Employees to Carry Service Credit to a New Employer

A third proposal to increase pension portability, and one that envelops the two preceding proposals, is to allow employees to carry service credit with them when they change employers. This idea is not new. Ten years ago, human resource strategists predicted that “[i]ntercorporate and interindustry agreements for pension portability will become commonplace by the turn of the century,” and “[c]ombined employer funding of such plans will become a major concern of human resources professionals.”\footnote{431. Kenneth A. Kovach & John A. Pearce II, \textit{HR Strategic Mandates for the 1990s}, HR \textit{FOCUS}, Apr. 1, 1990, \textit{available at} 1990 WL 2517454.} With the turn of the century now behind us, we have yet to realize this prediction.

The ability to transfer service credit could be beneficial for participants in either defined benefit or defined contribution plans.\footnote{432. Willborn, \textit{supra} note 112, at 347.} The most beneficial aspect for participants in defined contribution plans would be that it would serve nearly the same purpose as reducing or
eliminating vesting requirements. For example, an employee who changed jobs every three years would never vest if each of his or her employers imposed five-year cliff vesting rules. Under a scheme of transferable service credit, however, the employee could vest after two years with his or her second employer and with every employer thereafter. The ability to transfer service credit would permit more employees to vest and to receive amounts that they would otherwise forfeit.

The ability to transfer service credit would be even more important in defined benefit plans. In addition to alleviating vesting requirements, carried service would eliminate both the inflationary problems and the portability loss usually associated with back-loaded benefit formulas. By allowing an employee to transfer years of service to a new employer and to insert those years into the pension formula, the employee would receive the same benefits as one who remained with the same employer for his or her entire career. Carrying service credit would allow the wage-indexing property of the “final salary” component of the pension formula to combat inflation, and would allow mobile employees to benefit from the back-loaded features of defined benefit plans.

While portable service credit might eliminate the mobility problem, it may also impose enormous financial and administrative burdens on the pension system. Because a system of portable service credit will allow employees to receive benefits that would otherwise be forfeited to employers, either as a result of vesting requirements or plan design, the system will increase pension benefits for the worker while commensurately increasing costs for the employer(s). The question of who ultimately carries the burden of this increased cost will depend on the administrative design of the system and on the employer’s response in terms of plan design.

Designing an administrative system to support portable service credit, while fairly distributing the increased costs of the system, could prove to be immensely difficult. The simplest option may be to allocate all costs to the new employer, whereby each new employer agrees to recognize the service credit and pay the unvested benefits of transferring

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433. Id. at 348.
434. Id.
435. Id.
436. Id.
437. Willborn, supra note 112, at 348.
438. Id. at 352.
New employers, however, are “unlikely to be willing to accept the transfer of service credit if assets were not available to support the ultimate payments of benefits.” Therefore, this portability scheme would probably require that old employers transfer the assets that accumulated on behalf of the worker in the previous plan to the new employer (thus allocating the costs to the old employer). Another option might be that “the old employer could agree to use the worker’s final salary with the new employer to calculate its pension obligation (which would allocate the increased costs to the old employer).” In another variant, the new employer could “use all of the worker’s years of service to calculate its pension,” and then “offset the total” paid by the “amount the worker receives from the old employer” (which would allocate most costs to the new employer). Alternatively, the two employers could agree to a cost-sharing arrangement, such as totaling the costs at the end of each year and dividing equally between them. This option could become very complicated, however, where the employers’ workers transferred from, and to, numerous different firms.

Determining who bears the cost of carried service credit will not only depend on the arrangement between employers, but also on the flow of employees between them. For example, an arrangement in which the old employer transfers the worker’s unvested assets to the new employer tends to allocate the increased costs to the old employer (who would otherwise recapture the forfeited assets). The actual distribution of the costs between the two employers, however, will depend on their experience with transferring workers. If only one worker transfers, for example from Employer 1 to Employer 2, Employer 1 would bear all of the costs of enhanced portability. However, if one worker leaves each firm and goes to the other, “(and each has equal unvested amounts), the costs would be distributed evenly between the two employers.”

439. Id. at 350.
440. Id. at 350 n.14.
441. Id.
442. Willborn, supra note 112, at 355 n.30.
443. Id.
444. Id. at 355 n.29.
445. Id. at 352-55.
446. Id. at 354.
448. Id.
449. Id.
actual cost distribution between the employers therefore depends on both the allocation rule and the employers’ experience under the rule.\textsuperscript{450}

Cost and administrative burdens would be further complicated by the fact that employers do not use the same funding strategies, contribution rates, or defined benefit formulas. Even a plan that appears to allocate costs to the former employer may actually impose part of the costs on the new employer. For example, if the old employer’s plan were underfunded, the amount allocated to the transferring employee would be less than the present value of the promised benefit, and the new employer would eventually have “to make up the difference.”\textsuperscript{451} Even more complicating, however, is that plans differ on a number of parameters such as employer contribution levels, eligibility rules, the coefficient used in the benefit formula, and how final salary is calculated.\textsuperscript{452} Service credit portability would create a relationship among two or more different plans, and would require that pension plans deal with some of these differences when allocating costs and paying benefits.\textsuperscript{453} Finally, another problem in this area is that some employers inevitably go out of business, which in itself creates a myriad of complications for this strategy.\textsuperscript{454}

An administratively simpler option would be to create a quasi-portability scheme that permitted the worker to transfer service credits only if she or he provided assets to support their ultimate payment or purchased service credits from the new employer.\textsuperscript{455} The allocation of the increased costs under this scheme would be between the worker and the new employer, and would depend heavily on the purchase price.\textsuperscript{456}

a. Reaction Under All Three Proposals—Labor Market and Distributional Effects and Employer Responses

Before selecting any of the preceding proposals, it would be necessary to consider the distribution of the increased benefits, as well as the labor market effects and their implications for the future of the pension system. The effects of a new portability rule would differ in a

\textsuperscript{450} Id.
\textsuperscript{451} Id. at 354-55 n.28.
\textsuperscript{452} Willborn, supra note 112, at 362.
\textsuperscript{453} Id. at 363.
\textsuperscript{454} E-mail from Lawrence M. Becker, Director of Corporate Benefits, Xerox Corporation (August 30, 2001) (on file with the Hofstra Labor & Employment Law Journal).
\textsuperscript{455} Willborn, supra note 112, at 350 n.14.
\textsuperscript{456} Id. at 352 n.19.
\textsuperscript{457} Id.
static world from a dynamic world. As such, this article discusses each separately.

