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FEDERAL WORKERS' COMPENSATION

Issues Associated With Changing Benefits for Older Beneficiaries

Statement of Daniel Bertoni, Director
Education, Workforce, and Income Security Issues



G A O

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Chairman Walberg, Ranking Member Woolsey and Members of the Committee:

I am pleased to be here today to comment on issues related to possible changes to the Federal Employees' Compensation Act (FECA) program, a topic that we have reported on in the past. At the end of chargeback year 2010, the FECA program, administered by the Department of Labor (Labor) paid more than \$1.88 billion in wage-loss compensation, impairment, and death benefits, and another \$898.1 million for medical and rehabilitation services and supplies.¹ Currently, FECA benefits are paid to federal employees who are unable to work because of injuries sustained while performing their federal duties, including those who are at or older than retirement age. Concerns have been raised that federal employees on FECA receive benefits that could be more generous than under the traditional federal retirement system and that the program may have unintended incentives for beneficiaries to remain on the FECA program beyond the traditional retirement age. Over the past 30 years, there have been various proposals to change the FECA program to address this concern. Recent policy proposals to change the way FECA is administered for older beneficiaries share characteristics with past proposals we have discussed in prior work. In August 1996, we reported on the issues associated with changing benefits for older beneficiaries.² Because FECA's benefit structure has not been significantly amended in more than 35 years, the policy questions raised in our 1996 report are still relevant and important today.

My statement today will focus on (1) previous proposals for changing FECA benefits for older beneficiaries and (2) questions and associated issues that merit consideration in crafting legislation to change benefits for older beneficiaries. This statement is drawn primarily from our 1996 report in which we solicited views from selected federal agencies and employee groups to identify questions and associated issues with crafting benefit changes. In that report, we also reviewed relevant laws and analyzed previous studies and legislative proposals that would have changed benefits for older FECA beneficiaries. For purposes of this testimony, we

¹FECA benefits are paid out of the Employees' Compensation Fund and most are charged back to the employee's agency. Labor's chargeback year for FECA agency billing purposes ends June 30, 2010.

²GAO, *Federal Employees' Compensation Act: Issues Associated With Changing Benefits for Older Beneficiaries*, [GGD-96-138BR](#) (Washington, D.C.: Aug. 14, 1996).

did not conduct a legal analysis to update the results of our prior work, but instead relied upon secondary sources such as the Congressional Research Service (CRS). The work on which this testimony was based was conducted in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

In summary, we have reported that the perception that many retirement-age beneficiaries were receiving more generous benefits on FECA had generated two alternative proposals to change benefits once beneficiaries reach the age at which retirement typically occurs: (1) converting FECA benefits to retirement benefits and, (2) changing FECA wage-loss benefits by establishing a new FECA annuity. We also discussed a number of issues to be considered in crafting legislation to change benefits for older beneficiaries. Going forward, Congress may wish to consider the following questions in assessing current proposals for change: (1) How would benefits be computed? (2) Which beneficiaries would be affected? (3) What criteria, such as age or retirement eligibility, would initiate changed benefits? (4) How would other benefits, such as FECA medical and survivor benefits, be treated and administered? (5) How would benefits, particularly retirement benefits, be funded?

Background

FECA

FECA is administered by Labor's Office of Workers' Compensation Programs (OWCP) and currently covers more than 2.7 million civilian federal employees from more than 70 different agencies. FECA benefits are paid to federal employees who are unable to work because of injuries sustained while performing their federal duties. Under FECA, workers' compensation benefits are authorized for employees who suffer temporary or permanent disabilities resulting from work-related injuries or diseases. FECA benefits include payments for (1) loss of wages when employees cannot work because of work-related disabilities due to traumatic injuries or occupational diseases; (2) schedule awards for loss of, or loss of use of, a body part or function; (3) vocational rehabilitation; (4) death benefits for survivors; (5) burial allowances; and (6) medical care for injured workers. Wage-loss benefits for eligible workers with temporary or permanent total disabilities are generally equal to either 66-2/3 percent of salary for a

