Social Security Debate/Washington Scene

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Goal of Presentation

- Provide overview of :
  - Social Security Debate
  - Federal Pension Issues

Pension Resources from NCTR

- Check http://www.nctr.org/federal/index.html periodically for updates
- Washington Regulatory Wrap Up http://www.nctr.org/pdf/WashingtonRegyWW.pdf
- Washington Legislative Wrap Up http://nctr.org/pdf/WashingtonLegWU.pdf

Abbreviations Used

- State and Local Government = SLG
- Social Security = SS
- Employer = ER
- Employee = EE

President's Interest Social Security Reform

- President "earned capital in this election"
- Intends to spend it on Social Security reform and several other issues

No Social Security Reform Plan Yet

- President hasn’t released specific plan yet
- Cited 2001 Report by his Commission to Strengthen Social Security as a “good blue print”
- Listed principles for reform in State of Union Address (SOUA)

Social Security 101

- 1935: Program begun (SLG EEs not covered)
- 1939: Dependents' and survivors' benefits added

Social Security 101

- 1950’s: Congress authorized, under various Acts, agreements between states and the federal government for Social Security coverage of SLG EEs -- “Section 219 Agreements”
- 1956: Comprehensive disability program established

Social Security 101

- Old Age and Survivors Insurance trust fund (OASI)
- Disability Insurance trust fund (DI)
- Known collectively as the OASDI trust funds
- Other trust funds, such as Hospital Insurance (HI) for Medicare Part A

Social Security 101

- Funded principally by taxes required by Federal Insurance Contributions Act (FICA)
- Also known as “payroll taxes”

Social Security 101

- Tax on EEs wages
  - ER pays 6.2%
  - EE – same
  - Total: 12.4%

Social Security 101

- Trust fund in U.S. Treasury
- Purpose:
  - Account for all program income (payroll taxes) and disbursements (benefits)
  - Pay for administrative costs

Social Security 101

- Excess revenues in trust fund invested in special non-negotiable securities of U.S. government

- Market rate of interest credited to trust fund

Social Security Trustees' Annual Report (Released 3/23/05)

- Social Security Trustees annually look at trust fund over 75-year period
- Shortfall:
  - $4 Trillion between now and 2079

Social Security's Finances

- Another way to look at funding problem
  - $11 Trillion over life of program
  - Note that Medicare's finances over life of program $70.5 Trillion

Social Security Trustees' Annual Report

- As of 2005, projected 75-year actuarial deficit for OASDI trust fund is 1.92% (2004-1.89%)

Social Security Trustees' Annual Report

- *What does the actuarial deficit mean?*
- Congress would have to increase SS payroll tax rate by 1.92% points, starting this year, to close gap
- Payroll tax rate increase for EEs of 0.96% and same for ER would be require
- So rate would be 7.16% for ER and 7.16% for EE

Social Security Trustees' Annual Report

- Trustees make 75 year estimate of current law benefit structure and assumptions, such as:
  - economic growth
  - wage growth
  - inflation
  - employment
  - fertility
  - immigration
  - mortality

Social Security Trustees' Annual Report

- Whenever benefit payments exceed payroll tax collection bonds issued to pay difference
  - 2017 (Social Security Trustees – 2005 data)
  - 2020 (Congressional Budget Office – 2004 data)

Social Security Trustees' Annual Report

- Trust fund exhausted
  - 2041 (Social Security Trustees – 2005 data)
  - 2052 (Congressional Budget Office – 2004 data)

Social Security Trustees' Annual Report

- In 2041, 74% of annual benefit payments can be made
- *Why possible to pay portion of benefits?*
  - Payroll tax collections

Social Security Trustees' Annual Report

- In 2079, payroll taxes projected to cover about 68% of costs
- Assume no changes in payroll tax rates, benefits, or experience (e.g., economic growth)
- *Why 2079? Trustees take a 75 year look at SS finances*

Summary of SS Trustees Report (2004 v. 2005)

	2004	2005
Payouts exceed Benefits	2018	2017
Trust Fund Empty	2042	2041
Actuarial Deficit	1.89%	1.92%

