



FROM THE DESK OF

**V. M. SPEAKMAN, JR.
LABOR MEMBER**



U.S. RAILROAD RETIREMENT BOARD

V. M. Speakman, Jr.

For Publication
March 2002

Financing Changes to the Railroad Retirement System

In addition to amending benefit provisions of the Railroad Retirement Act, the Railroad Retirement and Survivors' Improvement Act of 2001 (P.L. 107-90) significantly revised the financing of the railroad retirement system through provisions for the investment of railroad retirement funds in non-governmental assets, adjustments in the payroll tax rates paid by employers and employees, and the repeal of a supplemental annuity work-hour tax. The following questions and answers provide information on the changes effected by the new law.

1. How is the railroad retirement system funded?

Payroll taxes paid by railroad employers and their employees are the primary source of funding for the railroad retirement system. Coordinated with social security taxes, tier I railroad retirement payroll taxes are at the same rate as social security taxes, while tier II taxes are set at rates considered necessary to finance railroad retirement benefit payments over and above social security levels.

Other sources of income include a financial interchange with the social security trust funds, revenues from Federal income taxes on railroad retirement benefits, appropriations from general treasury revenues provided after 1974 as part of a phase-out of certain vested dual benefits, and earnings on investments.

2. How is the financing of the railroad retirement system changed by the new law?

The new law allows greater latitude in the investment of railroad retirement assets. Under prior law, the investment of funds not needed immediately for benefit payments or administrative expenses had been limited to interest-bearing securities restricted to obligations of the U.S. Government, obligations guaranteed as to principal and interest by the U.S. Government, or other obligations that are lawful investments for trust funds.

(More)

The new law provides for the transfer of railroad retirement funds from the Railroad Retirement Account and the Social Security Equivalent Benefit Account to a new National Railroad Retirement Investment Trust, whose Board of Trustees is empowered to invest Trust assets, other than assets transferred from the Social Security Equivalent Benefit Account, in non-governmental assets, such as equities and debt, as well as in governmental securities.

3. Will the new National Railroad Retirement Investment Trust be a Federal body and who will serve as its Trustees?

The National Railroad Retirement Investment Trust will not be treated as an agency or instrumentality of the Federal Government. Its Board of Trustees will be comprised of seven members: three members selected by rail labor to represent the interests of labor; three members selected by rail management to represent the interests of management; and one independent member selected by a majority of the other six members. The Trustees will be appointed only from among persons who have experience and expertise in the management of financial investments and pension plans. The members shall be appointed for three-year terms. However, the initial labor and management members will be divided into three groups, with one group appointed for a one-year term, one group for a two-year term, and one group for a three-year term.

The Trustees are authorized to retain independent advisors to assist in the formulation and adoption of investment guidelines; retain independent investment managers to invest the assets of the Trust in a manner consistent with such investment guidelines; and invest assets of the Trust, pursuant to such guidelines.

4. Will the new National Railroad Retirement Investment Trust be subject to the Employee Retirement Income Security Act (ERISA)?

The Trustees are subject to reporting and fiduciary standards similar to ERISA requirements with respect to fiduciaries of private employee pension benefit plans. However, no rules similar to the funding requirements of ERISA and related provisions apply to the Trustees, the Trust, or Trust assets.

5. How did the financing provisions of the new law affect the tier II payroll tax rates paid by employers, employee representatives and employees?

The new law reduced the tier II tax rates on rail employers, including rail labor organizations, in calendar years 2002 and 2003, and beginning with 2004 provides automatic adjustments in the tier II

tax rates for both employers and employees. It also repealed the supplemental annuity work-hour tax rate paid by employers and employee representatives, beginning with calendar year 2002.

The tier II tax rate on rail employers was reduced from 16.10 percent to 15.60 percent in 2002 and to 14.20 percent in 2003, but the tier II earnings base was not changed; and for 2002, that amount remains at \$63,000. The tier II tax rate for rail employee representatives is 14.75 percent in calendar year 2002 and 14.20 percent in 2003. An employee representative is a labor official of a non-covered labor organization who represents employees covered under the Acts administered by the Railroad Retirement Board.

