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The cost and liabilities of Federal retirement programs are much greater than recognized by current costing and funding procedures. Findings/Conclusions: In 1976, seven of the Government's retirement systems paid over \$15.6 billion to retirees and the survivors of deceased employees and retirees--an increase of \$10 billion since 1970. The systems also reported liabilities exceeding \$320 billion for which less than \$44 billion had been set aside in Federal trust funds. Federal retirement systems' funding requirements vary, but in most cases are less stringent than those imposed by law on private pension plans. Usually, little or no consideration is given to the effect of future general pay increases and annuity adjustments on ultimate benefit payments, resulting in considerable understatement of benefit costs accruing each year. Recommendations: The Congress should enact legislation requiring that the full cost of Federal retirement systems be recognized and funded and that the difference between currently accruing cost and employee contributions be charged to agency operations. In addition, Congress should establish an overall Federal retirement policy to guide retirement system development. Centralization of committee jurisdiction over all Federal employee retirement systems would facilitate the establishment and implementation of such a policy. (Author/SC)

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# REPORT TO THE CONGRESS

BY THE COMPTROLLER GENERAL  
OF THE UNITED STATES

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## Federal Retirement Systems: Unrecognized Costs, Inadequate Funding, Inconsistent Benefits

Costs and liabilities of the seven Federal retirement systems discussed in this report are not fully recognized and funded. Consequently, the costs of agency operations and programs are understated. This also results in unrecognized subsidies to agencies whose operations are intended to be self-supporting.

The Congress has not provided an overall policy to guide the development of Federal retirement systems and should do so. The systems have developed on an independent, piecemeal basis, causing inequities and inconsistencies, as well as common problems. Many of the differences are without apparent explanation.



COMPTROLLER GENERAL OF THE UNITED STATES  
WASHINGTON, D.C. 20548

B-179810

To the President of the Senate and the  
Speaker of the House of Representatives

This report reiterates our concern over Federal employee retirement systems and discusses the many inequities, inconsistencies, and common problems that exist. We are particularly concerned that the full costs of benefits accruing under the systems are not being recognized, thereby inhibiting the ability of the Congress to make sound decisions on establishing, amending, or funding retirement and agency programs. An overall policy is needed to guide the development of Federal retirement systems.

We made our review pursuant to the Budget and Accounting Act, 1921 (31 U.S.C. 53), and the Accounting and Auditing Act of 1950 (31 U.S.C. 67).

We are sending copies of this report to the Chairman, Civil Service Commission; the Director, Office of Management and Budget; the Secretary of Defense; the Secretary of State; the Director, Administrative Office of the United States Courts; the Court Executive, United States Tax Court; the Secretary of the Board, Board of Governors of the Federal Reserve System; and the General Manager, Tennessee Valley Authority.

A handwritten signature in cursive script, reading "James B. Beardsley".

Comptroller General  
of the United States

COMPTROLLER GENERAL'S  
REPORT TO THE CONGRESS

FEDERAL RETIREMENT SYSTEMS:  
UNRECOGNIZED COSTS,  
INADEQUATE FUNDING,  
INCONSISTENT BENEFITS

D I G E S T

This report states once again GAO's concern over Federal employee retirement systems. In 1976, seven of the Government's retirement systems paid over \$15.6 billion to retirees and the survivors of deceased employees and retirees--an increase of \$10 billion since 1970. The systems also reported liabilities exceeding \$320 billion for which less than \$44 billion had been set aside in Federal trust funds.

The Congress should enact legislation requiring that the full cost of Federal retirement systems be recognized and funded and that the difference between currently accruing cost and employee contributions be charged to agency operations.

Federal retirement systems' funding requirements vary, and in most cases are less stringent than those imposed by law on private pension plans. The cost and liabilities of Federal retirement programs are much greater than recognized by current costing and funding procedures. Usually, little or no consideration is given to the effect of future general pay increases and annuity adjustments on ultimate benefit payments, resulting in a considerable understatement of benefit costs accruing each year. For the civil service retirement system alone, unrecognized retirement costs in 1976 amounted to an estimated \$7 billion. In some programs, none of the currently accruing cost is recognized. (See pp. 3 to 5.)

Because most Federal retirement trust funds are required by law to be invested in Federal debt securities, full funding of Government retirement liabilities would not eliminate the need for future taxing and borrowing to meet benefit payments as they become due.

However, full funding would enhance cost recognition and budgetary discipline as well as promote sounder fiscal and legislative decisionmaking. Under existing funding provisions, the unfunded liabilities of Federal retirement systems will continue to grow. (See pp. 5 to 13.)

Costs not covered by employee contributions must ultimately be paid by the Government. When retirement costs are understated, the costs of Government operations and agency programs are also understated. One side effect of the underallocation of retirement costs to agency operations is the unrecognized subsidy that accrues to Government organizations whose programs are required by law to be financed by the users of their services. Understatement of retirement costs may also result in a tendency to adopt benefits which could jeopardize the affordability of the retirement systems. (See pp. 16 to 21.)