worker with no spouse or dependent, or 75 percent of salary for a worker with a spouse or dependent. Wage-loss benefits can be reduced based on employees' wage-earning capacities when they are capable of working again. OWCP provides wage-loss compensation until claimants can return to work in either their original positions or other suitable positions that meet medical work restrictions.³ Each year, most federal agencies reimburse OWCP for wage-loss compensation payments made to their employees from their annual appropriations. If claimants return to work but do not receive wages equal to that of their prior positions—such as claimants who return to work part-time—FECA benefits cover the difference between their current and previous salaries.⁴ Currently, there are no time or age limits placed on the receipt of FECA benefits.

With the passage of the Federal Employees' Compensation Act of 1916, members of Congress raised concerns about levels of benefits and potential costs of establishing a program for injured federal employees.⁵ As Congress debated the act's provisions in 1916 and again in 1923, some congressional members were concerned that a broad interpretation threatened to make the workers' compensation program, in effect, a general pension. The 1916 act granted benefits to federal workers for work-related injuries. These benefits were not necessarily granted for a lifetime; they could be suspended or terminated under certain conditions. Nevertheless, the act placed no age or time limitations on injured workers' receipt of wage compensation. The act did contain a provision allowing benefits to be reduced for older beneficiaries. The provision stated that compensation benefits could be adjusted when the wage-earning capacity

³Employees eligible for FECA benefits could also be eligible for retirement disability benefits from the Office of Personnel Management or Social Security Disability Insurance benefits from the Social Security Administration. Depending on which benefits employees are entitled to, employees might have to make an election between them. In many cases in which individuals receive benefits from different programs simultaneously, one benefit would likely be offset against the other.

⁴The maximum monthly FECA compensation payment cannot exceed 75 percent of the basic monthly pay for a GS-15, step 10 employee (\$129, 517 per year as of Jan. 2, 2011). In general, OWCP continues to pay claimants the difference between their current salary and the salary they were earning at the time of their injury for as long as this difference exists and their medical work restrictions remains the same. (FECA benefits are indexed to the cost of living.) OWCP would not continue to pay this difference for claimants who quit their job without good cause (for example, if they quit because they did not like their work hours).

⁵39 Stat. 742.

of the disabled employee would probably have decreased on account of old age, irrespective of the injury.

While the 1916 act did not specify the age at which compensation benefits could be reduced, the 1949 FECA amendments established 70 as the age at which a review could occur to determine if a reduction were warranted.⁶ In 1974, Congress again eliminated the age provision.⁷

Federal Retirement Systems

Typically, federal workers participate in one of two retirement systems which are administered by the Office of Personnel Management (OPM): the Civil Service Retirement System (CSRS), or the Federal Employees' Retirement System (FERS). Most civilian federal employees who were hired before 1984 are covered by CSRS. Under CSRS, employees generally do not pay Social Security taxes or earn Social Security benefits. Federal employees first hired in 1984 or later are covered by FERS. All federal employees who are enrolled in FERS pay Social Security taxes and earn Social Security benefits. Federal employees enrolled in either CSRS or FERS also may contribute to the Thrift Savings Plan (TSP); however, only employees enrolled in FERS are eligible for employer matching contributions to the TSP.

Under both CSRS and FERS, the date of an employee's eligibility to retire with an annuity depends on his or her age and years of service. The amount of the retirement annuity is determined by three factors: the number of years of service, the accrual rate at which benefits are earned for each year of service, and the salary base to which the accrual rate is applied.⁸ In both CSRS and FERS, the salary base is the average of the

⁶63 Stat. 854.

⁷Public Law No. 93-416. 88 Stat. 1143. According to Senate Report 93-1081, the Committee on Labor and Public Welfare stated that (1) the provision requiring the review of compensation was an unnecessary burden on both the injured employees and the Secretary of Labor (who had the authority to conduct the review); (2) age 70 had no bearing on one's entitlement to benefits; and (3) such a provision was discriminatory. FECA currently does not include a provision to change benefits based on retirement age.