In a static world, the proposed changes would mean that employers lose and workers win, with “the magnitude of the increased benefits for workers” equaling the “magnitude of the increased costs for employers.” The increased benefits “would not be distributed uniformly across all workers,” however, but would only benefit mobile workers who would have otherwise suffered a portability loss.

Although the world may appear static in the short-run, in the long-run it is dynamic and allows for employer reactions. Therefore, any of these proposals are likely to induce additional changes in the pension system. If employers knew about the portability rule in advance, they would likely minimize or even eliminate the increased cost burden.

For example, they might shift cost[463] back to employees by lowering overall benefit levels for participants, by decreasing the defined benefit formula’s coefficient, by changing the way in which years of service or final salary are calculated, or by reducing the rate of future salary increases. Alternatively, some employers might substitute defined contribution arrangements for defined benefit pension plans in order to at least shift investment risks to employees.

Distributional issues in a dynamic world are complex and either employers or workers could emerge as winners. If employers react to enhanced portability by making precisely offsetting reductions elsewhere, there would be no net increase in costs to employers or benefits to workers. Instead of magnitude effects, enhanced portability would have only distributional effects. Stationary workers would be likely to suffer an overall loss, because they would likely receive[469] decreased pension benefits as employers attempted to recoup costs. Mobile workers, in contrast, would gain from enhanced portability, because the benefits they receive would be greater than the loss they

458. Id. at 358.
459. Id. at 355.
460. Willborn, supra note 112, at 355.
461. Id. at 355-56.
462. Id. at 356.
463. Id.
464. Labor Dep’t Study, supra note 291, at 1152.
465. Willborn, supra note 112, at 356.
466. Labor Dep’t Study, supra note 291, at 1152.
467. Willborn, supra note 112, at 358.
468. Id.
469. Id.
would suffer from an altered plan design. Whether the new portability rule is desirable would then depend on one’s view of the propriety of the distributions between types of workers “rather than on any overall benefits flowing to workers from employers.”

Regardless, it is unlikely that all employers would be able to make offsetting changes equal to the amount of increased costs due to portability. Labor market or political factors may interfere with their efforts, or employers might be unable to make a precise estimate of the offset necessary to recoup costs. To the extent that employers under-offset in their cost shifting, employees would receive a net benefit; to the extent that employers over-offset due to calculation problems, workers would suffer a net loss.

One should also consider the labor market effects that a change in portability rules might provoke. “Employers offer pensions, not out of the goodness of their hearts, but because pensions serve certain functions, such as retaining good employees, motivating them, and regulating retirement flows. Portability would interfere with the ability of pensions to perform these functions both by making it more difficult for pensions to serve these functions and by making it more expensive to do so.” The problem is that those elements of plan design that lead to portability losses are precisely those elements that employers view as effective workforce management devices to encourage loyalty and longevity of service. An appropriate balance, therefore, needs to be found between lowering barriers to reasonable work force mobility on the one hand, and encouraging unnecessary turnover on the other. Otherwise, employers might exercise another option “when portability interferes with their ability to use pensions to pursue their employment objectives: offer fewer and less generous pensions.” This balance “between portability and the availability of pensions . . . makes consideration of labor market effects critical in the portability debate.”

470. Id.
471. Id.
472. Willborn, supra note 112, at 358.
473. Id.
474. Id. at 345.
475. Id.
476. Labor Dep’t Study, supra note 291, at 1152.
477. Id.
478. Willborn, supra note 112, at 345.
479. Id. at 361.
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4. Expand Individual Pre-Tax Retirement Savings Limits

Rather than impose portability mandates that would modify employer-sponsored plans, Richard Kovach claims that the best portability solution is to allow IRAs to enjoy tax preferences comparable to those enjoyed by large employer plans. Arguing that the new psychological contract has eliminated paternalism in most aspects of the employment relationship, he believes the time has come to empower all employees to make retirement savings decisions for themselves under a universal, expanded IRA system.

Kovach is not an advocate of the traditional pension system. He argues that retirement savings vehicles for individuals and small employers do not adequately address the problem of access to retirement income security, because they do not allow savings opportunities comparable to those for large employers. He believes the primary flaw in the current pension system “stems from the combined effect of trying to compel plan sponsoring employers to pay additional deferred compensation [in the form of minimum contributions or matches], while giving them near exclusive control over employee access to tax-favored retirement savings.” Believing that all American workers should have an opportunity to accumulate substantial tax-favored retirement savings, Kovach complains that even less complicated retirement plans like SIMPLEs and 401(k)s preclude individual participation without employer sponsorship. He emphasizes that employers are free to reject plan sponsorship for almost any reason, “and often do so because of the funding costs, time, attention, and risks involved in the implementation and maintenance of a plan.”

Kovach believes that the recent popularity of cash or deferred arrangements points to an overall trend toward employee self-reliance. As support for this assertion, he notes that the new psychological contract has put employees in charge of their own development and has practically eliminated the expectation that an employee will remain with an employer until retirement. He therefore concludes that it is anomalous to allow retirement funding to remain under employers’

480. Kovach, supra note 149, at 437.
481. Id. at 420.
482. Id. at 435.
483. Id. at 409, 420.
484. Id. at 409.
485. Kovach, supra note 149, at 409.
486. Id. at 437.
487. Id.
control. Kovach advocates removing the burden of the pension access choice from employers and placing it directly on employees. He believes that “[s]hifting the burden of plan sponsorship would eliminate substantial complexity, because uncomplicated, self-funded IRAs already exist.” The only change he would require is raising the annual contribution limitation for IRAs from $3000 to a figure set somewhere between the $11,000 limitation under 401(k) plans and the $40,000 limitation on other tax-favored defined contribution plans.

Kovach even goes so far as to suggest that Congress abolish employer sponsorship of most tax-favored retirement plans. He believes this would place no hardship on employees, even if it meant that employer contributions otherwise paid under conventional employer-sponsored retirement plans would cease. Kovach argues that employees could command compensation equal to their former direct and deferred compensations, and replicate their former employer contributions to qualified retirement plans with substantial IRA contributions. In fact, he believes the system may be superior because employees would be empowered with complete economic freedom over their retirement income security.