Some of the agencies responsible for administering Federal retirement programs agreed with GAO that the full cost of retirement benefits should be recognized. The Department of Defense did not comment on the report, and others had no comments on GAO's recommendations. Self-supporting agencies, whose retirement contributions would be higher if costing and funding techniques recognized general pay increases and annuity adjustments, generally agreed that the costs of their operations were being understated. Some believed the Congress should appropriate funds to pay the higher costs rather than increase charges to the users of the agencies' services. (See pp. 21 and 22.)

GAO further recommends that the Congress establish an overall Federal retirement policy to guide retirement system development. Centralization of committee jurisdiction over all Federal employee retirement systems would facilitate the establishment and implementation of such a policy.

There is no standard or method of assessing the adequacy of Federal employee retirement programs. Different committees of the Congress

have legislative jurisdiction over the various systems. There is no overall policy for guidance in establishing, financing, or amending these programs.

Federal retirement systems have developed on an independent, piecemeal basis. Many inequities, inconsistencies, and common problems exist among the systems. Some of the differences may be legitimate, but many of the benefit provisions differ without apparent explanation.

- Employee contribution rates vary. Some systems require no cost sharing by the covered employees. (See app. I.)
- Each system has its own age and service requirements that employees must meet to become eligible for a retirement annuity. (See pp. 23 and 24.)
- Transfers of service credits between retirement systems are treated inconsistently. (See pp. 23 and 25-26.)
- Benefits payable at retirement vary from system to system. (See pp. 26 to 28.)
- There are wide variations in the survivor benefit programs of the systems. (See pp. 28 and 29.)
- Each system has differing provisions regarding the amounts reemployed annuitants may receive. (See pp. 29 to 31.)
- Disability provisions and practices are not consistent. (See pp. 31 and 32.)
- Social security coverage is provided to employees under two of the retirement systems. Employees in the other systems are prohibited by law from participating in social security through their Federal employment. (See p. 32.)

Most Federal agencies responsible for administering the various retirement systems made no specific comments to GAO on whether the many different provisions and practices followed are justified. (See pp. 32 and 33.)

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            District of Columbia

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ABBREVIATIONS

ERISA      Employee Retirement Income Security Act  
GAO        General Accounting Office  
OMB        Office of Management and Budget  
TVA        Tennessee Valley Authority  
CPI        Consumer Price Index

## CHAPTER 1

### INTRODUCTION

In a 1974 report to the Congress, we summarized the financial status and benefit provisions of various Federal employee retirement systems and discussed a number of issues related to basic policies, financing, administration, and benefits. <sup>1/</sup> We recommended that the Congress assume a major role in establishing an overall retirement policy to provide objectives and principles to guide future development and improvement of Government retirement systems. Since then we have reviewed in depth and reported on various aspects of Federal retirement programs and are presently, at the request of three House committee and subcommittee chairmen, conducting a comprehensive study of the desirability of consolidating all or part of the retirement systems administered by agencies and instrumentalities of the Federal Government into a centralized mechanism.

This report reiterates our concern over Federal employee retirement systems and provides additional and updated information on the issues involved.

A retirement system is basically a program for providing a pension to retired employees. The amount of the pension is generally based on either length of service or salary, or some combination of both. Although a life pension is considered the primary benefit of any system, retirement systems also frequently provide benefits for death, disability, and involuntary termination.

Seven retirement systems cover most Federal personnel. The table on the following page shows, for fiscal year 1976, the number of employees and annuitants covered by each system and the amount of benefits paid.

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<sup>1/</sup>"Federal Retirement Systems: Key Issues, Financial Data, and Benefit Provisions" (B-179810), July 30, 1974.

<u>Retirement systems</u>	<u>Employees</u>	<u>Beneficiaries (retirees and survivors)</u>	<u>Outlays (millions)</u>
Civil service	2,721,900	1,452,353	\$ 8,284.1
Foreign Service	7,983	4,606	66.9
Uniformed services	2,924,624	1,109,357	7,295.7
U.S. Tax Court judges	13	13	.4
Tennessee Valley Authority (TVA)	17,799	4,599	22.2
Federal judiciary	503	343	a/7.8
Federal Reserve Board	<u>1,302</u>	<u>289</u>	<u>a/2.4</u>
	<u>5,674,124</u>	<u>2,571,560</u>	<u>\$15,679.5</u>

a/As of Dec. 31, 1975.

SCOPE OF REVIEW

Our examination included a review of retirement legislation and related documents and reports, actuarial valuations, agency statistical reports, and previous studies of Federal employment retirement systems. We also interviewed system actuaries and other Government officials responsible for administering these programs.

## CHAPTER 2

### COST OF RETIREMENT PROGRAMS:

#### UNDERSTATED AND UNDERFUNDED

The benefits accruing under Federal retirement systems represent a large and growing long-term financial commitment of the U.S. Government. Full recognition of these growing liabilities as they accrue is essential not only in determining and allocating the cost of Government operations, but also in determining the present and future financial condition of the United States. However, benefit costs are not fully recognized and consequently the costs of Government programs are understated and large unfunded liabilities have been created.