While there is no change in the tier II tax rate of 4.90 percent on employees in the years 2002 and 2003, beginning with the taxes payable for calendar year 2004, tier II taxes on both employers and employees will be based on an average account benefits ratio. Depending on the average account benefits ratio, the tier II tax rate for employers will range between 8.20 percent and 22.10 percent, while the tier II tax rate for employees will be between 0 percent and 4.90 percent.

6. What is the average account benefits ratio and, in basic terms, how will this mechanism work?

As defined in the new law, the “account benefits ratio” is, with respect to any fiscal year, the amount determined by the Railroad Retirement Board by dividing the fair market value of the assets in the Railroad Retirement Account and of the National Railroad Retirement Investment Trust (and for years before 2002, the Social Security Equivalent Benefits Account) as of the close of such fiscal year by the total benefits and administrative expenses paid from the Railroad Retirement Account and the National Railroad Retirement Investment Trust during such fiscal year. If the ratio is not an exact multiple of 0.1, it is raised to the next highest multiple of 0.1.

Likewise, the term “average account benefits ratio” means, with respect to any calendar year, the average determined by the Secretary of the Treasury of the account benefits ratios for the 10 most recent fiscal years ending before such calendar year.

On or before November 1, 2003, the Railroad Retirement Board is to compute the account benefits ratio for each of the most recent 10 preceding fiscal years and certify those ratios to the Secretary of the Treasury. On or before November 1 of each year after 2003, the Railroad Retirement Board will compute the account benefits ratio for the fiscal year ending in such year and certify that ratio to the Secretary of the Treasury.

(More)

The following chart shows the employer/employee representative and employee tier II tax rates payable depending on the average account benefits ratio.

Average Account Benefits Ratio		Employer/Employee Representative Tax	Employee Tax
At least	But less than		
	2.5	22.1%	4.9%
2.5	3.0	18.1%	4.9%
3.0	3.5	15.1%	4.9%
3.5	4.0	14.1%	4.9%
4.0	6.1	13.1%	4.9%
6.1	6.5	12.6%	4.4%
6.5	7.0	12.1%	3.9%
7.0	7.5	11.6%	3.4%
7.5	8.0	11.1%	2.9%
8.0	8.5	10.1%	1.9%
8.5	9.0	9.1%	0.9%
9.0		8.2%	0%

7. Did the new law affect tier I tax rates?

The new law does not affect the 7.65 percent tier I social security equivalent tax rate. The tier I tax on employees and employers remains the same as for social security covered employees and employers, and is divided into 6.20 percent for retirement and 1.45 percent for Medicare hospital insurance. The maximum amount of an employee’s earnings subject to the 6.20 percent rate is \$84,900 in 2002; the Medicare hospital insurance tax is applied to all earnings.

8. How did the new law affect the railroad retirement supplemental annuity tax?

The new law repealed the railroad retirement supplemental annuity tax, which is no longer payable for years after 2001. This work-hours tax had been paid solely by rail employers, including rail labor organizations, and employee representatives and at a rate determined quarterly by the Board. It also eliminated the separate Supplemental Annuity Account under the Railroad Retirement Act. Supplemental annuities will now be funded by the new Railroad Retirement Investment Trust.

(More)

9. Will employees continue to receive supplemental annuities at age 65 if they have at least 25 years of railroad service and at age 60 if they have at least 30 years of railroad service?

The supplemental annuity provisions of the Railroad Retirement Act are not affected. Employees will still be eligible if they meet the requirements for a supplemental annuity, including a current connection with the railroad industry and at least one month of railroad service before October 1, 1981.

10. Did the new law change any other financing provision of the railroad retirement system?

The new law did not change the provisions for the financial interchange with social security or the vested dual benefit appropriations, or the transfer of revenues from income taxes on railroad retirement benefits to the railroad retirement trust funds.

###