Not everyone agrees with Kovach. Opponents note that while the new employment contract puts workers in charge of decisions affecting their career development and savings levels, there have been no fundamental changes that make individuals better equipped to manage security risks. Critics contend that employees still need protection through the pooling of risks, even in the area of savings for retirement. Opponents of Kovach draw opposite conclusions, believing that risk-pooling may be even more important today, because we are now more aware of increasing life expectancy and the need for major reserves during retirement.

488. Id. at 422-23.
489. Id. at 422.
490. Kovach, supra note 149, at 422.
492. Id.
493. Id. at 436.
494. Id.
495. Kovach, supra note 149, at 436.
496. EBRI NOTES 1996, supra note 84, at 2.
497. Id.
498. Id.
Pension research has also uncovered some patterns that are troubling for Kovach’s proposal. Statistics show that when individuals make their own retirement security decisions, they often do not make them wisely. When left to decide whether to participate in a 401(k) savings plan, more than one-third of workers decline to participate. Of those workers who changed jobs and took lump-sum distributions of their retirement accounts, nearly three-quarters failed to roll over these investments into another tax-qualified plan. Moreover, workers with the lowest income levels also have the lowest rates of savings participation and rollover. Eliminating a paternal stance on retirement savings would likely ensure that these individuals have inadequate retirement income.

Moreover, this article adds an additional challenge to Kovach’s proposal. His assertion that workers would be able to replicate employer contributions through an expanded IRA scheme may not be entirely correct. Employer contributions to qualified plans are not treated as wages subject to Social Security and unemployment taxes. Under Kovach’s scheme, employers would be subject to payroll taxes on this money and, therefore, would not be willing to pay the same amount to workers as under the current system. For employers to maintain expenses at current levels, employees would lose some portion of their current income, because the employer would pay that money to the government in the form of employer payroll taxes.

### B. Expanding Health Insurance Portability

As with pension portability, the health insurance portability problem might be solved “by completely unlinking health-insurance coverage from the employment relationship.” With one problem solved, however, we would be opening the door to several others. Any solution to health insurance portability will have to be implemented only after careful consideration of the distributional consequences and the risk that we may drive the health insurance industry out of business entirely.

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499. See generally WHITMAN, supra note 25.
500. Id. at 177.
501. Id.
502. Id.
503. LANGBEIN & WOLK, supra note 95 and accompanying text.
504. Id. at 270-71.
505. WHITMAN, supra note 25, at 174.
1. Government Provision of Health Insurance

“One mechanism for severing the tie between employment and health insurance would be some form of government-provided insurance financed by taxes and furnished as a matter of right to every citizen or resident." This option would achieve the goals of tying health insurance to an individual and alleviating job lock, while at the same time avoiding some insurance pitfalls (such as adverse selection) that would be associated with other proposals. The enormous costs of transitioning to such a system, coupled with the difficulties that other countries are experiencing with their national health-insurance schemes, make the likelihood of adopting such a scheme very small. Indeed, the failure of such a proposal in the early years of the Clinton administration makes it unlikely that government-provided health care will appear any time in the near future. Brown University political science professor Darrell West has analyzed the failure of the Clinton proposal, saying:

The problem with health care is that it's very easy to divide and conquer, just because people have such different interests and different fears and different experiences.

The fear was that we would end up with a lowest-common-denominator health-care system. In elevating the poorest elements within society, we might in the process lower the quality of the care received by others.

West believes that a real push for government reform will come when the middle class sees massive increases in health-insurance costs. Similarly, Katherine Stone of Cornell Law School predicts that if a large number of workers who formerly had employer-provided health insurance and pension no longer do, then it will be imperative to impose these obligations on the local, state, or federal government.

With the Patients’ Bill of Rights pending in Congress, there was

506. Id. at 175.
507. Id.
508. Ornstein, supra note 401, at 1H.
509. Id.
510. Stone, supra note 26, at 616-17.
recently fear that this could come to fruition sooner than we might have otherwise expected. More than one-third (36%) of U.S. employers surveyed by Hewitt Associates reported that they would probably drop health care benefits for their employees if provisions of the bill were enacted that would allow patients to sue their employer-sponsored health plans. The two versions of the bill currently pending, however, have adopted provisions allowing employers to avoid liability, thus averting the expected employer reaction and the potential crisis in the provision of health care.

Given the enormous complexity of government-provided health insurance and that Congress recently rejected a proposal to create such a system, this article does not dedicate any further discussion to it.

2. COBRA Expansion

Perhaps the least radical way to increase health care portability would be to remedy the deficiencies that exist in current portability legislation. For example, COBRA could be amended to increase the length of time that beneficiaries may purchase coverage, the law’s requirements could be extended to smaller employers, or the costs of COBRA coverage could be mitigated by government subsidies or tax incentives.

The problem with COBRA expansion is that it is an expensive proposition for employers. As discussed previously, due to adverse selection, those individuals who elect COBRA coverage are a higher risk population than the general workforce. Consequently, the average claims costs for employees with COBRA coverage are equal to 155% of the claims costs for active employees. Any expansion of COBRA, affecting either the size of the firm covered or the length of time that former workers are eligible for continuation coverage, would increase employer insurance costs. Other measures, such as subsidies or tax incentives for workers to elect COBRA coverage, would increase the percentage of eligible workers electing COBRA coverage. While this might reduce the degree of adverse selection if individuals at the margin

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513. TRACKING CHART, supra note 511.
514. EBRI, supra note 54, at 455.
now accept COBRA coverage, it would still drive up the overall claims costs for employers, especially those who are self-insured.  

Other changes to COBRA might help to alleviate the higher health care costs associated with continuation coverage. One option would be to allow workers to choose from plans that are similar to the current plan, but that are not as costly for the employer, such as plans with a higher deductible. Alternatively, allowing differential pricing based on the anticipated cost of the participant would also mitigate costs. For example, younger employees could be charged lower premiums based on their lower expected costs to the plan, thus helping to alleviate the adverse selection problem. Yet another option would be to amend the law to increase the premiums that COBRA beneficiaries may be charged, in order to ameliorate the higher level of claims costs associated with COBRA beneficiaries.