#### RECOGNIZING RETIREMENT COSTS

In actuarial terminology, the value of benefit rights earned (accrued) annually by employees covered under a retirement system is referred to as the "normal cost" of the system. For most Federal retirement systems, the estimated normal cost is understated, and for some it is not calculated at all.

Because of the uncertainty of such future events as death, disability, or retirement, the ultimate cost of a retirement system can be determined only as actual expenditures emerge throughout the life of the system. By the very nature of a retirement system, there is a timelag between the accrual of benefit rights and the actual payment of benefits. Under most Federal retirement systems, benefit rights accrue during an employee's years of service. That is, each year of service has an associated benefit value.

Normal cost is commonly expressed as a percent of payroll, and from a financing point of view represents an estimate of the amount of funds which, if accumulated annually and invested over covered employees' careers, will be enough to meet their future benefit payments. Estimating the normal cost is a complex actuarial process which requires consideration of a multitude of factors. Basically, however, the process involves mathematically predicting the future experience of the system (for example, salary progression, rate of return on invested funds, probable rates of employees' death, disability, retirement, and termination of employment) and translating this experience into cost on the basis of the systems' benefit provisions. If reasonable assumptions are not made on all factors affecting future benefit payments, normal cost will be incorrect.

Normal cost can be calculated on either a "static" or "dynamic" basis. Static calculations do not consider future general pay increases or future annuity cost-of-living adjustments; dynamic calculations consider such increases.

The normal cost of most Federal retirement systems is calculated on a static basis even though annuities are generally based on an employee's salary and length of service and most systems provide for increasing these annuities based on increases in the Consumer Price Index (CPI). General pay and annuity increases have occurred frequently and in large amounts. However, because the probability that such increases will occur in the future is generally ignored in calculating normal cost, accruing Government retirement liabilities are greatly understated.

For example, the costs accruing under the civil service retirement system are determined on a static basis, even though since 1969 Federal white-collar pay has increased 65 percent and annuity adjustments have totaled 80 percent. In its most recent actuarial report, the Board of Actuaries estimated the system's static normal cost to be 13.64 percent of pay. Thus, agency and employee contributions of 7 percent of pay each, as required by law, appear to cover the normal cost of the system. However, the report also included estimates of the system's dynamic normal cost which ranged from 21.56 to 28.74 percent, depending on the economic assumptions used. These estimates were not intended as a prediction of the system's future experience but as an expression of the Board's concern that the potential long-range obligations resulting from general pay increases and annuity cost-of-living adjustments be recognized. Between November 1969 and March 1976, benefit adjustments increased the system's liabilities by approximately \$28 billion.

The Office of Management and Budget (OMB) recently gave official recognition to the dynamic normal cost of the civil service retirement system. Using economic assumptions derived from past pay and cost-of-living increase experience, OMB estimated the dynamic normal cost to be 31.7 percent of pay. In October 1976, OMB instructed Federal agencies to use a retirement cost factor of 24.7 percent of base pay (31.7 percent less 7-percent employee contributions) when preparing cost analyses under OMB Circular A-76. 1/ In June 1977,

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1/This circular provides guidance to Federal agencies in making decisions and cost comparisons pertaining to in-house vs. contracting out for needed products and services.

OMB temporarily suspended use of this factor pending a complete review of the circular and its implementation. We were advised by OMB officials, however, that they have no reason to question the accuracy of the 31.7 percent dynamic normal cost figure.

In fiscal year 1976, the total payroll for employees covered by the civil service system was approximately \$39.2 billion. Based on this payroll figure, the following table indicates the difference in the estimated costs accruing under the system depending on whether such costs are determined on a static or dynamic basis.

<u>Computation method</u>	<u>Normal cost</u>	
	<u>Percent of pay</u>	<u>Amount (billions)</u>
Dynamic	31.70	\$12.4
Static	<u>13.64</u>	<u>5.3</u>
Understated cost	<u>17.06</u>	<u>\$ 7.1</u>

#### FUNDING RETIREMENT COSTS

The primary purpose of Government funding is to formally recognize cost. Funding Federal retirement systems promotes sound fiscal and legislative responsibility and enhances budgetary discipline.

The conventional approach to financing pension benefits is for the employer (and the employees in a contributory plan) to set aside funds in advance of the date on which the benefits become payable. However, some Federal retirement systems (for example, the uniformed services system) operate on a "pay-as-you-go" basis whereby the Government finances benefit payments through annual appropriations.

A retirement system is considered fully funded if funds on hand and to be received are equal to the system's liability for benefit payments to present retirees and the anticipated liability for active employees, expressed in terms of present value. <sup>1/</sup> However, when the fund balance and future receipts are less than the liability, an unfunded liability

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<sup>1/</sup>Present value is a concept which recognizes the time value of money. It is a technique for determining the amount of money which, if invested today at a given interest rate, would be sufficient to provide monthly benefits in the future.

is said to exist. (Under a pay-as-you-go system, all of the liability is unfunded.) As shown in the following table, the reported unfunded liabilities for three major Federal retirement systems have grown, on a static basis, from \$157 billion in fiscal year 1970 to \$280 billion in fiscal year 1976, an increase of 79 percent. Under existing funding provisions, the unfunded liabilities will continue to increase.

