Reference
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REINVENTION PROPOSALS
PHASE III

September 27, 1996

OFFICE OF INSPECTOR GENERAL
RAILROAD RETIREMENT BOARD

INTRODUCTION

The Office of Inspector General (OIG) has previously recommended changes to the organizational structure of the Railroad Retirement Board (RRB). The OIG provided proposals to assist the agency in effectively utilizing the resources available to administer the provisions of the Railroad Retirement Act (RRA) and the Railroad Unemployment Insurance Act (RUIA).

Although the RRB made certain modifications to the organizational structure, primarily within the Office of Programs, the overall operating environment has essentially remained unchanged. Agency management must consider additional changes to improve the overall control environment and increase the efficiency of the agency's operations. The OIG believes the following recommendation will enable the agency to focus its operations on core responsibilities and, as a result, provide the best possible service to its customers.

The Board should identify programs and operations that duplicate activities that are the primary responsibility of the Social Security Administration (SSA). These activities involve defining the Tier I benefits of the RRA and differences between Tier I and Social Security benefits. The Board should become proactive in supporting efforts to transfer these programs to the SSA over a three year period.

Many of the recurring difficulties the RRB encounters in processing benefits arise because of the necessary coordination with the Social Security Administration concerning historical employment coverage, earnings history, post retirement benefit adjustments and related issues. The continued decline in railroad workers covered by the RRA and the projected decline in annuitants suggest this is an appropriate time to consider changes to the administrative processes used to provide the benefits of each program.

Cost savings would be achieved through the elimination of coordination efforts and maintenance of dual administrative structures to achieve the same objective. Customer satisfaction and service would be enhanced because benefit claims could be settled faster, and the need for two separate agencies to coordinate the payment of entitlements under the same benefit structure would be eliminated. The marginal cost of including the Tier I benefits in the SSA processing systems should be negligible relative to the number of benefits currently being processed for all SSA recipients.

Future coordination efforts between the agencies will require additional resources, particularly as new systems projects are implemented in each agency. For example, the RRB has begun its Year 2000 initiative to accommodate computer systems changes to support the calculation of date sensitive information in the next century. SSA is also undertaking its Title II redesign effort which will impact how it pays old-age, survivors and disability insurance benefits. The OIG believes that significant efficiency improvements can be achieved by requesting enabling legislation that would allow for the transfer of certain program activities to SSA.

BACKGROUND

The RRB was established in 1934 to provide specific retirement plan services to the railroad industry. At that time, there was minimal pension coverage in the country and railroads were the dominant transportation mode. The Congress recognized the desirability of a national program of retirement benefits covering railroad workers through the collective bargaining process that was applicable to all labor organizations represented in the industry.

Important considerations at the inception of the railroad retirement system were the desire to provide for immediate pensions, recognition of prior railroad service and recognition of service with all employers in the industry. These features were not considered in the initial drafting of the Social Security Act. The initial Railroad Retirement Act passed in 1934 preceded the passage of the Social Security Act in 1935 which excluded railroad employment from coverage. The Railroad Retirement Act of 1937 continued the independence of the system from Social Security.

From the pensioners' standpoint, the separation of the two programs resulted in larger, immediate benefits. From the employers' perspective, the advantages included a single benefit structure and the opportunity to transfer pensions which the railroads had been paying from operating funds to the RRB. It was also considered beneficial to have a retirement system that would encourage retirement by older workers to allow for the advancement and hiring of younger employees. The initial funding for the RRA was derived from a payroll tax on employees and employers.

The later evolution of the RRB's responsibility with respect to the retirement program was largely due to the integration of Social Security features into the structure of the railroad pension plan. Legislation to remedy recurring financial problems, the complexity of the retirement provisions due to coverage under both systems, the effect of windfall benefits and the addition of the unemployment and sickness insurance programs expanded the role of the Federal government in the administration of railroad benefit plans.

The first general revenue support provided to the system, which occurred in 1944, funded retirement credits earned by covered employees who had served in the military. Amendments to the RRA in 1951 provided significant increases in the pensions payable to railroad retirees on a level consistent with those granted to Social Security beneficiaries. These amendments also introduced the concept of the Financial Interchange (FI) which required Social Security to measure its financial status as if the SSA had always covered railroad workers. SSA was also required to arrange for a transfer mechanism between its trust funds and the RRB to reflect the financial consequence of covering the railroad industry employees.

