

GAO

Report to the Chairman, Committee on  
Transportation and Infrastructure,  
House of Representatives

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August 1998

# RAILROAD RETIREMENT

## Enhancing Portability Would Raise Cost and Policy Concerns



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**General Government Division**

B-279596

August 10, 1998

The Honorable Bud Shuster  
Chairman, Committee on Transportation  
and Infrastructure  
House of Representatives

Dear Mr. Chairman:

The Railroad Retirement program was established in 1937 and is among the older retirement programs for private sector employees in the United States. In 1997, the program had about 254,000 active participants and provided pension benefits to about 742,000 retirees, spouses, and survivor and disability annuitants. Over the past 30 years, the railroad industry has experienced extensive downsizing. Also, about 60 percent of employees who begin railroad service leave the industry with less service than they need to qualify for a pension under the program. As a consequence, there has been discussion of possible legislation to enhance the portability of Railroad Retirement benefits.<sup>1</sup>

In accordance with your request that we study the portability of Railroad Retirement benefits, our objectives were to determine

- which, if any, Railroad Retirement benefits are portable;
- what changes could be made to the Federal Employees' Retirement System (FERS) that might enhance the portability of Railroad Retirement benefits into FERS for former railroad employees who secure federal civilian employment and the cost and administrative implications of those changes for FERS and whether such changes could be made cost-neutral to FERS; and
- what changes could be made to Railroad Retirement that might enhance the overall portability of its retirement benefits and what are the cost and administrative implications of these changes for Railroad Retirement.

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<sup>1</sup>While analysts have used several definitions of portability, in this report, portability refers to an employee's capacity to retain retirement benefits when leaving one employer and going to the next in a manner that generally maintains the value of those benefits until retirement. However defined, portability can be achieved in a variety of ways depending on how a retirement plan is designed.

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## Background

Railroad Retirement is a multiemployer defined benefit (DB) plan for railroad employees.<sup>2</sup> It is sponsored by interstate and other types of railroads and their affiliates that are engaged in railroad-connected operations as well as employer associations and national labor organizations and their subordinate units. Although the program's retirement benefits generally are determined through collective bargaining agreements, the program is governed by the Railroad Retirement Act of 1974, as amended, and administered by the Railroad Retirement Board (RRB), an independent agency of the federal government. The program is not subject to the Employee Retirement Income Security Act of 1974 (ERISA), as amended, and thus railroad employees are not covered by ERISA requirements designed to protect the pension benefits of most private sector employees.

Railroad Retirement benefits are provided in the form of a pension that is based on two formulas—known as Tier I and Tier II.<sup>3</sup> The first-tier formula, which takes into account both railroad service and nonrailroad service covered by Social Security, provides benefits that are equivalent to what would be provided by Social Security. The second-tier formula, which takes into account railroad service only, provides additional benefits and is comparable in design to other private sector DB plans, according to RRB. However, Railroad Retirement provides certain benefits not generally provided under pension systems, including Tier II benefits for spouses and survivor Tier II benefits without an offset in the employee's benefit. Regarding post-retirement benefit increases, the Tier I portion is increased automatically in the same way that Social Security benefits are increased. The Tier II portion is normally increased annually at 32.5 percent of the increase in living costs owing to inflation as measured by the Consumer Price Index (CPI).<sup>4</sup>

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<sup>2</sup>A multiemployer plan is one to which more than one employer is required to contribute under one or more collective bargaining agreements. A DB plan is one in which retirement benefits are computed on the basis of a formula generally reflecting years of service, or a percentage of salary, or both. In contrast, the retirement benefits for a defined contribution (DC) plan depend upon the amounts contributed to an employee's individual account and the investment experience of that account.

<sup>3</sup>In addition to these basic benefits, a federally funded added benefit is paid to the one-fourth of railroad retirees whose dual entitlement to Railroad Retirement and Social Security benefits was established before 1975. Railroad employees may also receive a supplemental annuity if at retirement they have (1) attained age 65 with 25-29 years of railroad service or age 60 with 30 years of service; (2) worked in the industry before Oct. 1, 1981; and (3) maintained a current connection with the industry, that is, worked in the industry for at least 12 of the 30 months preceding their retirement.

<sup>4</sup>The CPI is compiled by the Bureau of Labor Statistics and is intended to measure the average change in prices paid by urban consumers for a fixed market basket of goods and services.

Railroad Retirement benefits are financed primarily through payroll taxes, which are deposited in Railroad Retirement trust funds.<sup>5</sup> Tier I payroll taxes are the same as those for Social Security; for 1998, employers and employees are assessed 6.2 percent of pay on wages up to a maximum annual wage ceiling of \$68,400.<sup>6</sup> Tier II payroll taxes in 1998 are 16.1 percent for employers and 4.9 percent for employees, and they are assessed on wages up to a maximum of \$50,700. Both the Social Security and Tier II wage bases are adjusted annually for economywide increases in wages. Tier II tax rates are higher than employer and employee contributions to private sector DB plans.<sup>7</sup> According to an official of the Employee Benefit Research Institute, private sector employers that sponsor DB plans contribute 3 percent of payroll, on average, and most employees make no contribution to fund plan benefits.