	1970			1976			Percent of increase in unfunded liability
	Liability (note a)	Fund balance	Unfunded liability	Liability (note a)	Fund balance	Unfunded liability	
----- (millions) -----							
Uniformed services	\$103,426	\$	\$103,426	\$172,239	\$	\$172,239	67
Civil service	75,236	22,432	52,804	150,470	43,470	107,000	103
Foreign Service	528	53	475	b/1,252	185	b/1,067	125
	<u>\$179,190</u>	<u>\$22,485</u>	<u>\$156,705</u>	<u>\$323,961</u>	<u>\$43,655</u>	<u>\$280,306</u>	79

a/Net liability after deducting future agency and employee contributions and future amortization payments covering specific liability increases. (See pp. 8 and 10.)

b/As of Sept. 30, 1976.

Although some Federal retirement systems provide for advance funding of future benefit payments, Federal and private funding practices differ. Contributions to private pension funds are usually made in cash by employers and/or employees. These funds are managed by independent trustees who invest the contributions in income-producing securities and, as needed to make benefit payments, convert the investments into cash by selling them in the securities market. The essence of the private trust fund is that its receipts and balance represent cash or assets that can be converted to cash.

Some Federal retirement trust funds have the outward characteristics of private pension funds, but with an important difference. The receipts of Government retirement funds--for example, deductions from employees' salaries, agency contributions, direct appropriations, and interest earnings--are generally required by law to be invested in

Federal securities. 1/ There is no cash involved in this kind of intragovernmental transaction, only bookkeeping entries. Thus, funding in itself does not cause a financial hardship for the Government. When funds are needed to make benefit payments, the Treasury obtains the cash through its normal channels of tax receipts or borrowing from the public.

Billions of dollars in benefits are paid annually under Federal retirement programs. These annual outlays are increasing greatly. The following table shows the 1970 to 1976 increases for three Government retirement systems which cover approximately 98 percent of all Federal employees.

Retirement system	Outlays		Percent of increase
	1970	1976	
	(millions)		
Civil service	\$2,752	\$ 8,284	201
Uniformed services	2,853	7,296	156
Foreign Service	16	67	319
Total	<u>\$5,621</u>	<u>15,647</u>	178

The increase in outlays during this period was due primarily to (1) an increase in number of beneficiaries (50 percent), (2) increases in the pay rates upon which annuities are based (36 percent in white-collar jobs, for example), and (3) annuity cost-of-living adjustments (64 percent).

#### FINANCING AND FUNDING PRACTICES OF FEDERAL RETIREMENT SYSTEMS

No uniform practices or principles exist with respect to financing and funding Federal retirement systems. Different methods are used by each system. Some require employees to contribute to retirement funds, and some do not.

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1/The funds of two Federal retirement systems--TVA and the Federal Reserve Board--are not required by law to be invested in Federal securities. These funds are in diversified investments including fixed-income securities, common stocks, and real property.



Some provide for fully funding benefit rights as they accrue, some provide for partial funding, and some are completely unfunded. Following is a brief discussion of the financing and funding practices of each system covered by this report.

### Civil service retirement system

The last major change in civil service funding policies occurred in October 1969 with the enactment of Public Law 91-93 (83 Stat. 136). Immediately before this change, the only contributions to the fund consisted of agency and employee contributions of 6.5 percent each. Estimates at that time indicated the fund would be depleted by 1987 unless funding changes were made.

The 1969 legislation increased both agency and employee contributions to 7 percent. In fiscal year 1976, the agencies and their employees each contributed about \$2.7 billion to the retirement fund.

The 1969 law also requires the Government to make direct appropriations to liquidate, in 30 annual installments, any increase in the unfunded liability resulting from pay increases, liberalization of retirement benefits, or extension of retirement coverage to new groups of employees. In addition, the Secretary of the Treasury is required to transfer to the civil service retirement fund annual payments for interest on the unfunded liability and for the cost of allowing credits for military service. In fiscal year 1976, the Government appropriations and the Treasury transfers totaled \$4.7 billion.

In addition, the fund earned \$2.5 billion in interest on assets invested in Federal securities.

While the intent of the 1969 legislation was to stabilize the fund and retard the growth of the unfunded liability, this was not achieved. The Government's contributions to the Civil Service Retirement and Disability Fund, as well as the unfunded liability and outlays, are growing dramatically. From the end of fiscal year 1970 to the end of fiscal year 1976

--Government contributions to the retirement fund increased by 280 percent to \$7.4 billion, 18.9 percent of payroll;

--cash outlays increased by 201 percent to \$8.3 billion; and

--the unfunded liability, computed on a static basis, increased by 103 percent to \$107 billion.