Social Security – Previous Shortfalls

- 11 years in which benefits exceeded payroll taxes
- 1959, 1961, 1962, 1965, 1975-1981
- Social Security used trust fund bonds to pay difference

Social Security Reform -- President's Principles

- As he enunciated in State of the Union Address SOUA:
  - No increase in payroll taxes
  - Special provisions for low income individuals
  - No change for those retired or age 55 and older
  - Allow younger workers to have personal accounts

Social Security Reform

- Have principles been converted into specifics?
- No details yet
- 2 sources of ideas:
  - Model 2 of 2001 Report
  - President’s comments in SOUA

Social Security Reform

- Model 2
  - Personal accounts
  - Change in calculation of initial Social Security benefit

Social Security Reform -- Personal Accounts (PA)

- Per Model 2:
  - Younger workers could divert one-third of payroll tax into PA
  - Voluntary
  - Up to $1,000 per year (and indexed in future years for inflation)

Social Security Reform -- PA and Reduction in Traditional Benefit

- Per Model 2:
  - Quid pro quo for PA
  - Traditional Social Security benefits reduced by worker's PA contributions
  - Rate of reduction: compounded at an interest rate of 2% above inflation (2001 Commission)
  - Background materials for SOUA: 3%

Social Security Reform -- PA

- Additional details from President during SOUA:
  - Choice of conservative mix of bonds and stock funds
  - Earnings “not eaten up by hidden Wall Street fees”
  - Options to protect investments from sudden market swings on eve of retirement

Social Security Reform -- PA

- More details from President during SOUA
  - PA paid out over time, i.e., by an annuity, as an addition to traditional Social Security benefits
  - PA can be passed to others if worker dies before drawing it
  - Begin in 2009

Social Security Reform -- PA

- President likened PA to Thrift Savings Plan (TSP) for federal workers
  - Voluntary contributions of wages into accounts
  - Participants choose from 5 different, broadly based investment funds
  - Note: TSP is in addition to DB plan for federal workers

Social Security Reform -- PA

- Transition to PA
  - Portion of payroll taxes diverted into accounts
  - Thus less money available to pay benefits under traditional program
- Cost: $754 billion from 2009-2015 and total could reach up to $2 trillion
- Pay for cost through government borrowing

Social Security Reform -- Modification of Initial Benefit

- Personal Accounts only one element of SS debate
- They don’t resolve insolvency, so must look to additional alternatives to solve problem
- Most commonly discussed: Changing from wage to price indexing

Social Security Reform -- Modification of Initial Benefit

- Per Model 2:
  - Change factor used to calculate initial benefit
    - Currently: wage growth index
    - Proposed: price index (i.e., inflation-based)
  - Begin price indexing in 2009

Social Security Reform -- Modification of Initial Benefit

- Wages grow faster than prices, so proposed modification would lower benefits
- Proposed modification resolves financial problems over 75 year period

Social Security Reform -- Other Options (Mentioned by President)

- President briefly mentioned change to price indexing during SOUA
- Raised other options for discussion
  - Limiting benefits for wealthy retirees
  - Increasing retirement age
  - Changing benefit calculation
  - Discouraging early collection of Social Security benefits

Social Security Reform –Other Options

- Pay more into SS Trust Fund:
  - Raising payroll tax cap ($90,000 in 2005)
  - Raising payroll tax from current 12.4% (EE + ER)
  - Using general revenues
  - Invest part of SS trust fund in equities
  - Requiring newly hired SLG to participate – "mandatory coverage"

Social Security Reform -- “Mandatory Coverage”

- 2001 Report did not include this option
- President did not mention it during SOUA

Social Security Reform -- “Mandatory Coverage”

- Cost to SLGs and their workers: ~$25 billion
- If approved, SLGs and newly hired workers each responsible for 6.2% payroll tax, or total 12.4%

Social Security Reform -- "Mandatory Coverage"

- Provides 10% of financing needed to provide Social Security with solvency
- AARP Supports
- Coalition to Preserve Retirement Security
  - Lobbying against mandatory coverage
  - www.retirementsecurity.org

