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Railroad Retirement: Legislation in the 107th Congress

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Summary

The Railroad Retirement system provides retirement and disability benefits to more than 673,000 eligible railroad employees and their dependents. Both the 105th and 106th Congresses examined proposals to modify the current system. Legislation (H.R. 180, H.R. 1140, and S. 697) was introduced in the 107th Congress to effect broad changes to the current system. On July 31, 2001, H.R. 1140 was passed by the House of Representatives (384-33). Both the House of Representatives and the Senate passed H.R. 10 which incorporated H.R. 1140 as substitute text. On December 21, 2001, the legislation was signed into law by the President as Public Law 107-90. This report summarizes the provisions of the Railroad Retirement and Survivors' Improvement Act of 2001 (P.L. 107-90), and will not be updated.

The Railroad Retirement System

Qualified railroad workers receive retirement and disability annuities and unemployment and sickness benefits under the Railroad Retirement Act and the Railroad Unemployment Insurance Act. These are federal entitlement programs administered by an independent federal agency, the Railroad Retirement Board (RRB). In FY2000, $8.3 billion in retirement and disability annuities was paid to 673,000 recipients and $78.8 million in unemployment/sickness benefits was paid to 36,600 recipients.[1]

Railroad retirement and disability annuities consist of so-called tier I and tier II benefits. Tier I benefits are computed using the Social Security benefit formulas and are based on earnings credits covered by the Railroad Retirement system and other jobs covered by the Social Security system. Employers and employees pay tier I payroll taxes equivalent to Social Security taxes (6.2% each, on earnings up to $84,900 in 2002). A

[1] For a more detailed description of the rail industry's retirement and unemployment programs, see CRS Report RS20408, *Railroad Retirement and Unemployment Benefits: A Fact Sheet*, by Rachel W. Kelly.

financial interchange takes place each year to balance the benefits paid and taxes received by the Railroad Retirement and the Social Security trust funds. The Social Security Equivalent Benefit Account receives the financial interchange transfers from the Social Security trust funds.

Tier II benefits are based only on service in the rail industry and are similar to benefits paid by private sector industrial pension programs. Employer and employee tier II tax rates were 16.1% and 4.9%, respectively, on earnings up to $59,700 in 2001. Tier II tax proceeds are deposited in the Railroad Retirement Account. Railroad employers also finance a supplemental annuity for employees hired before October 1, 1981. In 2001, the supplemental annuity tax was currently 26 cents per work hour per employee. Retirees who were eligible for both Railroad Retirement and Social Security before 1975 also receive a monthly dual benefit payment. The Railroad Retirement Act specifically exempts benefits paid by the Railroad Retirement Board from state and local tax.

Recent Proposals to Change the Railroad Retirement System

The Railroad Retirement system has been amended many times since federal benefits were first paid in 1936. Most changes to the program (except for those changes identical to those made to Social Security) have originated in collective bargaining agreements between rail labor and management. In general, Congress examines possible modifications in terms of their adequacy and fairness regarding the industry, present and former workers, and taxpayers before amending either the Railroad Retirement Act or the Railroad Unemployment Insurance Act.

The 105th Congress examined the adequacy of Railroad Retirement benefits for widow(er)s. Under current law, a widow(er) receives the higher of 100% of the employee's tier I annuity or the spouse's own Social Security benefit plus 50% of the employee's tier II annuity payable at the time of death. Proponents of expanding the widow(er)s' benefit argue that the current benefit causes a large reduction in family income following a railroad employee's death, and is often inadequate. In the 105th Congress, concurrent resolutions H.Con.Res. 52 and S.Con.Res. 80 urged rail labor, management, and retirees to negotiate an improvement to these benefits. In January 2000, a coalition of organizations representing rail labor and management reached an agreement on an extensive package of changes, which was much broader than modification to widow(er)s' benefits recommended in the concurrent resolutions.

In the 106th Congress, the Railroad Retirement and Survivors' Improvement Act of 2000 (H.R. 4844) was based on this agreement. H.R. 4844 was passed by the House of Representatives. Though the Senate Committee on Finance favorably reported the bill (S.Rept. 106-475), it was not considered by the Senate as a whole.

Legislation (H.R. 180, H.R. 1140, and S. 697) containing similar provisions as those in the House-passed version of H.R. 4844 was introduced in the 107th Congress. On July 31, 2001, the Railroad Retirement and Survivors' Improvement Act of 2001 (H.R. 1140 as amended) was passed by the House of Representatives (384 -33). The Senate passed legislation (H.R. 10 as amended) with the same provisions as the House of Representatives-passed version of H.R. 1140 on December 5, 2001 (90 to 9). On

December 11, 2001, the House of Representatives agreed to the Senate's amendments to H.R. 10 (369-33) and it was signed into law by the President on December 21, 2001.