Former railroad employees who secure federal civilian employment would most likely also be covered by FERS—the federal retirement program nearly all new civilian employees must join. FERS provides benefits from three sources: a basic pension (a DB plan), Social Security, and the Thrift Savings Plan (TSP)—a DC plan much like private sector 401(k) plans. Starting at age 62, FERS pensions are to be increased automatically each year according to the CPI, unless inflation is greater than 2 percent. When inflation is between 2 and 3 percent, the adjustment is limited to 2 percent; and if inflation is 3 percent or more, the adjustment is limited to the CPI minus 1 percent.

FERS benefits are funded through various agency and employee contributions, which are deposited in the Civil Service Retirement and Disability Trust Fund (CSRDF) that is administered by the Office of Personnel Management (OPM). In 1996, agencies and employees contributed 11.4 and 0.8 percent of pay, respectively, to cover the cost of FERS pension benefits in addition to the 6.2 percent each paid in Social Security payroll taxes.<sup>8</sup> FERS also requires that agencies make automatic

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<sup>5</sup>The Tier I trust fund is technically known as the Social Security Equivalent Benefit Account, and the Tier II trust fund, as the Railroad Retirement Account. Funds that are not used to pay current benefits are invested in nonmarketable Treasury securities in the same manner as other federal trust funds, including Social Security. In contrast, other private sector DB plans invest these contributions in assets such as marketable stocks and bonds and are managed by fiduciaries for the exclusive benefit of plan participants as required by ERISA.

<sup>6</sup>Employers and employees are also assessed 1.45 percent of pay on unlimited wages for Medicare hospital insurance.

<sup>7</sup>On this point, see *Railroad Competitiveness: Federal Laws and Policies Affect Railroad Competitiveness* (GAO/RCED-92-6, Nov. 5, 1991).

<sup>8</sup>Agencies and employees also contributed 1.45 percent of pay for Medicare hospital insurance.

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contributions of 1 percent and matching contributions of up to 4 percent on voluntary employee contributions to employees' TSP accounts.

National trends toward increased workforce mobility and the aging of the baby boom generation have focused greater attention on retirement issues in recent years, including the portability of retirement benefits. In this regard, portability can be more easily achieved in DC than DB plans. For DC plans, employees own or are immediately vested in any contributions they make to their own retirement accounts, as well as any investment earnings or losses associated with those contributions. Employees also generally become vested in employer contributions to their accounts and any associated earnings or losses within 5 to 7 years. Thus, an employee who separates can either withdraw his or her vested account balance as a lump-sum payment or preserve the benefits by rolling the account over into an individual retirement account or a new employer's plan, if allowed.

For DB plans, portability depends on the way in which vesting and service credit provisions, if any, are designed and whether the vested benefits of separated employees are deferred. For DB plans other than Railroad Retirement, employees are immediately vested in their own plan contributions, plus interest, and become vested in employer-provided benefits within 5 to 7 years. When an employee separates, vested DB benefits can be withdrawn as a lump-sum payment; however, more commonly, plans require that these benefits be deferred until the point at which the separated employee would have become eligible to retire under the plan and begin receiving benefits.<sup>9</sup> If payment of vested benefits is deferred for many years, the value of those benefits may be eroded by the effects of inflation during the pre-retirement period. Indexation to protect the value of such benefits by increasing the value of the employee's final wages (i.e., wage indexation) is rare because it is expensive.

DB plan benefits can also be made portable through the transfer of service credits, where service under one employer is counted by a subsequent employer in determining retirement benefits under the more recent employer's retirement program. Although some private sector multiemployer plans and some state and local governments allow for the transfer of service credit, most do not because of concerns about

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<sup>9</sup>According to a 1993 U.S. Department of Labor survey of medium and large private sector establishments, less than 0.5 percent of full-time employees with a defined benefit plan had an option to cash out vested pension benefits valued at more than \$3,500. (Employee Benefits in Medium and Large Firms 1991 and 1993, U.S. Department of Labor, Bureau of Labor Statistics (Washington, D.C.: 1994)).

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differences in plan design and benefit levels and who would pay the potential increase in retirement costs.

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## Results in Brief

Under the Railroad Retirement program, Tier I and Tier II benefits are fully portable within the railroad industry; the benefits that employees earn from one railroad employer can be carried to the next employer without any reduction in value. Tier I benefits are also portable outside the industry; railroad employees can convert their Tier I benefits into Social Security benefits and vice versa. Tier II benefits, however, are less portable outside the industry; railroad employees must have at least 10 years of railroad service to establish their right to Tier II benefits (i.e., become vested), and the receipt of any benefits must be deferred until the time that the employee would have become eligible to retire under the plan. Although the Railroad Retirement program provides for indexing wages for inflation that occurred during the pre-retirement period, this provision applies only to former railroad workers who secure employment at selected federal agencies that are responsible for federal railroad policies.