Each of the above options would have adverse consequences for mobile employees. However, if COBRA were to be expanded without accompanying measures to combat employer costs, employers may resort to ways to reduce, shift, or eliminate the impact of this increased cost. For example, employers may require active employees to make higher premium contributions, reduce or eliminate health care benefits for active employees to reduce COBRA continuation coverage, or reduce the size of the workforce eligible for health insurance benefits by substituting part-time for full-time employees. Other alternatives for employers include passing additional costs to workers in the form of lower pay increases or to consumers in the form of higher prices.

3. Internal Revenue Code Amendments

A second proposal for severing the tie between employment and health insurance is to expand the use of “privately paid personally owned health-care plans vested in the individual worker, which would follow the worker from job to job.” Marina v. N. Whitman suggests that the place to start is to amend the Internal Revenue Code to allow individuals to deduct the full cost of health insurance premiums. This

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515. *Fronstin Statement, supra* note 41, at 41.
516. *Id.*
517. *Id.* at 46-47.
518. *Id.* at 45.
519. *Id.* at 46.
520. *Fronstin Statement, supra* note 41, at 46.
522. *Id.*
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proposal would provide individuals more flexibility in selecting a health insurance plan, and would eliminate the need to work for an employer who sponsors a health insurance plan in order to receive full tax deductibility of premiums.

4. Employer-Driven Expansion—Defined Contribution Medical Plans?

Another possible solution is to do for health plans what employers have already done for pension plans—to offer them on a defined contribution basis. Although many human resources professionals secretly acknowledge that this idea is long overdue, most employers are presently afraid to implement it due to employee relations’ considerations. In the meantime, new companies are emerging in anticipation of this change, organizations are holding conferences to explore the possibilities, and employer groups such as the Washington Business Group on Health are forming employer groups to explore the future of employer sponsored health care.

523. Shari Caudron, Employee, Cover Thyself, 79 WORKFORCE 34 (Apr. 2000), http://www.workforce.com/archive/feature/00/04/58/. Because early critics of defined contribution health dubbed it a “benefits takeaway” and “cut and run” strategy, the term “defined contribution health plan” has strong negative connotations. Peter Mead, First-Generation DC Health Plans Continue Rollout, EMPLOYEE BENEFIT NEWS (Feb. 2001), at http://www.benefitnews.com/pvf.cfm?id=960. As a result, vendors have abandoned the title and are instead using terms such as “self-directed” or “consumer-driven.” Id. Vendors are also using such terms as “defined care” or “DC-squared” (which stands for defined contribution dot com). Sandy Lutz & Steven J. Henkind, The Web Fuels Interest in Defined Contribution, at http://www.definedcare.com/submit34.htm (last visited Oct. 11, 2001).

524. A list of such companies is available. See http://www.morehealthoptions.com (last visited Oct. 12, 2001).


526. E-mail from Lawrence M. Becker, Director of Corporate Benefits, Xerox Corporation (Aug. 30, 2001) (on file with the Hofstra Labor & Employment Law Journal).
a. How Defined Contribution Might Work

The idea of a defined contribution health insurance plan is not entirely new. Since the cafeteria plan was started in 1974, some employers have been giving workers a set amount of money annually with which to purchase health care coverage, and allowing employees to choose among several plans. In such arrangements, employees can purchase less expensive plans and use the remaining allowance to buy other benefits, or employees can take the cash. Alternatively, employees can add personal funds to the employers’ contributions to purchase more deluxe coverage.

A true defined contribution system, however, would take the cafeteria plan one step further. Instead of allowing employees to use their “benefits allowance” to choose one of several plans offered by the employer, this system would allow the employees to take the money and purchase any health plan they choose on the open market. Employees would then shop around for plans that meet their individual health needs. This system is based on the belief that consumers—not their employers—are in the best position to know what kind of health care they need and how much they want to spend for it.

b. Hurdles to Defined Contribution Plans

The defined contribution approach sounds simple in theory, but there are several problems that would have to be addressed before such plans could become a reality. “Redefining the deal with employees, consumerism is one of the driving forces behind the movement toward defined contribution health care. As one proponent of defined contribution health plans explained, ‘[h]ealthcare is a failed marketplace today, because the person paying the bill isn’t the one choosing the service.’ Jill Elswick, Business Models Emerge for Consumer-Driven Health Care, EMPLOYEE BENEFIT NEWS (Sept. 2001) [hereinafter Elswick, Business Models, Part 1], at http://www.benefitnews.com/health/detail.cfm?id=1773 (quoting Howard Wizig, Chairman of the Board for Vivias, Inc.). In addition to consumerism, other “[f]actors pushing the concept toward reality include rising health costs, . . . distrust of managed care, demographic shifts, the need for individualized approaches to health treatment and the emergence of e-health.” Jill Elswick, Some Say DC Health “Inevitable,” EMPLOYEE BENEFIT NEWS (July 2001) [hereinafter Elswick, DC Health], at http://www.benefitnews.com/pfv.cfm?id=1578.

527. See supra note 72 and accompanying text.
529. Id.
530. Id.
531. Caudron, supra note 523.
532. Id. This idea of consumerism is one of the driving forces behind the movement toward defined contribution health care. As one proponent of defined contribution health plans explained, “[h]ealthcare is a failed marketplace today, because the person paying the bill isn’t the one choosing the service.” Jill Elswick, Business Models Emerge for Consumer-Driven Health Care, EMPLOYEE BENEFIT NEWS (Sept. 2001) [hereinafter Elswick, Business Models, Part 1], at http://www.benefitnews.com/health/detail.cfm?id=1773 (quoting Howard Wizig, Chairman of the Board for Vivias, Inc.). In addition to consumerism, other “[f]actors pushing the concept toward reality include rising health costs, . . . distrust of managed care, demographic shifts, the need for individualized approaches to health treatment and the emergence of e-health.” Jill Elswick, Some Say DC Health “Inevitable,” EMPLOYEE BENEFIT NEWS (July 2001) [hereinafter Elswick, DC Health], at http://www.benefitnews.com/pfv.cfm?id=1578.
which has traditionally been more paternalistic, is going to have some hurdles.\footnote{533. Elswick, \textit{DC Health}, supra note 532 (quoting Ken Berkowitz, consultant with PricewaterhouseCoopers).}