Main Provisions of the Railroad Retirement and Survivors' Improvement Act of 2001 (P.L. 107-90)

Summary

The Railroad Retirement and Survivors' Improvement Act of 2001 (P.L. 107-90) makes a number of changes to the current Railroad Retirement system. In sum, the act expands benefits for the widow(er)s of rail employees, lowers the minimum retirement age at which employees with 30 years of experience are eligible for full retirement benefits, reduces the number of years required to be fully vested for tier II benefits, repeals a maximum limitation on benefits, expands the system's investment authority, and phases in changes to the tier II tax structure. This report details the provisions of P.L. 107-90.

The Congressional Budget Office (CBO) completed a pay-as-you-go estimate for P.L. 107-90.[2] CBO estimates the net effect of the legislation will be to decrease the budget surplus by $7.9 billion over the 2002-2011 period. A table detailing the costs of the provisions of P.L. 107-90 appears at the end of this report.[3]

Amendments to the Railroad Retirement Act of 1974

Expanded Widow(er)s' Benefits. In keeping with the concurrent resolutions introduced in the 105th Congress, P.L. 107-90 changes the tier II benefit formula calculation for widow(er)s. Under current law, a widow(er)'s tier II annuity is generally equal to 50% of the employee's tier II benefit payable at the time of death. The Railroad Retirement and Survivors' Improvement Act of 2001 guarantees widow(er)s 100% of the tier II annuity to which the employee was entitled at the time of the death. The provision is effective on the first day of the first month that begins more than 30 days after enactment (February 1, 2002).

Unreduced Retirement Benefits at Age 60 with 30 Years of Employment. Under current law, the tier I benefits for early retirees are permanently reduced and no cost of living adjustments are received until age 62. The Railroad Retirement and Survivors' Improvement Act of 2001 allows employees with 30 years of rail industry employment (and their spouses) to retire at age 60 with unreduced tier I and tier II annuities. This provision applies to annuities awarded on or after January 1, 2002. Effective January 1, 2002, an age reduction for spouse annuities will still apply for a tier I annuity if it is derived from the records of an employee whose annuity was awarded before the effective date.

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[2] U.S. Congressional Budget Office (CBO) Pay-As-You-Go Estimate of H.R. 10, Railroad Retirement and Survivors' Improvement Act of 2001. January 16, 2002.

[3] Section 105(c) of P.L. 107-90 directs that all purchases of non-Treasury securities made by the Railroad Retirement Investment Trust will not be counted as outlays for budgetary purposes, but as an exchange of assets of equal value.

Liberalized Vesting. The Railroad Retirement program is not subject to the Employee Retirement Income Security Act of 1974 (ERISA). ERISA, which covers most private sector employee benefit plans, requires vesting after 5-7 years of employment. Under current law, rail employees must have 10 years (120 months) of creditable railroad service to be considered vested and fully eligible for benefits. Employees who are not vested before they leave the rail industry forfeit their tier II contributions.

Effective January 1, 2002, the Railroad Retirement and Survivors' Improvement Act of 2001 reduces the vesting requirement for retirement annuities from 10 years to 5 years of post-December 1995 employment. The 10-year vesting requirement for disability annuities is not affected by this provision. Employees with at least 5 years of post-December 1995 service, but less than 10 years of total service, may be eligible for a tier I disability annuity if their combined Railroad Retirement and Social Security earnings credits would satisfy Social Security eligibility requirements. The spouses, divorced spouses, and survivors of an employee with at least 5 years of rail employment since December 1995, but not a total of 10 years, are eligible for a tier I annuity if they would have been entitled to a Social Security benefit based on combined service.

Repeal of the Railroad Retirement Maximum Benefit. The total amount of monthly Railroad Retirement benefits payable to an employee and spouse at the time the employee's annuity begins is limited, based on the average of the 2 highest years of creditable Railroad Retirement/Social Security covered earnings in the 10 year period ending with the year the employee's annuity begins. This maximum is adjusted annually for cost of living increases. However, the maximum benefit cannot be less than $1,200/month and generally applies only at the time of the initial award. P.L. 107-90 eliminates the maximum benefit limitation, effective January 1, 2002. Benefit payments will be recalculated prospectively for individuals whose annuities were previously reduced due to the maximum.

Investment of Railroad Retirement Assets. Under current law, the RRB has the authority to invest funds not needed immediately for benefit payments or administrative expenses in interest-bearing U.S. government or U.S. government-guaranteed securities. The RRB's Investment Committee provides advice regarding investment decisions.