Legislation enacted in 1974 removed many differences that existed between benefits provided under RRA and SSA through the establishment of a two-tiered structure of railroad retirement benefits. This important legislation recognized two separate components of the railroad retirement plan and required the ongoing benefit coordination between the RRB and the SSA. Tier I was essentially designed to duplicate the SSA benefits although certain differences between the two programs still remain. Tier II was designed to resemble a private sector retirement plan similar to those adopted under multi-employer arrangements in other industries.

The 1974 legislation also ended the eligibility for windfall benefits. Such benefits were called the "windfall benefits" because individuals who had been covered by both the RRA and the Social Security Act received proportionately higher benefits than if they had been covered by only one of the programs for their entire career.

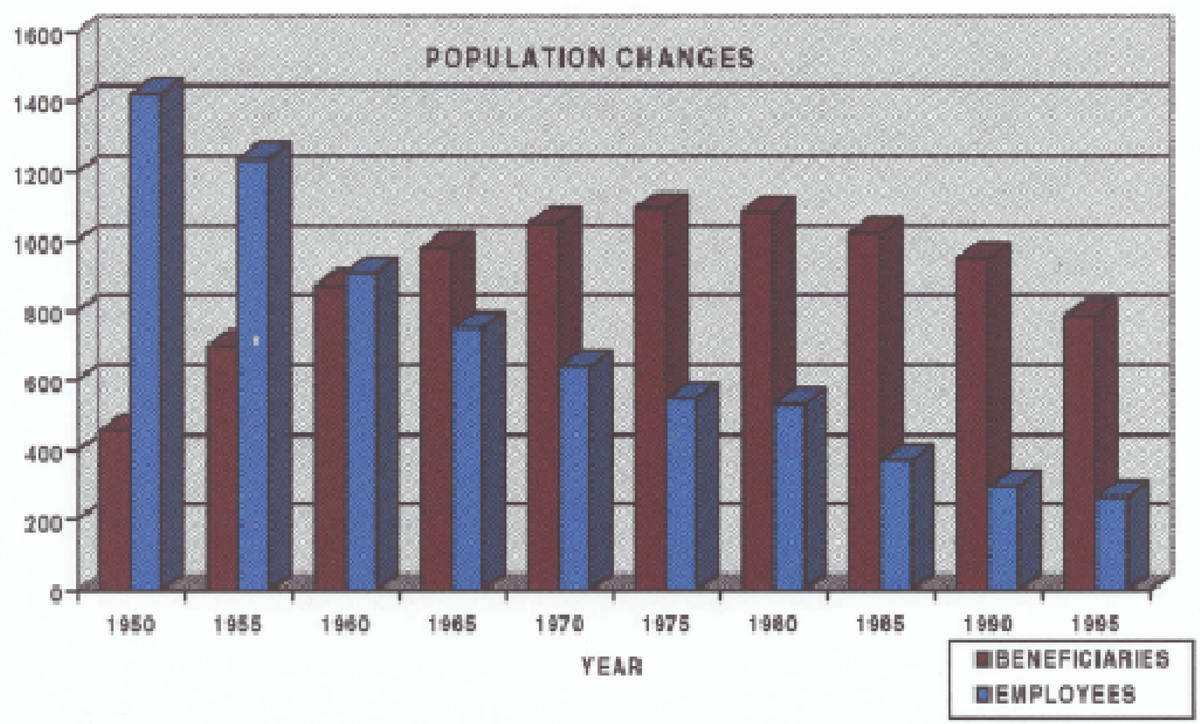
The most significant legislative changes following the 1974 amendments which affect the interaction of the RRB and SSA and the use of federal funding came in 1983. Pension benefits were subjected to federal income taxation and the revenues received transferred to the RRB trust funds. Revenues derived from the taxation of Tier I benefits were transferred to the RRB as a permanent funding source. Initially, the transfer of funds generated through the taxation of Tier II benefits was to be temporary through 1988. However, subsequent legislation extended the transfer and later made it a permanent transfer.