Social Security Reform -- Prospects for Enactment

- Latest news
  - President
  - House
  - Senate – hearing tentatively scheduled for April 26

Other Social Security Issues

- "Section 419" Notice
- GPO and WEP

“Section 419” Notice

- Individuals hired to fill non-Social Security covered positions
- Applicable to those hired on or after 1/1/05
- Notice informs them that because of non-covered status, their Social Security benefits from other work may be reduced

“Section 419” Notice

- ER must:
  - Have newly hired EE read notice and sign it
  - Send a copy of notice to retirement system that covers newly hired EE

GPO & WEP

- Both reduce Social Security benefit of individual who has worked in a non-Social Security governmental job and who is eligible for a Social Security through other work or through a spouse
- GPO = Government Pension Offset
- WEP = Windfall Elimination Provision

GPO & WEP

- GPO: reduces dependent or widow(er) benefit of non-covered SLG worker based on his/her spouse’s Social Security record
- WEP: lowers non-covered SLG worker’s own Social Security benefit from other work that is covered by Social Security

GPO & WEP

- Legislation to lower/eliminate GPO & WEP
  - 108th Congress: H.R. 594 to abolish both GPO & WEP attracted 300 co-sponsors
  - 109th Congress: Same legislation introduced (new number: H.R. 147) already has 238 co-sponsors
- Growing support in 2004 prompted by strong advocacy among employee groups

Pension Legislation

- Proposed Repeal of Pick Ups
- Portman-Cardin (House bill) and NESTEG (Senate bill)
- Other

Proposed Repeal of Pick Ups

- Eliminate the right of SLGs to pick up (i.e., pay) employee contributions
- Thus, employee contributions would be included in income and would be wages for FICA purposes

Current Treatment of ER and EE Contributions without Pick Ups

- ER contributions to a qualified retirement plan
  - NOT includible in EE's income at time of contribution
  - NOT wages for purposes of FICA payroll tax
- EE contributions to qualified retirement plan
  - ARE includible in income
  - ARE wages for FICA purposes

Current Treatment of ER Contributions with Pick Ups

- ER contributions – same regardless of whether pick up exists

Current Treatment of EE Contributions with Pick Ups

- EE contributions –
  - NOT includible in EE’s income at time of contribution
  - May not be wages for FICA purposes (depends on type of pick up)
  - For state law purposes (e.g., tax, salary), however, amount still deemed to be an employee contribution

Proposed Repeal of Pick Ups

- At present, 75% of contributory SLG plans pick up their employee contributions. *Survey of State and Local Government Employee Retirement Systems, Public Pension Coordinating Council* (2000) at 52.

Proposed Repeal of Pick Ups

- JCT rationales: (1 and 2 of 3)
  - #1-Pick ups unavailable to contributions made by employees of private employers or employees of the federal government
  - #2-Application of pick-up rules to employee contributions to defined contribution plans could be a means of avoiding the requirements applicable to elective deferrals

Proposed Repeal of Pick Ups

- JCT rationales: (3 of 3)
  - #3-Complexity of pick up rules:
    - whether contributions are eligible for pick-up treatment (as evidenced by the number of IRS rulings in this area)
    - with respect to whether pick-up contributions are made pursuant to a salary reduction agreement and are thus subject to FICA tax.

Proposed Repeal of Pick Ups

- JCT acknowledges problems: (1 and 2 of 4)
  - #1-Increased income taxes for participants in affected SLG plans with respect to employee contributions that are no longer eligible for pick-up treatment and thus includible in income
  - #2-Need for some SLGs to redesign their plans
    - SLGs might create plans with ER contributions only
    - So SLGs need to designate current EE contributions as ER contributions
    - In ER contribution only plans, contributions would not be includible in employees' income or wages for FICA purposes

Proposed Repeal of Pick Ups

- JCT acknowledges problems: (3 and 4 of 4)
  - #3-Need for participants to determine the portion of a distribution that is includible in income
  - #4-Need for plan administrators to keep records on after-tax employee contributions.