One problem is maintaining the full tax deductibility of employer and employee premium contributions. Second, employers will have to develop systems to administer their benefit allowance payment and to provide employees with tools they need to make informed health care decisions. Third, a defined contribution system could make individual plan purchases exorbitantly high as employees shop in the individual, as opposed to the group, health insurance market. Fourth, employers and insurance underwriters would have to find alternative ways to calculate risks and combat adverse selection under this new scheme. Finally, the role that employers play as champions of high quality care and access could get lost in a defined contribution system. The following sections describe these problems, and ways that they may be overcome.

c. Leaping Hurdles Along the Path to Defined Contribution

While defined contribution health plans might not be fully feasible today, there are ways to counter the problems noted above and to continue moving toward defined contribution plans. As discussed in section IV.B.3., tax deductibility could be addressed through amendments to the Internal Revenue Code to make individual health insurance purchases fully tax deductible. Section 106 of the Code, however, appears to leave open the possibility of defined contribution plans even absent a Code amendment. Plan administration and providing employees with information can both be addressed via the Internet with the emergence of websites that address insurance plan selection and administration. The high costs of individual pricing could be addressed by mandating a system of community rating in premium pricing or by forming other types of purchasing groups. Adverse selection can be addressed by alternative methods of insurance risk adjustment. Finally, quality concerns (as well as cost and adverse selection concerns) can be addressed by allowing groups other than employers to act as employee advocates and exercise group purchasing power.
i. Maintaining Tax Deductibility of Premium Contributions

Even absent a change in the Internal Revenue Code, 26 U.S.C. § 106(a) appears to leave the door open for a defined contribution system. This section states: “General Rule. Except as otherwise provided in this section, gross income of an employee does not include employer-provided coverage under an accident or health plan.” This language has served to entrench our current system of health insurance provision, whereby the employer selects a policy or several policies and offers them to its employees on a pretax basis. As long as each individual employer is responsible for plan selection, an employee will almost certainly have to change health insurance plans when changing employers.

The statutory language, however, does not inevitably lead to this situation. This section’s accompanying regulations provide clarification, stating, “[t]he employer may contribute to an accident or health plan either by paying the premium (or a portion of the premium) on a policy of accident or health insurance covering one or more of his employees, or by contributing to a separate trust or fund.” This language diverts the focus of the tax advantage away from the fact that the insurance is provided by the employer, and instead focuses on the fact that the employer pays all or a portion of the insurance premium. The suggestion is that employees may be able to choose an individual health insurance policy in the market and maintain the tax advantage as long as the employer pays for a portion of it.

One obvious disadvantage of such a scheme would be the difficulty of administration. Employers would have to design a complex network of administration to verify that an employee is enrolled for coverage with the plan and to pay premiums to hundreds of different insurance carriers. Internet-based benefit administration companies, such as eBenX, would provide one way to meet this need. Founded in 1993 as a network management services provider, eBenX furnishes solutions to improve the efficiency of the procurement and administration of group health benefits. With custom electronic connections to health plans (collectively serving approximately 85% of the managed care enrollment in the United States), the company facilitates the flow of eligibility and

535. Id.
financial data between employers and health plans. In addition to software to facilitate enrollment and payment, the company provides consulting services, including health plan selection and contracting and performance management.

While today’s Internet and software applications may assist in this administration, an alternative solution may be to give the money directly to employees and allow them to make the premium payments. Although this may be an attractive alternative for employers, it is not without limitations. There is little case law to provide guidance, but the opinions interpreting this section of the Internal Revenue Code make it clear that payments made directly to an employee for the purchase of health insurance, “without any use restrictions” do not qualify for privileged tax status. The implication of this qualification, albeit in dicta, is that employer payments with use restrictions may qualify for preferred tax status. If that is the case, then perhaps employers could meet the “use restriction” requirement by creating a benefits system whereby employees are given money to purchase benefits via vouchers or debit cards.

ii. Administration and Tools for Informed Choice

As mentioned above, Internet companies are emerging that can assist employers with the complicated administration of a defined contribution system. Likewise, Internet companies are also developing websites that can assist employees in plan selection. eBenX is one such company, providing not only administrative services to assist employers, but also tools to help employees select the right insurance plan. Other websites are emerging, such as www.plansmartchoice.com, which are interactive and help employees to make insurance decisions based on their priorities, preferences, and tolerance for risk.

539. About eBenX, supra note 537.
540. See, e.g., Adkins v. United States, 882 F.2d 1078, 1080, 1081 (6th Cir. 1989).
541. Id. at 1080.
542. Dr. Sally Trude, a senior researcher at HSC, concurs that the use of vouchers can preserve the tax deductibility of employer contributions. See, e.g., Dr. Sally Trude, Overview of Defined Contributions, Address Before the Center for Studying Health System Change Conference (Oct. 10, 2000), in Defining “Defined Contributions”: New Directions for Employer–Sponsored Health Insurance?, at http://www.hschange.org/CONTENT/275/2.html.
543. About eBenX, supra note 537.
Lawrence Becker, Director of Corporate Benefits at Xerox Corporation, laments that “the market in general lacks the sophisticated tools to understand the products and services.” He notes that the complexity of issues like quality of providers, plan constructs, and the relative safety of various institutions all lead workers to leave these issues in the hands of their employers. “There are tools such as Consumers’ Digest for commodity purchases, but no such counterpart in the healthcare setting.” Becker notes further, however, that organizations “such as Leapfrog (www.leapfroggroup.org) and Planlinx (www.planlinx.com)” are developing systems to address some of these problems.

“To make the transition, employers will have to reposition themselves from health care benefits decision makers to health benefit decision enablers.” By partnering with organizations such as those listed above, employers may be able to administer defined contribution systems, while at the same time encouraging employees to become better health care consumers. Defined contribution advocates believe that “[b]y implementing defined contribution, combined with innovative Web technology,” costs can be driven down while employee satisfaction rises.

### iii. Addressing Costs Through Community Rating

One of the problems associated with individual health insurance purchases is that the price for an individual is much higher than that for a participant in a group health plan. This is not true, however, across all insurers or regions of the country. Some insurers or localities use community rating as the method of premium determination.