INDUSTRY CHANGES

The addition of Social Security features and the financing provisions which accompanied them increased the administrative responsibilities required to provide RRA benefits. At the same time the administration became more complex, the railroad industry experienced a major decrease in the number of workers employed. The corresponding reduction in the payroll base resulted in lower tax revenues and diminished the RRB's ability to pay benefits. The reduction in the number of workers had been occurring at the same time as the number of beneficiaries had grown and life expectancy was increasing. Actuarial projections made by the Board do not predict a significant change in the employment pattern, even under the most favorable assumptions.

The demographic differences between the population covered by Social Security and Railroad Retirement was significant at the time the financial interchange was introduced. The number of workers covered by SSA was expanding faster than the growth in benefit recipients. In the case of the RRB the number of active employees covered by the system has declined from a peak of 1.7 million in 1944-45 to the current level of approximately 265,000. Conversely, the number of retirees and beneficiaries reached its peak of nearly 1.1 million in 1975 and although declining still remains at nearly 800,000 at the close of FY 1995. The most recent actuarial valuation projects that the number of annuitants will decline by nearly 20% over the next five years.

The ratio of covered workers to beneficiaries in 1950 was approximately 3 to 1. Currently this ratio is reversed as there are now nearly three beneficiaries for each worker. The following graph demonstrates how the proportions have shifted. (Number of participants is shown in the thousands.)



FINANCING CONSIDERATIONS

The railroad retirement system was designed to be primarily a "pay as you go" type of benefit program. This means that benefits are paid from a payroll tax on current employees and their employers. A pay as you go system will continue to be effective only if the number of current workers increases or revenues from contributions and investments outpace the relative growth in the payment of retirement benefits. Both Tier I and Tier II benefits are financed by the pay as you go method, and as stated above, the number of active workers has declined faster than the decline in the number of people receiving benefits.

The 1974 legislative changes to create a two-tiered system were based upon the findings of the Commission on Railroad Retirement, established by law in 1970. As noted in its 1972 report, the Commission was directed to "...study the railroad retirement system and recommend changes in it to provide adequate levels of benefits on an actuarially sound basis." In addition, the Commission was directed to review the relationship to Social Security and changes in the financing of the system.

In recommending the two-tiered benefit structure, the Commission noted that the Tier II portion should be structured to serve its members as do private plans in other industries. The two most notable exceptions between the private sector pension plans and Tier II benefits are:

1.) Private plans must provide advance funding for accrued liabilities whereas Tier II is on a pay as you go basis, and

2.) Private defined benefit plans must have plan termination insurance which provides coverage through the Pension Benefit Guaranty Corporation (PBGC).

Advanced funding for accrued liabilities generally requires payments over a period of up to 30 years. The RRB prepares an estimate of the unfunded accrued liability in its triennial actuarial valuation. The most recent actuarial valuation indicated that the present value of the unfunded accrued liability is $37.6 billion. Annual payments of approximately $ 2.6 billion would be required to amortize this unfunded liability over the next 30 years.

In addition, coverage by the PBGC would require the payment of annual premiums based upon the number of participants. Currently the premiums are $2.60 and $19.00 per participant for multi-employer and single employer plans, respectively. Additional premiums may be required for single employer plans if they are underfunded. At the multi-employer rate premiums of approximately $2.8 million would be required, presumably from additional taxes on employees and employers. The PBGC would also assess a withdrawal liability penalty for those employers wishing to cease participation in a multi-employer arrangement.

COORDINATION OF BENEFITS

The impact of the coordination between the SSA and the RRB is illustrated by the level of financial activity occurring between the two agencies. Revenues related to the provision of Social Security benefits or its equivalent represented over 60% of the RRB's total receipts over the past three years. (Dollar amounts in the chart below are shown in millions.)

	1995	1994	1993
Tier I Taxes (equivalent of Social Security tax)	$1,874.4	$1,812.4	$1,800.6
Financial Interchange	3,751.6	3,324.6	3,213.2
SSA Reimbursement	1,099.3	1,085.3	1,069.1
Revenues Related to SSA	$ 6,725.3	$ 6,222.3	$6,082.9
Total RRB Revenues	$10,836.7	$10,266.0	$9,733.8
% of Total	62.06%	60.61%	62.49%

The introduction of the Tier I benefit structure in 1974 removed many historical program differences relative to Social Security. The coordination of Tier I benefits and SSA has, however, created administrative complexities. Among the features requiring continuous coordination are determining the amount of benefits to be paid and then allocating the total between the two programs. The allocation feature must again be monitored when cost of living increases become effective.