The \$107 billion unfunded liability was attributable to various causes, including (1) creditable service for which neither the Government nor the employees made contributions; (2) not funding liabilities resulting from general pay increases, cost-of-living adjustments to annuities, and benefit liberalizations; and (3) lost interest income which would have been earned if the accrued liability had been fully funded. The unfunded liability will continue to increase, primarily because of cost-of-living adjustments for which no funding provision has been made.

Assuming the same yearly average pay and cost-of-living increases (6 percent) as occurred in fiscal years 1970 to 1975, it is estimated that by 1985

--the Government's annual contributions to the fund will increase another 192 percent to \$21.6 billion, about 34 percent of pay;

--expected benefit payments will increase another 254 percent to \$29.4 billion; and

--the unfunded liability will increase another 93 percent to about \$207 billion.

#### Foreign Service retirement system

This system is funded in much the same manner as the civil service system. Participants contribute 7 percent of their pay, and the employing agency makes a matching contribution. In addition, Public Law 94-350 (90 Stat. 823), approved July 12, 1976, authorized annual appropriations to the retirement fund equal to the amount that the system's normal cost exceeds employee and employer contributions.

The normal cost of the Foreign Service system as determined by the latest actuarial valuation was 18.6 percent of payroll. As in the civil service system, this figure is a static calculation that does not include the effect of future general pay increases or annuity adjustments. At the time of our review, a new valuation was being made which was to include future annual annuity cost-of-living adjustments. However, it did not provide for future general pay increases. Consequently, normal cost will continue to be understated.

The Government makes direct appropriations to amortize any increase in the unfunded liability resulting from (1) pay increases, (2) liberalization of retirement benefits, or (3) extension of retirement coverage to new groups of employees. Also, the Secretary of the Treasury annually credits to the retirement fund an amount equivalent to the interest on the unfunded liability and the cost associated with allowing credit for military service. For fiscal year 1976, amortization payments, interest on the unfunded liability, and military service credit payments totaled \$54.5 million.

The unfunded liability of the system as of September 30, 1976, was about \$1.1 billion. A portion of the civil service system, cost-of-living adjustments granted to annuitants had not been funded. Another factor which contributed to the unfunded liability was the requirement that Foreign Service staff employees be covered by the civil service system until they completed 10 continuous years with the Foreign Service. (This requirement was rescinded by Public Law 94-350.) During the time of the 10-year requirement, these employees and the Department of State made matching contributions to the civil service fund. When the 10-year requirement was met, the employees' service was credited to the Foreign Service system and employees' contributions plus interest earnings were transferred from the civil service fund to the Foreign Service fund. However, the agency contributions and amortization payments, along with the associated interest earnings, remained in the civil service fund.

#### Uniformed services retirement system

This system is noncontributory, meaning that the Government pays the entire cost of providing benefits. <sup>1/</sup> The system operates on a pay-as-you-go basis, and benefits are financed through annual congressional appropriations. As a result, the Department of Defense budget reflects some of the cost of operating the military services in prior years, but does not include any accrual of retirement costs for current military personnel.

The following table shows actual and projected outlays and accrued liabilities through fiscal year 1978.

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<sup>1/</sup>Military personnel are also covered under social security and provided certain death and disability coverage by the Veterans Administration.

	<u>Outlays (note a)</u>		<u>Accrued liabilities</u>
	<u>Amount</u>	<u>Percent of basic pay (note b)</u>	
	(millions)		(millions)
1970	\$2,743	22.3	\$103,426
1971	3,260	26.0	113,389
1972	3,742	28.5	121,392
1973	4,218	28.7	130,373
1974	4,962	33.2	148,016
1975	6,028	39.7	169,228
1976	7,048	45.5	172,239
1977	7,822	48.7	175,085
1978	8,536	51.9	177,724

a/Actual costs, fiscal year 1970 to 1976; projected costs, fiscal years 1977 and 1978. Excludes reserve retired pay and survivor benefits.

b/Based on budgeted basic pay for all years.

#### U.S. Tax Court judges retirement system

Retirement benefits under this system are financed by annual congressional appropriations. Judges who elect to participate in the system's survivor benefit plan contribute 3 percent of pay before and after retirement. Survivor benefit payments in excess of such contributions are financed by annual appropriations. Estimates of the expenditures and appropriations necessary for the maintenance and operation of the survivor annuity fund are submitted annually to OMB. Because the system is basically a pay-as-you-go operation, normal cost is not determined. The unfunded liability of the survivor benefit plan as of September 30, 1976, was less than \$500,000. The unfunded liability of the noncontributory retirement plan has not been determined.

#### Retirement Plan for Employees of the Board of Governors of the Federal Reserve System

This system is funded through employee contributions of 7 percent of pay and contributions by the employer equal to the difference between employee contributions and normal cost. In calculating normal cost, the actuary has always included an economic assumption regarding future general pay increases.