For former railroad workers who secure federal civilian employment, the portability of Tier II benefits could be enhanced if they could be converted into FERS pension benefits. Such a conversion could be accomplished by counting railroad service credit earned under Railroad Retirement as FERS service credit. However such an arrangement could increase federal retirement costs, which raises the question of how such costs would be paid. The arrangement would be cost-neutral to the CSRDF only if any increased costs were paid in full by the railroad industry, the former railroad employees, or a combination of the two. According to OPM analysis, per-person lifetime costs could be high. However, its analysis also suggests that the aggregate cost probably would not be high if the number of employees involved was small. According to OPM, the agencies that hire former railroad employees and OPM would both experience modest increases in administrative costs because they would need to record and verify employees' railroad service and calculate the cost of crediting railroad service into FERS on a case-by-case basis.

Although it believes the administrative burdens of adding a railroad service credit provision to FERS would be manageable, OPM has consistently objected to proposals that would extend service credit for work that was not covered by the Civil Service Retirement System (CSRS) or FERS, especially if such work was performed in the private sector. Consistent

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with that view, OPM strongly opposes adding a railroad service credit provision to FERS, because even if it were designed to be cost-neutral, such a provision would be inconsistent with the intent of FERS and set a troublesome precedent for other private sector employees to seek similar treatment.

The portability of Tier II benefits could also be enhanced by reducing the required vesting period for railroad employees—for instance, from 10 to 5 years—which would make more railroad employees eligible to receive deferred benefits, and/or by providing for a lump-sum payment of nonvested employee contributions upon separation. Under either option, according to an RRB actuary, the impact on Railroad Retirement trust fund assets, outlays, and receipts would be less if the option applied only to benefits earned by current or future employees. Because either of these options could increase benefits for some employees, their adoption would also increase Railroad Retirement costs. Currently, any increases in benefit costs are borne by the railroad industry, and they can be passed on in whole or in part to railroad employees through increased Tier II payroll taxes and/or reductions in other employee benefits or compensation. RRB officials told us that the Board would experience increases in administrative costs but that they would be manageable.

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## Scope and Methodology

As described in more detail in appendix I, to respond to your request, we reviewed our prior work, analyzed retirement literature on portability, and interviewed railroad and federal civilian retirement specialists and other retirement experts. We worked with an OPM retirement benefits specialist, RRB actuaries, and a Congressional Research Service (CRS) specialist in social legislation to (1) identify changes to FERS and Railroad Retirement that might enhance portability and (2) gain an understanding of the cost and administrative implications of such changes. The examples of cost increases presented in this report illustrate increases that might occur if the portability changes that we examined were enacted. More precise estimates would require detailed information on the design of any particular policy change and the specific requirements for its implementation.

We requested comments on a draft of this report from the Director of OPM and the Chair of RRB. These comments are discussed at the end of this letter. We did our review in Washington, D.C., from February 1998 to June 1998 in accordance with generally accepted government auditing standards.



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## Railroad Retirement Benefits Are More Portable Within the Industry Than Outside It

The portability of Railroad Retirement benefits depends on whether an employee changes employers within the industry or leaves the industry for nonrailroad employment. If the employee continues doing railroad work, then Tier I and Tier II benefits are fully portable, regardless of how many times the employee changes employers. Outside the industry, the employee's Tier I benefits are portable into nonrailroad employment; however, the portability of Tier II benefits depends on the employee's status concerning vesting and other factors specific to Railroad Retirement.

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## Tier I and Tier II Benefits Are Portable Within the Industry

Multiemployer plans such as Railroad Retirement are more portable than other types of DB plans because if an employee changes employers within the plan, any accumulated retirement benefits are transferred from the prior employer to the new employer—usually as credited service. The Railroad Retirement program has a service credit arrangement within the industry, and thus, a railroad employee who switches employers experiences no loss in retirement benefits as long as the employee eventually obtains the 10 years (120 months) or more of total railroad service that is required for vesting. Moreover, the 120 months need not be consecutive, and one full month is credited for each month in which any amount of service is compensated by a participating railroad employer.

In practical terms, service crediting may have diminished in value owing to a decline in railroad employment opportunities. According to RRB, about 60 percent of employees who begin railroad service leave the railroad industry with less than 10 years of service. Moreover, railroad employment has declined from more than 1.2 million in 1955 to less than 260,000 in 1997. Although railroad employment trends may have stabilized in recent years, a smaller number of job opportunities remains an important indicator that an employee who loses one railroad job may not be able to find another or return to the railroads after a period outside the industry.

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## Outside the Industry, Tier I Benefits Are Portable to Any Employment Covered by Social Security

Outside the industry, Tier I benefits are portable to any employment covered by Social Security and vice versa. A combined total of at least 10 years (or 40 quarters or 120 months) of railroad employment or nonrailroad employment covered by Social Security, or both, is required to establish eligibility for either Tier I or Social Security benefits. Wage information and service credits that are used to compute retirement benefits are entirely transferable between the two programs, and the

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benefits that a retiring employee would receive are comparable under either program as well, other factors being equal.

To illustrate, if a railroad worker retired from the railroads with at least 10 years of railroad service, any wage information and service credits earned under Social Security from prior nonrailroad employment would be transferred to RRB and used to compute the employee's Tier I benefits. Similarly, if a railroad employee separated without accumulating 10 years of railroad service, RRB would transfer Tier I wage information and service credits to the Social Security Administration to be used in computing any future Social Security benefits.