The separate tax rates and wage base against which the rates are applied require that the RRB maintain separate funds and accounting records for Tier I and Tier II collections and disbursements. The information required for Tier I mirrors that required for SSA and as such represents a duplication of effort and produces no real benefit.

RRA provisions require that a comparison be made to ensure that an individual covered under the RRA receives at least as much as an individual who had comparable earnings but was covered by Social Security. Coordination problems for benefits paid by SSA and the RRB resulted in the overpayment of $14.7 million in benefits during the FY 1995 by the RRB. The need to control exposure to overpayments, determine the extent of any overpayments, adjust future pensions and ensure collections adds administrative expense to the RRB, and, therefore, represent an unnecessary cost to the trust funds.

Modifications to the administrative systems for recording data and transactions in the next century will require additional coordination and expense. Any major changes made to the structure of the Social Security program, such as the establishment of individual participant investment accounts, will add even greater complexity to the recordkeeping requirements and increase the coordination problems between the agencies.

FINANCIAL INTERCHANGE

In addition to the administrative burden required by the coordination of benefit payments, the RRB and SSA are also required to resolve program financing issues through an intricate process called the Financial Interchange (FI). The intent of this process is to place the SSA trust funds in the same financial condition as if all railroad workers had been covered under SSA. If the amount of benefits SSA would have paid exceeds the amount of Tier I taxes collected the transfer is made to the RRB. If taxes exceeded benefits, the transfer is made to the SSA trust fund.

The FI was initially introduced in 1951 and since 1958, the result has been a transfer of funds to the RRB. The total level of financial activity between the RRB and the SSA represented over 62% of the RRB's receipts for fiscal year 1995. The net transfer to the RRB for the FI alone was $3.8 billion which represented approximately 35% of total receipts. Activity to separate the financial positions of the respective trust funds produces no incremental benefit to the pension recipient or to the taxpayers. RRB transactions related to the FI are tracked through the Social Security Equivalent Benefit Account which was established in 1984 to identify the sources of funding and benefit payments. Previously, all activity was handled through the Railroad Retirement Account.

The inability of the RRB to accurately estimate the amount of the FI also precludes issuance of timely and accurate financial statements; an extensive amount of estimating is required to determine the net transfer amount. The current similarities in the respective programs and the necessity for ongoing coordination of benefits and sources of financing indicate that an assessment of the roles of each agency in the administration of the retirement benefits should be initiated.

The complexity of the FI activity recently became more when the Chief Financial Officer and the Chief Actuary of the RRB proposed that nearly $800 million including interest should be transferred to the Railroad Retirement (RR) Account from the Social Security Equivalent Benefit (SSEB) Account. According to their analysis the SSEB Account has accumulated a balance in excess of $2 billion for two reasons:

> First, the SSA trust funds transfer to the RRB an amount equal to what the SSA benefits would have been even though the RRB may not provide similar benefits under the Tier I program. As an example, Tier I does not pay benefits to the children of living retirees which will cause a build-up in the SSEB account.
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> Second, the RRB prepares estimates of the benefits which SSA will reimburse and charges these amounts to the SSEB account. The actual reimbursements from the SSA trust funds are determined through the FI. Over the years the RRB has not adjusted the benefit charges to the final amount of the FI settlement. The excess of the reimbursed benefit amounts over the estimates is approximately $600 million since 1984. The additional $200 million represents an accrual for interest.

The analysis supporting the proposed transfer of funds concluded that the balance of the RR Account was not to be significantly affected by the creation of the SSEB Account. As a result the RR Account had been overcharged.

These adjustments were not made on a more timely basis which suggests that (1) interim procedures have been less than adequate to ensure appropriate recording of benefit charges, or (2) that the procedures were not understood. While this adjustment does not reflect a loss of funds, the allocation of trust assets can impact the projections related to the financial stability of the Railroad Retirement Account.