⁸Under CSRS, a worker with at least 30 years of service can retire at the age of 55; a worker with at least 20 years of service can retire at the age of 60; and a worker with 5 or more years of service can retire at the age of 62. The FERS minimum retirement age for an employee with 30 or more years of service is 55 for workers born before 1948. A worker who has reached the minimum retirement age and has completed at least 30 years of service can retire with an immediate, unreduced annuity. A worker with 20 or more years of service can retire with an unreduced annuity at age 60, and a worker with at least 5 years of service can retire at age 62 with an unreduced annuity.

highest three consecutive years of basic pay. This is often called “high-3” pay.

According to CRS, an injured employee cannot contribute to Social Security or to the TSP while receiving workers’ compensation because Social Security taxes and TSP contributions must be paid from earnings, and workers’ compensation payments are not classified as earnings under either the Social Security Act or the Internal Revenue Code. As a result, the employee’s future retirement income from Social Security and the TSP may be reduced. Legislation passed in 2003 increased the FERS basic annuity from 1 percent of the individual’s high-3 average pay to 2 percent of high-3 average pay while an individual receives workers’ compensation, which would help replace income that may have been lost from lower Social Security benefits and reduced income from TSP.⁹

Proposals to Change Benefits for Older Beneficiaries

Concerns that beneficiaries remain in the FECA program past retirement age have led to several proposals to change the program. Under current rules, an age-eligible employee with 30 years of service covered by FERS could accrue pension benefits that are 30 percent of their average high-3 pay and under CSRS could accrue almost 60 percent of their high-3 average pay. Under both systems benefits can be taxed.¹⁰ FECA beneficiaries can receive up to 75 percent of their preinjury income, tax-free, if they have dependents and 66-2/3 percent without dependents. Because returning to work could mean giving up a FECA benefit for a reduced pension amount, concerns have been raised by some that the program may provide incentives for beneficiaries to continue on the program beyond retirement age.

In 1996, we reported on two alternative proposals to change FECA benefits once beneficiaries reach the age at which retirement typically occurs: (1) converting FECA benefits to retirement benefits, and (2) changing FECA wage-loss benefits to a newly established FECA annuity.

⁹Pub. L. No. 108-92, 117 Stat. 1160 (2003).

¹⁰The replacement rate for a federal worker who retires with 30 years of service under CSRS is 56.25 percent. FERS accrual rates are lower than the accrual rates under CSRS because employees under FERS pay Social Security payroll taxes and earn Social Security retirement benefits. Estimating replacement rates under FERS is complicated by the fact that income from two of its components—Social Security and the TSP—will vary depending on the individual’s work history, contributions to the TSP, and the investment performance of his or her TSP account.

The first proposal would convert FECA benefits for workers who are injured or become ill to regular federal employee retirement benefits at retirement age. In 1981, the Reagan administration proposed comprehensive FECA reform, including a provision to convert FECA benefits to retirement benefits at age 65. The proposal included certain employee protections, one of which was calculating retirement benefits on the basis of the employee's pay at time of injury (with adjustments for regular federal pay increases). According to proponents, this change would improve agencies' operations because their discretionary budgets would be decreased by FECA costs, and, by reducing caseload, it would allow Labor to better manage new and existing cases for younger injured workers. A bill recently introduced in Congress includes a similar provision, requiring FECA recipients to retire upon reaching retirement age as defined by the Social Security Act.¹¹

The second proposal, based on proposals that several agencies developed in the early 1990s, would convert FECA wage-loss compensation benefits to a FECA annuity benefit. These agency proposals would have reduced FECA benefits by a set percentage two years after beneficiaries reached civil service retirement eligibility. Proponents of this alternative noted that changing to a FECA annuity would be simpler than converting FECA beneficiaries to the retirement system, would result in consistent benefits, and would allow benefits to remain tax-free. Proponents also argued that a FECA annuity would keep the changed benefit within the FECA program, thereby avoiding complexities associated with converting FECA benefits under CSRS and FERS. For example, converting to retirement benefits could be difficult for some employees who currently are not participating in a federal retirement plan. Also, funding future retirement benefits could be a problem if the FECA recipient has not been making retirement contributions. Labor recently suggested a change to the FECA program that would reduce wage-loss benefits for Social Security retirement-aged recipients to 50 percent of their gross salary at the date of injury, but would still be tax-free.¹² Labor's proposal would still keep the changed benefit within the FECA program.

