UNITED STATES GENERAL ACCOUNTING OFFICE

WASHINGTON, D.C. 20548

STATEMENT OF THE

UNITED STATES GENERAL ACCOUNTING OFFICE

BEFORE THE

COMMITTEE ON POST OFFICE AND

CIVIL SERVICE

U.S. HOUSE OF REPRESENTATIVES

ON

PROPOSED CIVIL SERVICE SUPPLEMENTAL

RETIREMENT SYSTEM

Mr. Chairman and Members of the Committee:

We are pleased to provide the views of the U.S. General Accounting Office on the proposed Civil Service Supplemental Retirement System (CSSRS). The Social Security Amendments of 1983 required all federal civilian employees hired after December 1983 to participate in social security. The Congress has set January 1, 1986, as the target date for establishing new retirement programs for these employees. This proposal applies to new employees who otherwise would have been in the current civil service retirement system.

During the past 10 years, we have issued a series of reports covering a number of issues related to basic policies, financing, and benefits of the civil service and other federal retirement programs. A common thread that ran throughout many of these reports was the need for the establishment of an overall policy to guide retirement system development and improvement. We have also endorsed the principle that when adjusting any one element of compensation, the comparability of all other elements to private sector practices should be considered.

During these many years of reviewing federal retirement matters, we have become convinced that a reasonable standard on which to base federal retirement benefits is the prevailing private sector practice. Heretofore, this has been a difficult standard to apply because federal employees in the civil service retirement system were not under social security. Private sector retirement programs are constructed to supplement social security. Federal retirement programs could not be constructed in the same way. Now that new federal employees are covered by social security, the Congress has the unique opportunity in designing their retirement programs to supplement social security benefits to take advantage of the experiences of private sector employers.

To assist the Congress in designing a new retirement program, we gathered and analyzed considerable information on nonfederal retirement programs. The detailed results of our analysis are included in three of our reports entitled Features of Nonfederal Retirement Programs (GAO/OCG-84-2, June 26, 1984), Benefit Levels of Nonfederal Retirement Programs (GAO/GGD-85-30, Feb. 26, 1985), and Retirement Before Age 65 is a Growing Trend in the Private Sector (GAO/HRD-85-81, July 15, 1985).

The proposed system combines a three-tiered approach to retirement--social security, a defined benefit pension plan, and a thrift plan. We found this approach to be typical among private sector employers also. Moreover, the provisions of the thrift plan portion of the proposed program are completely consistent with prevailing provisions in the private sector. However, many aspects of the pension plan are different from what the private sector programs we examined usually provided.

The cost of the proposed retirement program is estimated to be 25.5 percent of pay. This is about one-third more costly than the typical private sector retirement program, but some private sector programs cost more.

For your information as the Committee considers this proposal, we would like to briefly discuss how the features of the proposed retirement program compare with retirement programs typically found in the private sector.

Retirement age

The proposal provides for unreduced benefits to be paid at age 55 if the employee has 30 years of service, age 60 with 20 years of service, or age 62 with 5 years of service. Early retirement with reduced benefits would not be available except for those employees retired involuntarily.

Our analysis of private sector pension plans showed that age 62 is usually the earliest age at which employees can receive unreduced benefits. Also, nearly all plans we examined provide for early retirement with reduced benefits at age 55. Typically, the early retirement requirement is age 55 with at least 10 years of service, and benefit reductions are about 4 percent a year for all retirees younger than age 62.

Benefit amounts

The proposed pension plan provides a benefit of 1 percent of high 3 year average annual salary for each year of service. Pension plan benefits would simply be added to social security benefits. Moreover, to provide a steady level of retirement income for those eligible to retire before 62, a supplement equal to the federally earned social security benefit would be paid up to age 62.

Use of a 3 year average salary for benefit computation purposes is not consistent with private sector practices. The overwhelming majority of private sector plans use a 5 year average salary. Furthermore, the proposed "add on" of plan benefits to social security is not the typical private sector approach.