Employee contributions during calendar year 1976 totaled about \$1.5 million, while the employer contributed about \$2.7 million. In addition, \$1.2 million was required to fully fund the 5.4 percent annuity cost-of-living adjustment effective March 1, 1976, and this was covered by previously accumulated excess reserves of the plan.

According to the plan's most recent annual report, issued in July 1976, the employer's required contribution was 11.1 percent of basic pay, based on assumptions of 4-percent future annual salary increases and a return on investments at the rate of 5.5 percent. This contribution when combined with the 7-percent employee contributions covers the current normal cost, but not the costs of annuity adjustments based on changes in the CPI. Under the system, any annuity adjustments granted because of changes in the CPI are to be funded immediately by the employer, thus calling for lump sum payments in the amount determined by the actuary. Based on the required normal cost contributions and lump sum payments, the plan's actuary expressed the opinion that funds on hand and those to be received will be sufficient to provide benefits to all retired and active members; in other words, the system reports no unfunded liability.

#### Federal judiciary retirement system

Federal judiciary retirement benefits are financed from funds appropriated for Federal judicial salaries. Because the financing is pay-as-you-go, normal cost is not calculated and the system is completely unfunded. No determination has been made of the amount of the system's unfunded liability.

The system also provides an elective survivor benefit plan which, under Public Law 94-554 (90 Stat. 2611) of October 19, 1976, is financed jointly by contributions of 4.5 percent of salary each by participants and the Government. These contributions are made both before and after retirement. The law also requires the Government to make a direct appropriation to fund the plan's unfunded liability as of January 1, 1977. At the time of our review, the amount of appropriation needed to fund the liability had not been determined. As of March 1, 1976, the unfunded liability of the survivors plan was \$8.5 million.

#### Tennessee Valley Authority retirement system

The TVA retirement system is financed by employee and employer contributions. The system provides retirement

benefits composed of two amounts--an annuity, the employee-financed portion of the benefit, and a pension, the employer-financed portion. The standard employee contribution is 6 percent of basic pay, but it may be adjusted depending on the member's date of entry into the system. TVA employees are also covered under social security, and a member may elect to reduce his contributions to the TVA retirement system by 3 percent on that part of his salary not in excess of the social security base. In fiscal year 1976, TVA employees contributed \$13.9 million to the retirement system.

TVA contributes the amount required to cover the administrative cost of operating the system and to provide all benefits other than those derived from members' contributions. The amount TVA contributes, determined by an annual actuarial valuation, consists of a normal cost contribution, a contribution to amortize any unfunded liability, and a cost-of-living contribution. In fiscal year 1976 TVA contributed \$24.9 million.

Based on the most recent actuarial valuation of the system, prepared as of June 30, 1975, the current employer contribution rate is 10.01 percent of pay. This rate consists of

- 6.81 percent of pay to cover the normal cost,
- .25 percent of pay to fund fiscal year 1975 cost-of-living increases, and
- 2.95 percent of pay to amortize the remaining unfunded liability.

In computing normal cost, factors for prospective pay increases were included. The system's unfunded liability was estimated to be \$85 million.

#### FUNDING REQUIREMENTS IN THE PRIVATE SECTOR

While the Government has not adopted any uniform practices or principles for financing and funding its own retirement programs, it has imposed stringent requirements on pension plans in the private sector through enactment of the Employee Retirement Income Security Act of 1974 (ERISA) (88 Stat. 829). Although government plans are exempted from these requirements, the law does provide for congressional committee studies of retirement plans established by Federal, State, and local governments.

Generally, the minimum funding requirements for private employer plans include: (1) payment of normal cost and (2) minimum amortization periods for funding unfunded liabilities that

- arise initially upon establishment of a new plan (30 years);
- exist as of January 1, 1976, for plans in operation (40 years);
- are created by plan amendments (30 years);
- arise from variations between assumed and actual plan experience (15 years); or
- are created by a change in the plan's actuarial assumptions (30 years).

ERISA does not specify the manner in which normal cost and unfunded liabilities of the private plans are to be determined. It does, however, require that the actuarial assumptions used in making the determinations be reasonable. Section 1013 of the statute states that

"\* \* \* all costs, liabilities, rates of interest, and other factors under the plan shall be determined on the basis of actuarial assumptions and methods which, in the aggregate, are reasonable (taking into account the experience of the plan and reasonable expectations) and which, in combination, offer the actuary's best estimate of anticipated experience under the plan."

Following the enactment of ERISA, the Committee on Actuarial Principles and Practices in Connection with Pension Plans, a body of the American Academy of Actuaries, approved draft recommendations for exposure to the membership of the academy regarding compliance with the ERISA requirements. One of the committee's recommendations would require that the impact of future inflation on retirement costs be recognized in each actuarial assumption affected.

## CONCLUSIONS

The Congress is not being provided realistic and consistent information on the cost of Federal retirement programs; this inhibits its ability to make sound fiscal and legislative

decisions on establishing, amending, or funding retirement and agency programs.