¹¹Federal Employees' Compensation Reform Act of 2011, S. 261, 112th Cong. (2011).

¹²According to CRS, an injured employee cannot contribute to Social Security or to the TSP while receiving workers' compensation because Social Security taxes and TSP contributions must be paid from earnings, and workers' compensation payments are not classified as earnings under either the Social Security Act or the Internal Revenue Code.

In our 1996 report, however, we identified a number of issues with both alternative proposals. For example, some experts and other stakeholders we interviewed noted that age discrimination posed a possible legal challenge and that some provisions in the law would need to be addressed with new statutory language.¹³ Others noted that benefit reductions would cause economic hardships for older beneficiaries. Some noted that without the protections of the workers' compensation program, injured employees who have few years of service or are ineligible for retirement might suffer large reductions in benefits. Moreover, opponents to change also viewed reduced benefits as breaking the workers' compensation promise. Another concern was that agencies' anticipation of reduced costs for workers' compensation could result in fewer incentives to manage claims or to develop safer working environments.

Questions and Issues to Consider if Crafting FECA Changes

We also discussed in our 1996 report a number of issues that merit consideration in crafting legislation to change benefits for older beneficiaries. Going forward, Congress may wish to consider the following questions as it assesses and considers current reform proposals: (1) How would benefits be computed? (2) Which beneficiaries would be affected? (3) What criteria, such as age or retirement eligibility, would initiate changed benefits? (4) How would other benefits, such as FECA medical and survivor benefits, be treated and administered? (5) How would benefits, particularly retirement benefits, be funded?

How Would Benefits Be Computed?

The retirement conversion alternative raises complex issues, arising in part from the fact that conversion could result in varying retirement benefits, depending on conversion provisions, retirement systems, and individual circumstances. A key issue is whether or not benefits would be adjusted. The unadjusted option would allow for retirement benefits as provided by current law. The adjusted option would typically ensure that time on the FECA rolls was treated as if the beneficiary had continued to work. This adjustment could (1) credit time on FECA for years of service or (2) increase the salary base (for example, increasing salary from the time of injury by either an index of wage increases or inflation, assigning

¹³Some argued that changing benefits for older beneficiaries violates protections against age discrimination contained in federal law by forcing them into accepting retirement benefits or a reduced annuity at a certain age.

the current pay of the position, or providing for merit increases and possible promotions missed due to the injury).

Determining the FECA annuity would require deciding what percentage of FECA benefits the annuity would represent. Under previous proposals benefits would be two-thirds of the previous FECA compensation benefits. Provisions to adjust calculations for certain categories of beneficiaries also have been proposed. Under previous proposals, partially disabled individuals receiving reduced compensation would receive the lesser of the FECA annuity or the current reduced benefit. FECA annuity computations could also be devised to achieve certain benchmarks. For example, the formula for a FECA annuity could be designed to approximate a taxable retirement annuity. One issue concerning a FECA annuity is whether it would be permanent once set, or whether it would be subject to adjustments based on continuing OWCP reviews of the beneficiary's workers' compensation claim.

Which Beneficiaries Would Be Affected?

Currently most federal employees are covered by FERS, but conversion proposals might have to consider differences between FERS and CSRS participants, and participants in any specialized retirement systems.¹⁴ Other groups that might be uniquely affected include injured workers who are not eligible for federal retirement benefits, individuals eligible for retirement conversion benefits, but not vested; and individuals who are partially disabled FECA recipients but active federal employees. With regard to vesting, those who have insufficient years of service to be vested might be given credit for time on the FECA rolls until vested. There is also the question of whether changes will focus on current or future beneficiaries. Exempting current beneficiaries delays receipt of full savings from FECA cost reductions to the future. One option might be a transition period for current beneficiaries. For example, current beneficiaries could be given notice that their benefits would be changed after a certain number of years.