Community rating bases premiums on expected costs for all policyholders, with low-cost individuals or groups (e.g., young, healthy individuals) helping to fund participants requiring more extensive hospitalization services through a cross-subsidy of premium contributions. The practice of community rating is almost as old as health insurance itself, even dating back to Blue Cross’s first plan in

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544. E-mail from Lawrence M. Becker, Director of Corporate Benefits, Xerox Corporation (August 30, 2001) (on file with the Hofstra Labor & Employment Law Journal).
545. Id.
546. Id.
547. Id.
548. Lutz & Henkind, supra note 523.
549. Id.
The health care pricing system changed dramatically, however, with the appearance of commercial insurers. These insurers generally rejected community rating, and instead “employed experience rating under which the premium rate for each employer group was based on historic costs for that specific group.” Commercial insurance premiums thus became cheaper for employers than the community-rated Blue Cross and Blue Shield plans, because they offered low premiums to employers with groups of relatively healthy, low risk employees—a practice known as “cherry picking.” This system of experience rating contributes to employers’ ability to purchase health insurance plans at discounted prices. Today, many Blue Cross and Blue Shield plans have followed suit, departing from community rating and utilizing experience rating for large employee groups.

The practice of community rating has a history of Congressional support. Congress passed the Health Maintenance Organization Act of 1973 to “encourage the growth of HMOs” and to establish “requirements for an entity seeking designation as a federally qualified HMO.” One of the Act’s requirements was that federally qualified HMOs must community-rate their services. In 1988, however, amendments to the Act allowed employers to abandon community rating for negotiated group rates based on the expected costs of providing services to the employee group.

One way to maintain affordability of individual health insurance purchases would be to mandate a community-rated pricing system, perhaps by repealing these 1988 amendments to the HMO Act. This repeal would ensure that health insurance prices for all individuals would be the same, regardless of employment or health status, and would help to alleviate job lock as workers leave large employers for smaller employers or self-employment.

The key disadvantage of a community rating scheme is that it may promote adverse selection. In any scheme where young, healthy participants are partially funding older, less healthy participants, there will be an incentive for the former group to choose no coverage and pay

551. Id.
552. Id. at 238.
553. Id. at 239-40.
555. EBRI, supra note 54, at 237. “Under these requirements, HMOs must offer certain benefits and satisfy federal regulations for administrative, financial, and contractual arrangements.” Id.
556. Id. at 239.
557. Id.
for services as they receive them, since the anticipated cost of services would be less than the cost of purchasing insurance. This choice would leave only older and less healthy participants in the insurance pool, which would either reduce profits for the insurance company or increase premiums for the remaining participants.

iv. Combating Adverse Selection Through Risk Adjustment

Providing employees with unlimited choice in selecting health insurance plans will also exacerbate the problem of adverse selection. A new company in Cleveland, Ohio, may have found a solution to this adverse selection problem: risk adjustment.558 558

HealthSync is among the new companies in the emerging defined contribution market. Part of HealthSync’s strategy is a plan to combat the adverse selection problem by rearranging premium payments to reflect the true risk that an insurer faces.559 In HealthSync’s arrangement, the “price tags” that employees see for each insurance plan would be merely tools for collecting money on behalf of each employee to contribute to the employer’s plan account.560 The actual amount of the “price tag,” however, would not necessarily be transferred to the insurance plan in which the employee enrolled.561 Instead, once all of the contributions from an employer pool were consolidated into an employer plan account, HealthSync would analyze which employees selected what plan, and would assess the actual expected costs to the plan for each employee based on risk factors.562 Those plans that enroll older and less healthy employees would actually receive more money per employee from the pooled account than reflected in the price tag, while those plans that enroll younger and healthier employees would receive less in premium contributions than reflected in the price tag.563 This method would allow employees to select the health plan that best met their needs, and simultaneously protect the insurance carriers against the

558. Defining “Defined Contributions,” supra note 525. In an HSC conference, on October 10, 2000, HealthSync’s CEO, Ray Herschman, used the term “risk adjustment” when describing the company’s strategy for combating the adverse selection problem.
559. Id.
560. Id.
561. Id.
562. Id.
uncontrolled costs normally associated with adverse selection. By organizing workers into groups, such as employer affiliations, HealthSync will be able to analyze the real anticipated costs for each plan participant and compensate the insurance carrier accordingly, thus defeating the problem of adverse selection.

eBenX is developing an analogous plan to address adverse selection. The plan includes “sort[ing] participants according to 10 levels of health risk: the young and healthy in category 1, and older people with chronic ailments in 9 or 10.” The company will then “assign vouchers different values according to a person’s risk and invite insurers to bid for consumers in each category.” Thus, insurers will receive an amount in premiums equal to their actual expected costs for insuring each group, and will not suffer financial loss attributable to adverse selection.

v. Other Groups as Employee Advocates

Even if employers step out of their traditional role as employee advocates in the selection, design, purchasing, and monitoring of health insurance plans, there are other groups waiting in the wings that would like to fill this void. For example, employee benefit firms are emerging as a center for quality and price control. Other groups that have traditionally represented employee interests, such as unions, may also play a central role in the provision of health insurance. In addition, new groups are emerging that would like to represent employee interests in the health insurance arena.