MEDICARE

In 1966, the RRB was authorized to select a separate carrier to administer the Medicare Part B program for railroad beneficiaries; in 1972, the agency's authority to contract with a carrier was added to section 1842(g) of the Social Security Act. Numerous proposals have subsequently been made to eliminate the agency's role in processing Medicare claims. In 1993, the National Performance Review recommended the repeal of the authority and the transfer of the railroad Medicare program to contracts negotiated by the Health Care Financing Administration (HCFA). In 1995, HCFA again proposed eliminating the RRB's independent authority over railroad retirees' Medicare Part B claims.

RRB annuitants and their representatives have strongly opposed every motion to transfer the administration of this program to HCFA. Proponents of the agency's Medicare program cite many factors in support of the separate RRB contractor: (1) the processing cost per claim is less than HCFA contractors' cost; (2) the processing accuracy rate is higher; (3) the timeliness of processing is faster; and (4) better quality service is provided to railroad beneficiaries. In fact, the railroad community has taken the position that elimination of the RRB's Medicare authority would undermine the integrity of the railroad retirement system.

The OIG supports the deferral of any change in the RRB's current authority to administer the Medicare Part B program for the following reasons:

The Health Insurance Portability and Accountability Act of 1996

The Act contains several provisions that may impact the administration of Medicare Part B by the RRB. The Act stipulates that the agency has the authority to establish regulations to directly impose monetary penalties and assessments on health care providers who submit prohibited claims or seek fraudulent payment under the Medicare program.

The Act also potentially provides additional funding to the Office of Inspector General (OIG) for the investigation, prosecution, audit or evaluation of health care fraud and abuse. The OIG currently has 127 open Medicare fraud cases representing $26 million in potential recoveries to the HCFA trust fund.

Proposed Amendments to HCFA Procedures

The Health Care Financing Administration plans to amend its current procedures for Medicare claims contracting. As a result, any modifications to the RRB authority should be postponed until HCFA has made a final decision on any changes.

Service and Administrative Issues

A difference of opinion exists concerning any cost advantage to changing the contracting authority at this time. The existence of a single carrier for the railroad community has proven effective in terms of customer service. The RRB's beneficiaries have repeatedly expressed a high level of satisfaction with the current carrier.

The existence of a separate carrier for Railroad Medicare does not require the expenditure of RRB trust funds. Funding is provided through the Financial Interchange and produces revenue for the agency.

UNEMPLOYMENT AND SICKNESS BENEFITS

The RUIA was originally enacted in 1938 to provide benefits to unemployed railroad workers. Many of the workers were denied benefits by individual states due to jurisdictional issues because many railroad operations crossed state lines. Sickness benefits were added to the program in 1946.

Several unique operating features of the RUIA benefit programs support retention of administration with the RRB or that no action with respect to these programs is required:

1. The two programs of sickness and unemployment insurance are combined for purposes of financing, and are experience rated costs are generally matched to employers with the highest utilization.

2. While state programs are based upon periods of weekly unemployment, the RUIA benefit program considers days of unemployment in a benefit period. Transferring this type of program to the states would require extensive modification to existing administrative processes.

3. Program expenses for FY 1995 totaled $80.3 million. Therefore, administrative improvements cannot provide the type of savings which can be achieved by concentrating on opportunities within the retirement program.

OIG PROPOSAL

The OIG recommends that the Board propose the type of enabling legislation that would facilitate the transfer of the RRB's Tier I responsibility to SSA over the next three years. The transfer of the Tier I program would reduce the overall cost of providing the same level of income security by eliminating the duplicate administrative mechanisms, including the financial interchange process, and would minimize the need for continuous benefit coordination. The transfer of the respective program responsibilities would also significantly reduce the involvement of the RRB in providing services more typically considered to be inherently governmental functions.

Attempts have been made in the past to end Federal administration of retirement benefits for a single industry. In particular, the role of the Federal government in administering two duplicative programs (RRA and SSA) which have the same intended outcome has been questioned several times. The current demographic patterns emerging within the industry and the employment ceilings projected for the RRB require substantial changes within the RRB and suggest that these proposals be revisited.

IMPACT OF PROPOSAL

This proposal will impact the railroad beneficiaries and the government as a whole in two main areas. It will enhance customer service to the railroad beneficiaries and will reduce the overall cost of providing the same level of benefits. The merger of Tier I and Social Security programs would enhance service to the program beneficiaries through more timely and accurate payment of initial benefits. The need for coordinating the entitlement earned under SSA for offset to the Tier I payment would be eliminated. The coordination on cost of living increases for those receiving both SSA and Tier I payments would no longer be required. The end result is greater efficiency in terms of the product delivered to the customer as well as cost savings to the taxpayers.