Because social security benefits, as a percent of salary, decrease as income levels increase, private sector pension plans usually use some form of integration to compensate for social security's "tilt" to lower income employees. Between 64 and 96 percent of private sector pension plans included in the surveys we reviewed were integrated with social security. For example, the average benefit formula in plans surveyed by the Bureau of Labor Statistics, which was the primary source of information on private sector plans we studied, provided for each year of service 1.5 percent of the high 5 year average salary, less 1.25 percent of the employee's social security benefit.

In our analysis of private sector plans, we found that the payment of a benefit-leveling supplement to those retiring before age 62 was commonly available as an option. However, employees choosing the benefit-leveling option paid for the supplemental benefits by having their pension benefits reduced after age 62.

Cost-of-living adjustments

The proposal calls for annuities to be adjusted each year by the increase in the Consumer Price Index (CPI). Our study of private sector practices showed that the average increase each year in annuities was approximately 40 percent of the change in the CPI, while large employers of more than 10,000 employees granted increases averaging close to 60 percent.

Vesting

The proposed pension plan provides for vesting--the point in time at which a participant has earned the right to a future benefit--at 5 years of service. The typical private sector plan requires 10 years of service for vesting to occur, but the trend is toward earlier vesting.

Employee contributions

The proposed pension plan requires employees to contribute 7 percent of salary to the retirement fund less the contribution to social security. This is not consistent with the private sector approach. The studies of private sector plans we reviewed showed that very few plans require employees to contribute toward the cost of pension benefits. For example, 93 percent of the employees covered by the Bureau of Labor Statistics survey were in plans that did not require employee contributions.

Disability benefits

The proposed pension plan includes provisions for disabled employees to receive their accrued retirement benefits, subject to a guaranteed minimum amount based on service projected for 20 years or to age 60, if earlier, in addition to any social security benefits. Disabled employees unable to perform the duties of their current positions but not qualifying under the stricter social security disability definition, would receive a supplement equal to the social security benefit. A disabled employee would typically receive replacement income of about 50 percent of salary under these provisions.

The proposed disability program is not consistent with prevailing practices in the private sector. Our work has shown that salaried employees are most often covered by a separate long-term disability insurance plan. These plans generally provide 60 percent of salary to employees who meet the social security criteria for disability benefits (inability to perform substantive gainful employment) less any social security benefits they receive. Other disabled employees generally receive insurance benefits for up to 2 years, after which they are dropped from the rolls and receive no further benefits.

Providing a benefit of 50 percent of salary to employees who are not totally disabled is more generous than private sector practices. Since these employees could obtain other employment, we believe their benefits should be lower than the benefits totally disabled employees receive.

Survivor benefits

Like private sector plans, the proposed pension plan would provide a survivor benefit of 50 percent of the employee's pension earned at death except that the protection would be available sooner (after 18 months of service compared to at least 10 years of service in private sector plans). Retiring employees could elect to continue this protection by accepting a 10-percent reduction in their annuities, whereas private sector plans usually require an actuarial reduction taking into account the differences in the ages of the retiree and spouse.

Thrift plan

The features of the proposed thrift plan are consistent with the prevailing practices in private sector thrift plans. An employee could voluntarily contribute up to 10 percent of his or her salary to the plan with the government matching half of the first 6 percent of salary. The monies contributed would be invested in funds to be established by an independent Civil Service Investment Board, except that government contributions during the first 5 years must be invested in a Treasury bond fund.

Financing

In our opinion, the proposal's provisions for fully funding accrued pension benefits are sound and represent a major improvement over the funding requirements in the current civil service retirement system. We have long held the view that federal retirement systems should be fully funded to enhance cost recognition and budgetary discipline as well as to promote sounder fiscal and legislative decisionmaking. The proposal accomplishes this objective for the new pension plan. However, it does not apply the same funding requirements to the currently underfunded civil service retirement system. We would urge the Committee, either as part of this proposal or as a separate action, to address the funding of the current system in a similar manner. Unless this change is made, future benefits for retirees under the current system will eventually be paid from funds contributed for the new pension plan.

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