1. Employee Benefit Firms

Frank McArdle, a principal at Hewitt Associates LLC, does not expect to see a defined contribution approach to health benefits any time soon. William Falk, a Towers Perrin principal, notes that simply providing employees with a “pot of money” is not the answer, because individuals have so few insurance coverage options. He believes that

565. See generally id.
566. Winslow & Gentry, supra note 528.
567. Id.
569. Id.
some group or organization, such as an employee benefit firm, needs to step in as an intermediary to provide benefits.\footnote{570}

In response to this call, approximately twenty vendors either presently operate in this market or were preparing for a launch by the close of 2001.\footnote{571} Eight of these vendors recently collaborated to form the Consumer Driven Health Care Association (CDHCA), an association working to raise the profile of defined contribution health plans and to reach agreement on terminology for describing it.\footnote{572} The CDHCA has already identified five distinct business models being used by companies in this market. These business models, and companies that use them, are described as follows:

1. Decision Support: The company provides online tools and personal assistance to help employees choose among multiple health plans that are priced by varying deductible levels.\footnote{573} Companies using this model include Definity Health, Lumenos, and Sageo.\footnote{574}

2. Benefit Design: The company encourages health care consumerism by requiring employees to make a broad variety of coverage decisions, such as choosing among hospitals, provider networks, pharmacy plans, alternative medicine coverage, vision care, and copay levels.\footnote{575} Companies using this model include Choicelinx and Destiny Health.\footnote{576}

3. Health Plan Catalog: The company requires employees to choose some level of health coverage, and employees may put the remaining funds into an accrual account to be used for any qualified medical expense.\footnote{577} Companies using this model include eBenX and MyHealthBank.\footnote{578}

4. Time-of-Need Network: The company offers products, such as negotiated discounts on dental and vision care, alternative therapies, pharmacy benefits, or infertility counseling to supplement traditional

\footnotesize{\begin{itemize}
  \item[570.] Id.
  \item[571.] Mead, supra note 523.
  \item[572.] Elswick, Business Models, Part 1, supra note 532.
  \item[573.] Id.
  \item[574.] Id.
  \item[575.] Id.
  \item[577.] Id.
  \item[578.] Id.
  \item[579.] Id.
\end{itemize}}
health insurance products. Companies using this model include HealthAllies and Healthmarket.

5. Advance Selection Network: The company allows consumers to build their own provider network by selecting a hospital and individual physicians before the time services are needed. Companies utilizing this model include Vivius and Buyers Health Care Action Group.

The variety among these business models illustrates that “'[d]efined contribution is simply a funding strategy,'” and that “[t]here’s no such thing as a defined contribution company.”

2. Unions

With the decline in the percentage of unionized employees, little attention has been paid to union efforts to address the portability issue. There are existing provisions in tax and benefit law, however, that enable unions to play a key role. Section 302(c)(5) of the Labor Management Relations Act of 1947 provides for the establishment of “multiemployer plans” to provide pension or welfare benefits (including health insurance) to employees on a tax-preferred basis. A multiemployer plan is one that covers the workers of two or more unrelated companies in accordance with a collective bargaining agreement. Multiemployer plans tend to be concentrated in those industries comprised of many small companies, each too small to justify an individual company plan. They are also found in industries where irregular employment and high mobility would result in few workers qualifying under an individual employer’s plan if one were to be established.

The American Nurses’ Association provides one example of a national union taking advantage of a multiemployer plan specifically to address the portability problem. In 1988, the union set up a national pension program designed to provide portable retirement benefits to

580. Id.
582. Id.
583. Id. (quoting Robert Christadore, President and CEO of Benefits Alliance).
584. EBRI, supra note 54, at 154.
586. EBRI, supra note 54, at 149.
587. Id.
588. Id. at 150.
589. Id.
nurses who were not vested in an employer-sponsored pension plan.\textsuperscript{590} The union designed this plan to address the high mobility characteristic of the profession, which prevented most nurses from remaining with an employer long enough to become vested. In the year before the plan was implemented, 55\% of full-time registered nurses had worked less than five years for their current employer.\textsuperscript{591} Also, nearly one-third of all registered nurses worked part-time and were rarely covered by pension plans.\textsuperscript{592} The plan consists of three savings plans for nurses who hold membership in state nurses’ associations.\textsuperscript{593}

The portability of multiemployer plans themselves is also on the rise. Congress recently decreased the maximum vesting requirements, from ten-year cliff vesting to either the five-year cliff vesting or seven-year graded vesting, to be consistent with all other ERISA-governed plans.\textsuperscript{594} Furthermore, international unions have been encouraging reciprocity agreements among multiemployer plans, allowing workers to shift from one employer to the next and among different plans without losing pension credits.\textsuperscript{595} Multiemployer plans therefore serve as a viable way to reduce the portability problem among unionized employees, and could perhaps serve as a selling point in union organizing efforts.

3. Employee Communities

Rachel Geman notes that “[t]he decline of union participation, the powerful status of the contemporary American corporation, and the tendency of legislative attention to focus on individual employee rights . . . have all combined to leave a void in employees’ proactive role in safeguarding and promoting their own rights.”\textsuperscript{596} She proposes that our current legal system be supplemented by legislative encouragement and support of employee communities.\textsuperscript{597} Geman criticizes our current system of employment-centered benefit provision, noting that “[e]mployees should have benefits that accrue to them because they are

\textsuperscript{590} National Voluntary Pension Program Offered by American Nurses’ Association, 15 Pens. & Ben. Rep. (BNA) 1789 (Oct. 17, 1988).
\textsuperscript{591} Id.
\textsuperscript{592} Id.
\textsuperscript{593} Id.
\textsuperscript{594} Yakoboski, supra note 71, at 3.
\textsuperscript{595} EBRI, supra note 54, at 153.
\textsuperscript{597} Id.
workers, not because they are workers for a given company. She believes that workers, not corporations, should be the starting point for making legislative decisions, and that “[a]s a means and as an end, the law must encourage worker self-help through community.”

Several such employee communities have been emerging that might serve as intermediaries for employees and provide benefits to workers generally. A description of two such communities follows.

a. Credit Unions

A recent editor’s note at Benefitnews.com highlighted the possibility that credit unions will enter the benefits delivery business. In some states, credit unions have already started offering supplemental insurance products to employers, such as cancer or dental insurance. At least two statewide credit union associations, one in Colorado and another in Kentucky, are considering pilot projects that could offer complete health insurance packages.

The Colorado Credit Union Association is planning its expansion into the benefits arena in anticipation that employers will eventually move to defined contribution health insurance. However, in some states, including Colorado, the law currently prevents affiliations other than employers from purchasing group health insurance plans. The Credit Union Association is teaming with the Colorado Bar Association to lobby for a change in this law.

The Kentucky Credit Union League has taken a different approach than group purchasing, and is pursuing self-insurance. The League plans to extend benefits to all credit union members.