One measure of efficiency for a benefit program is a comparison of administrative costs to similar programs. The financial statements of the RRB indicated that the ratio of administrative expenses to benefit payments for the Railroad Retirement and Survivor Program was .9% over the past three years. Over the same period SSA has reported a decline in its ratio of expense to benefits from .8% to .6% in the retirement program. The productivity gain by transferring the Tier I benefits to SSA, based on benefits paid from the Social Security Equivalent Benefit account during the last fiscal year, would be approximately $ 14.6 million.

Transferring the Tier I program administration to SSA would also enable the RRB to examine its service delivery process. A large part of the initial application processing would be eliminated since only the Tier II portion of an annuity would have to be processed. The agency could determine the advantages of locating the field service representatives in SSA offices. Having each program serviced at the same location would result in broader geographic coverage and achieve cost savings for office space and equipment.

Further refinements could also be considered such as direct applications from the larger employers or by initiating the application process through automated voice response systems. The technological advantages of using the telephone service delivery system of the SSA could be expanded to include RRB beneficiaries. This should also result in savings because the development of a new system would not be acquired.

The overall coordination with SSA represents approximately two-thirds of the RRB's operating revenue. It is reasonable to expect that staff reductions of 500 positions should be achievable by the transfer of program responsibilities. The total reduction in expense related to the operations should approach $ 30 million annually. Comparable savings should also be expected in indirect costs such as office space and office equipment. Reduced audit and oversight activity within the OIG is also expected since the scope of program operations would be simplified.

Providing a three year period to complete the transfers will allow sufficient time for coordinated systems planning, determination of the most effective manner of resolving program differences and securing the necessary enabling legislation. The objective for transferring activity to SSA should be to include all programs that SSA would normally provide without diminishing the benefits protection to which railroad workers are entitled. In addition to the transfer of program responsibilities, the agency should anticipate that the employees currently involved in the Tier I program administered by the RRB would also be transferred to the SSA.

Transferring the affected employees would provide an effective transition team knowledgeable in both programs who could be absorbed within the larger organizations. As a result, the RRB could avoid incurring the costs associated with a reduction in force. SSA could more easily absorb staff reductions through attrition and retirement incentives than a smaller agency like the RRB.

During the transition phase, an analysis of specific program differences between SSA and the Tier I program would be necessary. As an example of program differences to be resolved, Social Security retirement benefits cannot begin until age 62 but Tier I RRA benefits can begin at age 60 with 30 years of service. All program differences must be identified to determine the equitable treatment of program beneficiaries as well as the financial and funding implications.

By providing sufficient time for the transfer of responsibilities, any necessary benefit modifications could be reviewed by all interested parties. Changes in benefit provisions, where necessary, could be implemented gradually with appropriate grandfathering provisions to protect the existing annuitants and beneficiaries.

The removal of the Tier I administration would substantially reduce the size of the RRB and enable the agency to focus on program activities that directly affect program beneficiaries rather than coordination efforts which affect sources of a benefit rather than the actual entitlement. Program simplification should enable the RRB to simplify its organizational structure as fewer positions will be required to support the coordination of existing programs.

The separation of the Tier I responsibilities from the RRB will also eliminate the need to maintain the SSEB Account. The financial statements of the RRB would no longer reflect the balance of the SSEB Account or the income derived from its investments. Current legislation also allows for the transfer of SSEB funds to pay railroad retirement benefits if the funding of the Railroad Retirement Account is inadequate to meet its benefit obligations in the future. Funds transferred to the Railroad Retirement Account would not have to be repaid. The Chief Actuary has reported that, even under the most pessimistic employment assumptions, no cash flow problems are expected for the next 20 years.

CONCLUSION

The type of initiatives recommended by the NPR suggest major changes in the type of services provided by government agencies and the most efficient method for providing needed services. The OIG believes the preceding proposals are compatible with these objectives and should be given immediate consideration. Combining the Tier I program with SSA will also provide greater career opportunities to the employees of the RRB because larger agency organizations will be more likely to absorb reductions in force through attrition and retirement incentives.

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