Funding of Federal retirement systems remains a serious, growing problem that needs further attention. We believe that retirement costs for all systems should be determined and funded on a dynamic basis. The Congress, employees, and the taxpayers should not be misled by unrealistic estimates of retirement costs. When the full costs are not recognized, there may be a tendency to adopt added benefits which could jeopardize the eventual affordability of the retirement systems. Lack of full cost recognition also results in the understatement of the cost of Government programs, including subsidies to agencies whose operations are intended to be self-supporting. (See ch. 3.) Furthermore, without full funding, the Government's retirement system liabilities are not totally reflected in the public debt.

#### RECOMMENDATION TO THE CONGRESS

We recommend that the Congress enact legislation requiring all Federal retirement systems to be funded on a dynamic normal cost basis and that the difference between dynamic normal cost and employee contributions be charged to agency operations.

#### AGENCY COMMENTS

The Civil Service Commission generally agreed with our conclusions and acknowledged that current financing measures do not directly show the long-range cost of the civil service retirement system or proposed amendments to the system. The Commission agreed that the full long-term cost of the system should be recognized and stated that it is currently studying various possible approaches to introducing dynamic cost measures into the system's financing.

The Federal Reserve Board indicated full agreement with the report. The Board and the Tennessee Valley Authority reiterated that their retirement system costs were already calculated on a dynamic basis. The Department of Defense did not comment on the report, and responses from the agencies responsible for administering the other three systems did not comment on the recommendation that costs for these systems be calculated on a dynamic basis and charged to agency operations.



## CHAPTER 3

### UNDERSTATED CIVIL SERVICE RETIREMENT COSTS

#### RESULT IN UNRECOGNIZED SUBSIDIES

Because agencies are being charged only a portion of the costs accruing to the Government for the civil service retirement system, those agencies whose operations are intended to be self-supporting are annually receiving large unrecognized subsidies.

Most agencies whose employees are covered by the civil service retirement system are required to make a matching contribution of 7 percent of pay to the retirement fund. While this combined employer-employee contribution of 14 percent of pay covers the static normal cost (13.64 percent) of the system, it is less than half the cost of the system when future pay increases and annuity adjustments are considered. Based on OMB's economic assumptions (see p. 4), the system's dynamic normal cost is 31.7 percent of pay. Using this cost factor as a guide, agencies' operating costs are understated by approximately 17.7 percent of pay (31.7 minus 14).

#### SELECTED AGENCIES RECEIVING SUBSIDIES

Many Government agencies have been established to operate on a self-supporting basis, and others that sell products or services are expected to recover costs incurred. However, because most of these agencies are charged only 7 percent of payroll for civil service retirement contributions, their operations are, in effect, subsidized by an amount equal to their share of unrecognized and unallocated retirement costs. For example, the agencies listed below received subsidies of approximately \$41 million in 1976. These subsidies were calculated using OMB's estimate of 24.7 percent as the dynamic normal cost for the retirement system not covered by employee contributions.

<u>Agency</u>	<u>Estimated cost of accruing benefits</u>	<u>Agency contribution to the retirement fund</u>	<u>Estimated subsidy</u>
----- (millions) -----			
Federal Home Loan Bank Board	\$ 6.6	\$ 1.9	\$ 4.7
Export-Import Bank	2.0	.6	1.4
Federal Deposit Insurance Corporation	12.6	3.6	9.0
Panama Canal Company and Canal Zone Government	35.0	9.9	25.1
Farm Credit Administration	<u>1.1</u>	<u>.3</u>	<u>.8</u>
<b>Total</b>	<b><u>\$57.3</u></b>	<b><u>\$16.3</u></b>	<b><u>\$41.0</u></b>

Certain other self-supporting agencies--the Federal National Mortgage Association and the various Farm credit banks--are not required to match employees' contributions but must, by law, contribute the difference between their employees' contributions and the system's total normal cost. The obvious purpose of this requirement was to charge these agencies the total cost, less employee contributions, of providing retirement benefits to their employees. In actual practice, however, they are paying far less than the full cost. In 1976 the agencies were required to pay only 6.77 percent of pay into the retirement fund (imputed static normal cost estimate for 1976 less 7 percent employee contributions). Based on the 31.7 percent dynamic normal cost figure, we estimate they received subsidies totaling approximately \$2.2 million in 1976.

<u>Agency</u>	<u>Estimated cost of accruing benefits</u>	<u>Agency contribution to the retirement fund</u>	<u>Estimated subsidy</u>
----- (millions) -----			
Federal National Mortgage Association	\$1.3	\$.3	\$1.0
Farm credit banks	<u>1.7</u>	<u>.5</u>	<u>1.2</u>
<b>Total</b>	<b><u>\$3.0</u></b>	<b><u>\$.8</u></b>	<b><u>2.2</u></b>

As a further indication that the Congress intended these agencies to be charged their share of all costs associated with the retirement system, laws require that they pay a portion of the cost of administering the system.