The Railroad Retirement and Survivors' Improvement Act of 2001 establishes a National Railroad Retirement Investment Trust. The Trust will not be considered a government agency and it will be administered by a Board of Trustees. P.L. 107-90 specifies the District of Columbia as the legal domicile for the Trust. The Board of Trustees will have seven members: three chosen by and representing the interests of rail labor, three chosen by and representing the interests of rail employers, and one chosen by the majority of the other 6 members and representing the general public. The trustees will have experience and expertise in the management of financial investments and pension plans. Five members of the Board of Trustees must be present to conduct business. The adoption of investment requirements requires unanimity, while all other decisions require a majority vote.

With the assistance of independent advisors and investment managers, the Board of Trustees will invest assets, pay administrative expenses, and transfer funds to the disbursing agent responsible for benefit payments. The Board of Trustees is subject to reporting and fiduciary standards similar to the ERISA standards. The Railroad

Retirement Board may bring civil action against the Trust if any provisions of the Railroad Retirement Act are violated.

As a result of P.L. 107-90, the Board of Trustees will have the authority to invest trust funds in non-governmental assets, such as equities and debt. In addition to the option of purchasing insurance for individual trustees, every trustee and person who handles trust fund property and assets must be bonded. An independent qualified public accountant will annually audit the financial statements of the trust fund. A management report will be submitted each fiscal year to Congress, the President, RRB, and the Office of Management and Budget. The provisions of this section are effective on the first day of the first month that begins more than 30 days after enactment (February 1, 2002).

Abolition of the Supplemental Annuity Account. P.L. 107-90 eliminates the Railroad Retirement Supplemental Annuity Account. Effective January 1, 2002, the Railroad Retirement Board will determine the balance in the Supplemental Annuity Account and direct the Secretary of the Treasury to transfer the funds to the Railroad Retirement Investment Trust, which will pay out future benefits.

Transfer Authority. Effective January 1, 2002, the Railroad Retirement Board will determine the portion of the Railroad Retirement Account not needed to pay current administrative expenses and direct the Secretary of the Treasury to transfer that amount into the Railroad Retirement Investment Trust, which will transfer the necessary amount of funds to pay benefits and related administrative expenses to the disbursing agent.

Social Security Equivalent Benefit account funds not needed to pay current benefits also will be transferred to the Trust. However, these funds will be used only to pay benefits or to invest in U.S. government or government-guaranteed securities. The amount necessary to make dual benefit payments will be transferred from the Dual Benefit Account to the disbursing agent. The Board of Trustees will consult with the Secretary of the Treasury to develop an appropriate method for transferring or converting existing account obligations.

Average Account Benefits Ratios. Beginning in 2003, P.L. 107-90 requires the RRB to calculate the ratio of assets to benefits to determine annual tier II tax rates for employers, employee representatives, and employees. If the average account benefits ratio, based on the ratios for the 10 most recent fiscal years is above six, tax rates will decrease according to an established schedule. If the ratio is below four, employer and employee representatives' tax rates will increase according to a set schedule.

Amendments to the Internal Revenue Code of 1986

Tax Exempt Status. P.L. 107-90 exempts the Railroad Retirement Investment Trust from taxation.

Repeal of Supplemental Annuity Tax. Under current law, employers pay a supplemental annuity tax (26 cents/hour/worker) that finances a benefit for long-time rail employees. P.L. 107-90 repeals this tax, effective for all calendar years after December 31, 2001.

Tier II Tax Rate Adjustments. Under P.L. 107-90, employers' tier II tax rate, 16.1% in 2001, will be 15.6% in 2002, 14.2% in 2003, and in the years after 2003 will follow a tax rate schedule based on the 10-year average account benefit ratio. Depending on the average account ratio described above, the tier II tax rate will range from 8.2% to 22.1%. Employee representatives' tax rate, 16.1% in 2001, will be 14.75% in 2002, 14.2% in 2003, and will then follow the same tax rate schedule as the employer schedule. Rail employees' tier II tax rate will remain at the current level of 4.9% for 2002 and 2003 at which point it will be determined annually based on the account benefit ratio. The new employee tax rate may range from 0% to 4.9%. No later than December 1 of each year, the Secretary of the Treasury will publish tax rates for the following year. This section was effective December 31, 2001.

Table 1. Summary of Congressional Budget Office (CBO) Pay-As-You-Go Estimate of the Railroad Retirement and Survivors' Improvement Act of 2001

Provision	CBO cost estimate for 2002-2011
Changes in direct spending	**Increases direct spending by $3.9 billion**
Expanded widow(er)s' benefits	Increases direct spending by $957 million
Unreduced retirement benefits at age 60 with 30 years of employment	Increases direct spending by $2.8 billion
Liberalized vesting	Increases direct spending by $6 million
Repeal of railroad retirement maximum	Increases direct spending by $182 million
Changes in revenues	**Decreases revenues by $4.0 billion**
Repeal of supplemental annuity tax	Decreases revenues by $749 million
Tier II tax rate adjustments	Decreases revenues by $3.2 billion