Proposed Repeal of Pick Ups

- Revenue raised: $4.8 billion

Proposed Repeal of Pick Ups

- No specific legislative proposal yet
- Proposed by staff of Joint Committee on Taxation (JCT)
- JCT's role is, among other activities, to investigate the operation and effects of tax statutes and their administration

Themes of Portman-Cardin/NESTEG Legislation

- During 108th Congress (2003-2004) pension legislation proposed, but not enacted, mainly for private plans also included provisions that would help SLG plans to:
  - Safeguard portability reforms
  - Expand portability options
  - Add flexibility to plan administration
- Same issues in 109th Congress

Pension Legislation in 108th Congress (2003 & 2004)

- House: H.R. 1776, Portman-Cardin Bill
- Senate: S. 2424, National Employee Savings Trust Equity Guarantee (NESTEG) Act
- Bills are similar not identical

Pension Legislation in 109th Congress (2005 & 2006)

- House: no bill yet and Rep. Portman, the Republican pension champion, is going into Bush Administration and Rep. Cardin, the Democratic champion, may run for Senate
- Senate: S. 219, National Employee Savings Trust Equity Guarantee (NESTEG) Act, introduced 1/31/05

Theme 1: Safeguard portability reforms

- Clarify purchase of service credit provisions (PSC)
- PSC = allows EEs to purchase service for which they will not receive pension credit
- Provides portability for participants in DB plans

Theme 2: Portability Expansion

- After-Tax Contributions to Enhance Portability:
  - Allows defined benefit plans to accept after-tax rollovers, if they so wish, provided that they separately track the after-tax funds from the pre-tax funds
- At present, defined contribution and other plans may accept these types of rollovers, but not defined benefit plans

Theme 3: Add flexibility to SLG plan administration

- Relief from Minimum Distribution Rules (MDRs)
- Exemption for Public Safety Workers from 10% Early Withdrawal Tax

Outlook for Pension Legislation in 2005

- NESTEG already re-introduced (S. 219)
- Unclear what will happen in House
- Enactment depend on how busy tax-writing committees are with Social Security and other issues

Administration's Pension Package

- LSAs = Lifetime Savings Accounts
- RSAs = Retirement Savings Accounts
- ERSAs = Employer Retirement Savings Accounts

Administration’s Pension Package

- Part of Administration’s FY 2006 Budget
- Also in FY 2004 and FY 2005 Budget

LSAs and RSAs

- Individual accounts
- $5,000 maximum annual contribution into each account
- Available to all individuals, i.e., no income limits (except that RSAs cannot exceed compensation)

LSAs and RSAs

- Contributions non-deductible (like Roth IRAs)
- Earnings accumulate tax-free
- Qualified distributions excluded from gross income

LSAs and RSAs

- LSAs -- distributions could be made at any time and at any age
- RSAs -- distributions after age 58 or in event of death or disability

LSAs and RSAs

- LSAs would replace:
  - Health accounts (e.g., HSAs)
  - College savings programs
- RSAs would replace:
  - All IRAs, except those for rollovers

ERSAs

- Consolidates 401(k)s, 403(b)s, 457s, and several other existing retirement vehicles into a single plan

Changes for ERs if ERSAs Enacted

- Higher cost:
  - Freeze existing plans and establish ERSAs for future contributions = two plans result

    OR

  - Merge old plan into new plan = one plan results

Changes for ERs if ERSAs Enacted

- Higher cost: EE education
- Amendment of SLG statutes

Changes for EEs if ERSAs Enacted

- Possible loss of attractive features, such as special catch up contributions
- Confusion of having an old frozen plan and a new plan OR having completely new plan that replaces old plan

Bill introductions of LSAs, RSAs, and ERSAs

- LSAs – H.R. 1163 and S. 545
- RSAs – H.R. 1162 and S. 546
- ERSAs – H.R. 1161 and S. 547

Pension Regulations

- Minimum Distribution Rules (MDRs) Final Regulations
- 403(b) Proposed Regulations
- Phased Retirement Proposed Regulations

Questions?