¹⁴One conversion decision concerns whether to exempt injured workers who are ineligible for federal retirement benefits. Ineligible workers include, for instance, those without 5 years of federal service under CSRS, those who have withdrawn retirement contributions, temporary workers, and state and local police covered under special FECA provisions.

What Criteria Would Initiate Changed Benefits?

Past proposals have used either age or retirement eligibility as the primary criterion for changing benefits. If retirement eligibility is used, consideration must be given to establishing eligibility for those who might otherwise not become retirement eligible. This would be true for either the retirement conversion or the annuity option. At least for purposes of initiating the changed benefit, time on the FECA rolls might be treated as if it counted for service time toward retirement eligibility. Deciding on the criteria that would initiate change in benefits might require developing benchmarks. For example, if age were the criteria, it might be benchmarked against the average age of retirement for federal employees, or the average age of retirement for all employees. Another question is whether to use secondary criteria to delay changed benefits in certain cases. The amount of time one has received FECA benefits is one possible example of secondary criteria. Secondary criteria might prove important in cases where an older, injured worker may face retirement under the retirement conversion option even when recovery and return to work is almost assured.

How Would Other Benefits, Such As FECA Medical Benefits Or Survivor Benefits, Be Treated and Administered?

In addition to changing FECA compensation benefits, consideration should be given to whether to change other FECA benefits, such as medical benefits or survivor benefits. For example, the 1981 Reagan administration proposal would have ended survivor benefits under FECA for those beneficiaries whose benefits were converted to the retirement system. Another issue to consider is who will administer benefits if program changes shift responsibilities—OPM administers retirement annuity benefits for federal employees, and Labor currently administers FECA benefits. Although it may be advantageous to consolidate case management in one agency, such as OPM, if the retirement conversion alternative were selected, the agency chosen to manage the case might have to develop an expertise that it does not currently possess. For example, OPM might have to develop expertise in medical fee schedules to control workers' compensation medical costs.

How Would Benefits, Particularly Retirement Benefits, Be Funded?

For the retirement conversion alternative, another issue is the funding of any retirement benefit shortfall. Currently, agencies and individuals do not make retirement contributions if an individual receives FECA benefits; thus, if retirement benefits exceed those for which contributions have been made, retirement funding shortfalls would occur. Retirement fund shortfalls can be funded through payments made by agencies at the time of conversion or prior to conversion. First, lump-sum payment could be made by agencies at the time of the conversion. This option has been

criticized because the start-up cost was considered too high. Second, shortfalls could be covered on a pay-as-you-go basis after conversion. In this approach, agencies might make annual payments to cover the shortfall resulting from the conversions. Third, agencies' and employees' contributions to the retirement fund could continue before conversion, preventing shortfalls at conversion. Proposals for the FECA annuity alternative typically keep funding under the current FECA chargeback system. This is an annual pay-as-you-go system with agencies paying for the previous year's FECA costs.

In total, these five questions provide a framework for considering proposals to change the program.

Concluding Remarks

In conclusion, FECA continues to play a vital role in providing compensation to federal employees who are unable to work because of injuries sustained while performing their duties. However, continued concerns that the program provides incentives for beneficiaries to remain on the program at, and beyond, retirement age have led to calls for the program to be reformed. Although FECA's basic structure has not significantly been amended for many years, there continues to be interest in reforming the program. Proposals to change benefits for older beneficiaries raise a number of important issues, with implications for both beneficiaries and federal agencies. These implications warrant careful attention to outcomes that could result from any changes.

Mr. Chairman, this concludes my prepared statement. I would be pleased to respond to any questions that you or other members of the committee may have at this time.

GAO Contact and Staff Acknowledgments

For further information about this testimony, please contact Daniel Bertoni at (202) 512-7215 or bertonid@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this testimony. In addition to the individual named above, key contributors to this testimony include Patrick Dibattista, H. Brandon Haller, Michelle Bracy, Tonnye Conner-White, James Rebbe, Kathleen van Gelder, and Melinda Bowman.

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