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## Tier II Benefits Are Less Portable Outside the Industry

Outside the industry, Tier II benefits are less portable than Tier I benefits because of Railroad Retirement's stringent vesting and forfeiture rules and the fact that Tier II service credits are not transferable to nonrailroad employers. As described earlier, private sector plan participants become fully vested in DB plan benefits within 5 to 7 years, while railroad employees must have 10 years of railroad service to vest in their Tier II benefits.<sup>10</sup> Railroad employees who are not vested also forfeit their Tier II employee contributions at separation.<sup>11</sup> ERISA, as amended, requires other private sector employers to return such employee contributions even for those employees who separate before they are vested. Similarly, federal employees who are covered by CSRS or FERS can withdraw their contributions upon separation other than retirement, regardless of their vesting status, as can many state and local government employees.

Tier II benefits are also less portable because any vested Tier II benefits must be deferred upon separation. It is difficult to generalize about the financial consequences of deferring benefits because the impacts vary depending on the length of the pre-retirement period and the rate of inflation over that same period. However, the impacts could be substantial if inflation rates were high and/or many years passed before the separated employee began to draw benefits. According to a Hay/Huggins analysis of private sector plans, up to two-thirds of the average loss in the value of

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<sup>10</sup>The Social Security program also has a 10-year (40 quarters) vesting requirement.

<sup>11</sup>As noted in the background section of this report, the contributions technically are mandatory payroll taxes imposed by the Railroad Retirement Tax Act.

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deferred retirement benefits could be eliminated if vested benefits were indexed for inflation.<sup>12</sup>

Railroad Retirement does have a wage indexation feature for certain Tier II deferred benefits. In particular, any former railroad employee who secures employment at one of five federal agencies—Department of Transportation (DOT), RRB, Surface Transportation Board (STB), National Mediation Board, and National Transportation Safety Board (NTSB)—would have his or her deferred Tier II pension benefits indexed for inflation in the same way that Social Security benefits are indexed for changes in wages.<sup>13</sup> However, if that employee separated from the federal agency before retirement, then Tier II benefits would not be indexed.

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### **Crediting Railroad Service Into FERS Could Enhance Tier II Portability, but Could Increase FERS Costs**

Crediting railroad service as federal service under FERS could enhance the portability of Tier II benefits by allowing former railroad workers who secure federal employment to effectively convert their Tier II pension benefits into FERS pension benefits. However, adding a railroad employment service credit provision to FERS could increase FERS costs as well as raise policy and administrative issues.

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### **Crediting Railroad Service Into FERS Could Increase FERS Costs**

Although transferring service credits across DB plans can be complicated to implement, conceptually it involves little more than totaling the employee's years of service under both a former and current plan when calculating the employee's pension under the current plan. Following this logic, a provision could be added to FERS to allow railroad service to be credited when computing a FERS pension for former railroad employees who secure federal employment and become covered by FERS.

Extending service credit for railroad employment in this way could increase FERS retirement costs. Any such increased costs would be borne by the federal government unless the added costs were not paid from the CSRDF. The amount of any increase would depend on how many former railroad employees would actually become FERS participants, the number of those who would elect the service credit, and the characteristics of these employees (e.g., their railroad salary and work histories).

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<sup>12</sup>Hay/Huggins Company, *The Effect of Job Mobility on Pension Benefits*, prepared for the U.S. Department of Labor, Pension and Welfare Benefits Administration (Washington, D.C.: July 1988), p. viii.

<sup>13</sup>For more information on Railroad Retirement wage indexation, see 20 CFR ch. II, sections 226.60 and 226.63.

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At our request, an OPM retirement specialist prepared cost estimates to illustrate the potential per-person lifetime cost increase for three hypothetical employees, using various assumptions about age, salary, and service that the Federal Railroad Administration (FRA) believed represented a realistic range of former railroad employee circumstances. The calculations were present-value calculations and assumed that all of the former railroad employees began their FERS-covered employment at a GS-12, step 1 federal pay grade and had a normal salary progression thereafter.<sup>14</sup> The OPM specialist used this starting pay grade because FRA told us that virtually every former railroad employee who has been hired by FRA has started at that grade, including those who had earned substantially more from the railroads. The results varied depending on the employees' salaries, length of service, and age at retirement.

For example, according to OPM's calculations, the cost of a FERS pension could increase by about \$34,000 for a 35-year-old railroad employee who had a railroad salary of \$40,000 and 6 years of railroad service, a beginning federal salary of \$47,066, and retired at age 56 after reaching the FERS minimum retirement age. The cost could increase by about \$53,000 if the same employee worked until he or she reached age 62 and became eligible to retire with unreduced benefits. The cost could increase considerably more for senior employees who received higher salaries during their railroad employment than during their federal employment. For example, the cost could increase by as much as \$148,000 for a 50-year-old railroad employee who had a railroad salary of \$60,000 and 15 years of railroad service, a beginning federal salary of \$47,066, and retired at age 62.