598. Id. at 378.
599. Id. at 396.
600. Id. at 405.
601. Cosmos, supra note 568.
602. Id.
603. Id.
604. Id.
605. Id.
606. Cosmos, supra note 568.
607. Id.
608. Id.
b. Working Today

Working Today is an advocacy organization whose agenda is focused on developing a new labor infrastructure that responds to the changing organization of work and supports the mobile workforce. As part of this agenda, Working Today is developing a strategy that would link benefits directly to individual workers. One of the organization’s goals is to develop a Portable Benefits Fund that will deliver health insurance within the community-rated market, as well as retirement savings products, to independent workers. The aim of the Portable Benefits Fund is to create a new benefits delivery model for those workers who are not connected to a long-term employer. The organization’s goals, in creating this fund, are to:

Allow individuals to carry benefits with them from job to job;

Reduce insurance premium rates through product customization, group purchasing, and lower marketing costs;

Encourage long-term participation to counter adverse selection by creating incentives to stay within the fund, as well as by setting re-entry requirements for people who have dropped out of the fund; and

Link health insurance to a retirement-savings product.  

Recognizing that many workers are members of groups like professional organizations, unions, trade associations, or community and faith-based groups, the Portable Benefits Fund is built around this natural organization in the marketplace. A central aspect of the fund is an eligibility requirement that requires workers to either work in a selected industry, or to be linked to a partner organization, such as those listed above. The role of the intermediaries is to act as access points to

611. Id.
612. Id.
613. A list of Working Today’s partner organizations can be found at http://www.workingtoday.org/about/intermediaries.html (last visited Oct. 11, 2001).
the Portable Benefits Fund, acting both as a communication channel to inform members about the fund and as a means to counter adverse selection. A minimum of three months of organization membership is generally required before workers are eligible for fund participation.\[614\]

While the primary goal of the Portable Benefits Fund is to provide independent workers with access to high quality, affordable insurance and retirement savings products, a secondary purpose is to help strengthen those organizations that represent workers’ interests. Working Today hopes that this partnering strategy will enhance services for independent workers by taking advantage of group purchasing power, while simultaneously generating revenue to increase the self-sufficiency of groups that serve the mobile workforce. Working Today believes that these local groups can best meet freelancers’ other concerns, including career development, professional training, and networking.\[615\]

The pilot Portable Benefits Network launched on September, 2001\[616\] and was made available to independent workers in New York’s Silicon Alley (covering new media, traditional media, and high-tech industries).\[617\] The organization selected this population because it believes it is an ideal model of the new workplace and because the rate of uninsurance within this group is approximately 34%.\[618\] Furthermore, it wanted to pilot with a group where cross-subsidization across income lines would be possible and where some participants could partially pay for their premiums. Working Today believes this will better create the infrastructure necessary for controlling adverse selection, reducing administrative costs, and efficiently delivering insurance.\[619\] The infrastructure resulting from the pilot will later be leveraged for an expansion to low-wage workers.\[620\]

The Portable Benefits Network offers a multi-tiered product, to reflect the balance between choice and price demanded by those


\[616\] Id.

\[617\] Id.


\[621\] Id.

\[622\] Id.

\[623\] Id.
surveyed for the pilot. The design centers around a comprehensive HMO offered through HIP Health Plan of New York. Coverage includes doctor and specialist visits, prescription drug coverage, hospitalization, emergency room service, preventative dental coverage, and discounts on other dental work. The organization plans to eventually add an option to go completely out of the network for a higher deductible and co-insurance. The goal is to create a product with considerable choice while maintaining an affordable premium.

The Portable Benefits Network also bundles health insurance products with other services to reduce plan turnover and to create incentives for continuous participation. It includes a retirement savings product, as well as group-rate disability and life insurance. Working Today anticipates that if the Silicon Alley pilot is successful, it will serve as a model for insuring the uninsured working poor. The organization’s aim is not to replace the employer-based insurance market, but to supplement it with a delivery system for health insurance for the individual market that reduces adverse selection, encourages broad participation, and results in more affordable premiums for all.

PART V: CONCLUSION

Having completed a survey of employee benefit portability, it must be concluded that employee benefit portability has been steadily increasing over the last several decades, both as a result of portability-enabling legislation and because of changes in the offerings of employer-sponsored benefits.

Although employee benefit portability has been on the rise, we have not yet achieved full portability. Employees who change retirement plans still suffer from “portability loss” due to vesting requirements, the failure to index benefits for inflation, and back-loaded defined benefit

624. Id.
626. Id.
628. Id.
629. Id.
632. Id.
formulas. While remedying these problems is possible, the result would have distributional implications for workers and cost implications for employers. An alternative solution, the expansion of IRAs, would place responsibility for retirement savings completely in the hands of employees, who have consistently done a poor job of handling their own retirement accounts.

Likewise, health insurance remains a major cause of job lock for employees. Job change often entails a lack of health insurance during an unemployed job search or a waiting period for coverage with the new employer, and typically requires a change in health plans, premium contributions, covered benefits, and physicians. True health insurance portability will not be possible unless we vest health insurance in the individual worker, perhaps by creating defined contribution health insurance plans. Before these plans can become a reality, systems must be developed to enable tax-deductibility, administer enrollment and premium payments, ensure that employees are making informed choices, lower the costs of individual health insurance premiums, combat adverse selection, and ensure continued health plan quality. Third-party intervention appears to be the solution to these problems, with employee benefit firms, unions, or some other independent organization playing an intermediary role.

Moreover, it is important to note that achieving pension and health insurance portability still may not eliminate the job lock phenomenon. Employers offer other benefits that employees value and that may act as a barrier to job change. COBRA does not provide portability of most other employer-sponsored benefits, nor does HIPAA’s pre-existing condition limitation apply to other valuable benefits like life insurance or long-term disability plans.

A portability solution is difficult to select for two interrelated reasons. First, choosing a solution involves difficult questions about the costs and distributional effects of changes in the portability rules. Second, choosing a solution is difficult because any portability changes affect not only the ability of employees to transfer benefits, but also the calculation employers and insurance companies make when deciding whether to offer insurance benefits at all.

Each improvement for a

634. Willborn, supra note 112, at 345.
635. Id.
636. Id.
mobile worker has the potential to result in a corresponding cost increase to employers, insurers, or long-service employees, or to lead to the elimination of that benefit offering altogether. Before making any further advances toward true portability, it will be necessary to consider carefully the ramifications of that decision, and to take the course of action that will result in a net gain to employees.