Although OPM's illustrations suggest that per-person lifetime costs could be high, the aggregate cost probably would not be if the number of employees involved was small. On this point, more than 1.6 million employees are covered by FERS, but only about 2,600 employees in all work for the five federal agencies that would most likely attract former railroad employees. Moreover, these five agencies made very few new appointments in 1997, ranging from 6 at STB to 100 at NTSB. The number of former railroad employees involved might be even smaller than these statistics suggest. The OPM specialist with whom we worked said that if given the choice, former railroad employees who secure employment at any of the five agencies might decide not to transfer their railroad service into FERS. Because their Tier II pension benefits would be indexed at retirement, these employees might be better off by drawing separate Tier II and FERS

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<sup>14</sup>This cost calculation—the actuarial present value of the increase in FERS pension benefits—equals the amount of money that, with interest, would fully fund the additional retirement benefits an employee would receive above those earned while a federal employee.

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pensions. However, as the specialist also noted, if extending FERS service credit for railroad employment was made available to former railroad employees who secured employment in any federal agency, the number of employees who elected the service credit might increase, and as a consequence, so might the costs.

The only way that adding a railroad service credit provision would be cost-neutral to FERS would be if the increase in FERS retirement costs attributable to the change was not paid from the CSRDF. One arrangement that could serve as a cost-neutral model was applied to employees of non-appropriated fund instrumentalities (NAFI)—organizations that generally provide morale and welfare support services to the military, such as military exchanges. Under section 1043 of the National Defense Authorization Act of 1996,<sup>15</sup> FERS and NAFI employees of the Department of Defense or Coast Guard who met certain conditions after December 31, 1965, and before August 10, 1996, were allowed to credit all of their federal civilian service—both as NAFI employees or employees covered by FERS—toward a single pension. In practice, the credit could be combined under either FERS or NAFI. The opportunity to elect the transfer of service credits into FERS expired August 11, 1997.

The railroad industry and each employee who elected the credit could together be required to pay the full actuarial cost of that portion of his or her FERS pension benefits attributable to railroad employment, similar to the arrangement for NAFI employees. As the illustrative examples described earlier suggest, however, the costs that would need to be paid could be considered high, perhaps too high to be paid as a lump-sum by an individual employee. As an alternative, cost-neutrality could also be accomplished by requiring a transfer of the employee and employer retirement contributions, plus interest, from Railroad Retirement trust funds to the CSRDF. Similar to the NAFI approach, if the amount transferred was insufficient to cover the full cost of the increase in the employee's FERS pension, the employee could be required to pay any remaining cost. Rather than having the employee make a cash deposit to meet such a shortfall, OPM could make up the difference by making an actuarial reduction in the amount of the employee's monthly FERS pension equaling the present value of the difference.

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## Policy and Administrative Issues Could Arise

Because they would need to collect and verify the railroad service of each employee who elected the credit, OPM and the agencies that hire former

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<sup>15</sup>Public Law 104-106, Feb. 10, 1996.

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railroad employees could experience some increase in administrative costs if a railroad service credit provision were added to FERS. In addition, OPM would need to determine the actuarial cost of crediting the employees' railroad service into FERS. OPM officials told us that the increased administrative costs would be manageable, largely because they expect that the number of employees who would elect the credit would be small.

OPM has consistently objected to proposals to extend service credit for work that was not covered by CSRS and FERS, especially if it was performed in the private sector. As far back as 1969, the Civil Service Commission opposed extending service credit to state employees who were involved in federal grant activities. Although federal funds might have been involved, the Commission asserted that the programs were state functions and that the employees engaged in their administration were selected, employed, and supervised by states or their instrumentalities. Accordingly, OPM concluded that CSRS' effectiveness as a retirement system would be severely reduced if it was to become a pension plan for numerous types of nonfederal service and that allowing individuals with such service to credit that service into CSRS would inevitably generate pressures for extending credit for almost any type of nonfederal work.

We prepared several letters on the same issue, the most recent one at the request of the Chairman of the House Committee on the Post Office and Civil Service.<sup>16</sup> Our letters recognized that the proposed amendment involved a matter of policy for the determination of Congress; however, they also recognized certain problems. In particular, they noted that any amendment to existing law that would permit the crediting of nongovernment service for civilian retirement purposes appeared to be inconsistent with the concept that an employee's retirement annuity will be based upon, and will vary in proportion to, the length of civilian government service rendered. The letters also concluded that the amendment would impose a financial burden upon the federal government not contemplated under basic retirement law and suggested that if credit was to be extended, action should be taken to prevent any increase in the unfunded liability of the retirement trust fund.

In 1986, OPM criticized provisions of the proposed Railroad Service Retirement Credit Act that would have granted retroactive railroad service credit into the now-closed CSRS to former railroad employees who had secured employment at DOT, Interstate Commerce Commission, National

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<sup>16</sup>Letter from the Comptroller General of the United States to the Chairman, House Committee on Post Office and Civil Service (B-84843, Apr. 10, 1969). This letter references three earlier GAO letters.

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Mediation Board, NTSB, or RRB. Under that proposal, an employee who elected service credits would have been required to deposit into the CSRDF an amount equal to the difference between his or her retirement contributions under Railroad Retirement and the amount the employee would have contributed under CSRS if he or she had been covered by that program during the years of railroad service. OPM opposed the legislation, in part because the deposit would be substantially less than other covered employees would have contributed to the CSRDF. OPM also asserted that there was no justification for granting civil service retirement credit for private sector work and expressed strong concern that once the threshold of extending coverage for nonfederal service was crossed, it would be difficult to exclude employment in other sectors having needed expertise or a special relationship with the government.

In interviews for this report, OPM officials told us that OPM would strongly oppose adding a railroad employment service credit provision to FERS.<sup>17</sup> OPM's rationale continues to be that providing credit for railroad service would be inconsistent with the intent of FERS and would create a troublesome precedent. As OPM has stated, FERS was designed to be a staff retirement program, providing deferred compensation benefits to employees based on the service that they perform while federal employees. Under the basic FERS statute, only service that was performed while an employee was covered under FERS would be credited in computing a FERS pension.

However, past amendments to the CSRS statute provided for certain service credits and have applied to employees covered by FERS under limited circumstances. Specifically, there were 16 types of service for which federal civilian retirement credit could be granted, including work performed while a VISTA (Volunteers in Service to America) or Peace Corps volunteer; Nurse Cadet; U.S. Capitol Guide; or NAFL employee.<sup>18</sup> A review of the terms under which credit for these services has been provided shows that although the work is not federal employment because there was no appointment to the civil service by a federal official, in most cases the work served a federal purpose.

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<sup>17</sup>In testimony on June 24, 1998, OPM reiterated its opposition. See Federal Employees Integrity, Performance, and Compensation Improvement Act, Janice R. Lachance, Director, Office of Personnel Management. Statement before the Subcommittee on Civil Service, Committee on Government Reform and Oversight, U.S. House of Representatives.

<sup>18</sup>According to an OPM official and 5 U.S.C. section 8411, these services are creditable under FERS only if (1) a deposit was made and (2) the service was performed before Jan. 1, 1989, except for service as a full-time volunteer or volunteer leader with the Peace Corps or VISTA, which could be performed at any time before separation.

These election opportunities were available for a limited time and applied retrospectively only to past service performed by an individual who had since become a federal employee covered by CSRS or FERS. Currently, the only creditable service not performed while under FERS is military service and service performed under the Foreign Service Pension System. In no case has service credit been allowed for private sector service.

## Changing Vesting and Contribution Forfeiture Rules Might Enhance Portability, but Railroad Retirement Costs Might Increase

The overall portability of Railroad Retirement Tier II benefits outside the industry could be enhanced in several ways. First, Tier II vesting requirements are stringent compared with requirements under ERISA. By allowing a 5-year rather than 10-year vesting period, more separated employees might receive deferred Tier II retirement benefits. Second, as Railroad Retirement is currently designed, a separated employee who is not vested forfeits not only any accrued plan benefits but also his or her own contributions. If these contributions were returned, they could be reinvested to provide additional assets in retirement.

Railroad Retirement costs could increase if the vesting and forfeiture changes were adopted, but the amount of the increase could be small. At our request, RRB actuaries prepared illustrative estimates of these costs. The results of their analysis showed that if the vesting requirement was reduced from 10 to 5 years, there would be little difference in trust fund assets, outlays, and receipts. Annual outlays for program benefits and administration would increase by about \$14 million more (or 0.26 percent) by 2022—if 5-year rather than 10-year vesting was used.<sup>19</sup> As for trust fund balances, at the end of 1998, the Tier II trust fund asset balance was projected to be \$14.2 billion. Under both 5-year and 10-year vesting, this balance would grow to a high of \$18.7 billion in 2009 and then decline to about \$9 billion in 2022.<sup>20</sup>

Reducing the vesting requirements would have no effect on Tier II payroll taxes. Because Tier II benefits would increase, federal income taxes on these benefits would increase, and such taxes are paid to the Railroad Retirement Account. Finally, with or without the change in vesting rules, tax revenues into the account are projected to decline from 88 to

<sup>19</sup>RRB actuaries told us that annual outlays for program benefits would be projected to increase by about \$232 million (or 2.23 percent) by 2071, and the Tier II balance would be \$19.3 billion less, which would be a 25 percent reduction. The actuaries calculated that the \$19.3 billion reduction could be offset through an additional 0.1 percent increase in Tier II payroll taxes.

<sup>20</sup>In 2022, the Tier II fund balance under 5-year vesting would be about \$131 million less than under 10-year vesting—which represents a 1.5 percent reduction.



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65 percent of Railroad Retirement benefits and administration costs between 1998 and 2022.

Regarding the potential cost of forfeiture rule changes, the RRB analysis showed that if lump-sum payments equal to contributions plus interest had been paid to employees who separated in 1995 and who were not vested, program costs in that year would have increased by \$31.7 million—\$23.9 million for contributions and \$7.8 million for interest. Excluding interest from these payments would reduce costs by about 25 percent. The annual cost of providing refunds to separating employees in future years would depend on how many employees would separate from the railroad industry and the amount employers contributed toward the Tier II benefit.<sup>21</sup>

According to RRB officials, if either or both of the potential changes were adopted, the Board's administrative burdens would also increase but they would be manageable. The changes would require substantial software modifications in application processing, calculation, recordkeeping, and edits.

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## Conclusions

Our work has shown that it would be possible to enhance the portability of Railroad Retirement benefits; however, the changes that we considered might not be desirable for cost, administrative, and policy reasons. If a service credit provision was added to FERS, it would be cost-neutral from the federal government's perspective only if the costs were paid in full by the former railroad employees or the railroad industry or a combination of the two. If the required vesting period under Railroad Retirement were reduced and/or the contributions of nonvested employees were provided to them in a lump-sum payment upon their separation, the costs would be borne by the railroad industry and/or other railroad employees.

Under the assumption that the number of former railroad employees that federal agencies would hire is limited, the aggregate administrative costs for agencies that might be involved—including OPM, RRB, and the hiring

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<sup>21</sup>A somewhat different perspective on the potential per-person costs—and benefits from the employee's perspective—is provided by comparing the amounts that currently would be forfeited by employees with different work histories. Of the 8,872 employees who separated in 1995 and were not vested, 7,381 separated with between 1 and 59 months of service and forfeited contributions averaging \$1,952 per employee (\$1,577 excluding interest). The 1,491 employees with between 60 and 119 months of service forfeited an average of \$11,582 per employee (\$8,235 excluding interest). The average amount of payroll tax contributions, plus interest, attributable to the 8,872 employees who separated during 1995 with between 1 and 119 months of service was about \$3,571 per employee (\$2,696 excluding interest).

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agencies—would be manageable if one or all of the changes were adopted, according to the OPM and RRB officials with whom we talked.

Although a change to FERS could be made cost-neutral from the perspective of the CSRDF and the administrative costs could be manageable, according to OPM officials, any change to existing law to permit the crediting of nongovernment service for civilian retirement purposes would be strongly opposed by OPM. And as we have said in the past, such a change would appear to be inconsistent with the fundamental concept of CSRS and FERS that an employee's retirement benefits, exclusive of Social Security, will be based on the years of his or her CSRS or FERS government service. Such a change could set a precedent for other private sector employees to seek similar treatment.

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## Agency Comments and Our Evaluation

We requested comments on a draft of this report from OPM and RRB. We received oral comments from RRB's Deputy General Counsel. RRB agreed with the contents of the draft report and offered several technical and clarifying comments, which we incorporated where appropriate.

We received written comments from the Director of OPM, which stated that the report effectively evaluated the cost and policy implications if provisions governing CSRS or FERS were amended to allow crediting Railroad Retirement as a means of enhancing portability. The letter, which is reproduced in appendix II, reiterated OPM's opposition to such a change.

We are sending copies of this report to the Ranking Minority Member of your Committee, the Director of OPM, and the Chair of RRB. Copies of this report will also be sent to other parties interested in railroad retirement matters and will be made available to others upon request.

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Major contributors to this report are listed in appendix III. If you have any questions, please call me at (202) 512-8676.

Sincerely yours,

A handwritten signature in black ink that reads "Michael Brostek". The signature is written in a cursive style with a large, stylized initial "M".

Michael Brostek  
Associate Director, Federal Management  
and Workforce Issues

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## Abbreviations

AAR	Association of American Railroads
CPI	Consumer Price Index
CRS	Congressional Research Service
CSRDF	Civil Service Retirement and Disability Trust Fund
CSRS	Civil Service Retirement System
DB	Defined benefit
DC	Defined contribution
DOT	Department of Transportation
ERISA	Employee Retirement Income Security Act of 1974
FERS	Federal Employees' Retirement System
FRA	Federal Railroad Administration
NAFI	Non-appropriated fund instrumentalities
NTSB	National Transportation Safety Board
OPM	Office of Personnel Management
RRB	Railroad Retirement Board
STB	Surface Transportation Board
TSP	Thrift Savings Plan
UTU	United Transportation Union
VISTA	Volunteers in Service to America

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# Objectives, Scope, and Methodology

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## Objectives

The Chairman, House Committee on Transportation and Infrastructure, asked us to provide information on the portability of Railroad Retirement Program benefits and the potential for enhancing that portability. This review was undertaken in response to that request. The objectives of our review were to determine

- which, if any, Railroad Retirement benefits are portable;
- what changes could be made to the Federal Employees' Retirement System (FERS) that might enhance the portability of Railroad Retirement benefits into FERS for former railroad employees who obtain federal civilian employment and the cost and management implications of those changes for FERS and whether such changes could be made cost-neutral to FERS; and
- what changes could be made to Railroad Retirement that might enhance the portability of its retirement benefits and the cost and management implications of such program changes for Railroad Retirement.

Portability refers to an employee's ability to retain retirement benefits when leaving one job for another while maintaining the value of those benefits until retirement.

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## Scope and Methodology

To determine which, if any, Railroad Retirement program benefits are portable, we first reviewed our prior work and retirement literature and interviewed experts at the Employee Benefit Research Institute, Watson-Wyatt Worldwide, Office of Personnel Management (OPM), Congressional Research Service (CRS), Railroad Retirement Board (RRB), Association of American Railroads (AAR), and the United Transportation Union (UTU) to determine what portability means and how retirement program features can help to achieve it. We then reviewed RRB documents and provisions of the Railroad Retirement Act, as amended. We compared program features regarding eligibility for benefits to the ways in which such features could be designed to enhance portability as determined through our literature review and discussions with experts. We confirmed our understanding of what and how Railroad Retirement features enhance or limit portability with officials at RRB, CRS, and OPM.

To identify changes to FERS that could enhance the portability of the Railroad Retirement program benefits into FERS and develop information on any associated costs and the policy and management implications of the changes, we worked with retirement policy specialists at OPM and CRS. In collaboration with these specialists, we used feasibility and

cost-neutrality as our criteria for selecting changes to FERS. Using these criteria, we selected a transfer of service credit approach, which was similar to transfers of service credit commonly described in the literature on multiemployer defined benefit (DB) plans and could be cost-neutral to FERS.

To understand the potential increase in retirement costs from a service credit arrangement, we developed illustrative examples for three hypothetical employees, using information provided by the Federal Railroad Administration that represented former railroad employees. To calculate what the full actuarial cost would be if those employees purchased service credits under FERS, OPM used different salary and service histories for each. We did not determine how or what funds might be transferred from the Railroad Retirement fund to the Civil Service Retirement and Disability Trust Fund to help fund the purchase.

To identify changes to Railroad Retirement that might enhance the portability of its retirement benefits and the cost and management implications of the changes, we interviewed private sector, RRB, and CRS retirement experts to determine the most feasible changes. We focused on Tier II benefits because Tier I benefits are equivalent to what would be provided by Social Security if an employee left the railroad industry and thus are portable. First, we identified the Railroad Retirement provisions that affected portability. On the basis of our review, we selected changes in vesting and forfeiture rules, because these are the features that most limit the portability of Tier II benefits. We worked with the RRB actuary and a CRS specialist in social legislation to develop a methodology for estimating the potential cost of a shorter vesting period and more liberal forfeiture rules. The RRB actuary projected the cost of 5-year vesting on Railroad Retirement over 25 years and compared it to the projected cost under 10-year vesting required by current law. These projections allowed us to compare alternative trust balances, payouts, and income.

We also worked with the RRB actuary to estimate the potential cost of requiring that employees who are not vested receive lump-sum payments of their own contributions, with and without interest, at the time of separation. We estimated the costs for 1995 because it was the most recent year for which data were available. The actuary estimated the cost of refunds by determining the number of employees and the aggregated amount of the employee contributions with and without interest in excess of Social Security for employees who (1) separated in 1995; (2) had not died or retired; (3) were not on the retirement rolls in 1996; and (4) had

between 1 and 59 service months (0 to 5 years), between 60 and 119 service months (more than 5 but less than 10 years), and between 1 and 119 service months (0 to almost 10 years). He then calculated the average amount of forfeited contributions with and without interest for these groups of employees. The forfeited contributions for the group with between 0 and almost 10 years of service served as an estimate of the costs of immediate vesting of employee contributions. The average forfeiture of contributions in the other groups showed how the length of service affected the average amount forfeited per employee.

As agreed with Committee staff, we developed information on portability primarily as it relates to DB plans, because Railroad Retirement is a DB plan. Also as agreed, we only examined portability changes prospectively.

In the case of FERS, the term prospective means that the change would apply only for employees who obtained federal employment after the portability service credit change was adopted. We did not consider any changes to FERS that would be applied retroactively for former railroad employees who were already federal employees and covered by FERS as of the date the option would be adopted. In the case of changes to Railroad Retirement, the term prospective means that the option would generally apply for all railroad employees who were employed within the industry as of the date the option would be adopted. If any of the changes—whether to FERS or Railroad Retirement—would be applied retroactively, they potentially would be much more costly. The information that we developed on the potential costs of portability enhancements should be viewed as illustrative, because more precise estimates of costs would require detailed information on the design of the portability enhancement and how it would be required to be implemented.

We did not independently verify any of the estimates made by OPM or RRB actuaries.



# Comments From the Office of Personnel Management



OFFICE OF THE DIRECTOR

UNITED STATES  
OFFICE OF PERSONNEL MANAGEMENT  
WASHINGTON, DC 20415-0001

JUL 20 1998

Mr. Michael Brostek, Associate Director  
Federal Management and Workforce Issues  
United States General Accounting Office  
General Government Division  
Washington, D.C. 20548

Dear Mr. Brostek:

Thank you for the opportunity to review the proposed draft report entitled "Railroad Retirement: Enhancing Portability of Benefits Is Possible But May Not Be Desirable".

I believe the report effectively evaluates the cost and policy implications if the provisions governing the Civil Service Retirement System (CSRS) or the Federal Employees Retirement System (FERS) were amended to allow Railroad Retirement credit as a means of enhancing portability. The Office of Personnel Management is opposed to any effort to extend CSRS or FERS credit to individuals who are employed in the private sector. Such a provision would violate the most basic principle underlying CSRS and FERS: that they are programs through which the Government, as an employer, provides retirement benefits for its own employees.

Again, thank you for the opportunity to provide comments.

Sincerely,

A handwritten signature in cursive script that reads "Janice R. Lachance".

Janice R. Lachance  
Director

# Major Contributors to This Report

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**General Government  
Division**

Margaret T. Wrightson, Assistant Director  
H. John Ripper, Evaluator-in-Charge

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