In 1976 the two agencies paid administrative expenses of \$5.41 for each employee covered by the retirement system at the end of the year. This amount was determined by dividing the total administrative expense of the civil service retirement system by the total number of active employees covered by the system at the end of 1976. Although a relatively minor amount, this charge actually represents a double payment by these agencies, because the Commission includes a factor for administrative expenses in computing normal cost. The administrative expenses paid by the Farm credit banks go into the Treasury as miscellaneous receipts, while the amount paid by the Federal National Mortgage Association goes into the civil service retirement fund.

### Postal Service

The United States Postal Service is required by law to match its employees' contributions to the retirement fund and to pay additional amounts to cover the retirement liabilities associated with employee-management bargaining agreements. The additional payments include, but are not limited to, retirement liabilities resulting from negotiated employee pay increases. If retirement costs were calculated on a dynamic basis, total Postal Service and employee contributions would be insufficient to cover the retirement costs accruing each year.

The Postal Reorganization Act (84 Stat. 719) of August 12, 1970, created the Postal Service to be a self-sustaining enterprise and authorized it to bargain collectively with its employees. When initially enacted, however, the act made no provision for funding the retirement liabilities created by employee-management agreements.

The Civil Service Commission requested appropriations from the Congress for fiscal years 1972 and 1973 to cover the annual installments necessary to amortize the Postal Service's portion of the retirement system liability caused by past pay raises. However, the Subcommittee on Treasury--Postal Service--General Government, House Committee on Appropriations, denied the request because it was not clear whether the liability was to be funded by Government appropriations or by the Postal Service. Following this denial, the Comptroller General rendered a

decision to the subcommittee chairman expressing the opinion that it was technically permissible to finance the Postal Service's portion of the amortization payments out of the General Fund of the Treasury.

Realizing the substantial subsidy that would be going to the Postal Service each year by not requiring it to fund the retirement liabilities resulting from employee-management agreements, the Congress passed Public Law 93-349 (88 Stat. 354) in July 1974, making the Postal Service liable for such costs. However, the law did not require the Postal Service to pay for cost-of-living adjustments received by its retirees.

The retirement liabilities resulting from employee-management agreements are determined by the Civil Service Commission and are payable by the Postal Service in 30 equal annual installments, with interest computed at the rate used in the most recent valuation of the retirement system. Although the requirements of Public Law 93-349 were made retroactive to July 1, 1971, the Postal Service was relieved of payments due June 30, 1972, 1973, and 1974, attributable to pay increases granted before July 1, 1973. The Congress appropriated money for these payments to the Postal Service, which in turn transferred the appropriation to the Civil Service Retirement and Disability Fund. The Postal Service was made responsible for making all amortization payments beginning in 1975. The following table shows the annual payments required to amortize the increases in the unfunded liability resulting from negotiated pay increases, Postal Service payments, and the Government appropriations necessary to cover the amortization payments which the Postal Service was not required to make.

	Annual payments required to amortize the increase <u>in unfunded liability</u>	Postal Service <u>payments</u>	Government <u>appropriations</u>
	----- (000 omitted) -----		
1972	\$ 62,991	\$ -	\$ 62,991
1973	104,985	-	104,985
1974	174,185	69,200	104,985
1975	207,441	207,441	-
1976	385,865	385,865	-

Of all the agencies participating in the civil service retirement system, the Postal Service is the only one re-

quired to amortize the increases in the unfunded liability resulting from employee pay raises and benefit improvements. In 1976, the Postal Service paid about \$1 billion to the civil service retirement fund, including \$614.5 million to match employees' contributions and \$385.9 million in amortization payments. However, if accruing costs were calculated on a dynamic basis and the Postal Service was required to pay all costs not covered by employees' contributions, the Service's 1976 contribution would have been approximately \$2.2 billion--\$1.2 billion more than the amount paid. Subsidies will continue each year as long as the Postal Service is not required to pay for cost-of-living adjustments received by its retirees.

### Tennessee Valley Authority

Basically, TVA operates independently of appropriations. Its power programs--which accounted for about 96 percent of its fiscal year 1975 program receipts--are completely self-supporting. Its nonpower programs, with the exception of its fertilizer program, depend primarily on appropriated funds. The fertilizer program is supported 80 percent through fees charged to users and 20 percent through appropriations.

TVA had about 31,000 employees as of June 30, 1976, of which 248 were covered by the civil service retirement system. (Employees entering TVA within 3 days after leaving a position in which they were covered under the civil service system are required to continue under civil service coverage.) Of the 248 employees, 121 are in the power program, 23 are in the fertilizer program, and the remaining 104 are in programs primarily financed through Government appropriations. The remainder of TVA's employees are covered by the TVA retirement system and/or social security.

TVA employees contributed \$384,404 to the civil service retirement fund in 1976, and TVA matched their contributions. We estimate, using dynamic calculations, that TVA was undercharged about \$1 million in retirement system costs. Of this amount, about \$574,000 was applicable to programs not dependent on appropriations.

### District of Columbia

Although the District of Columbia annually receives a Federal payment, its main source of income is money collected through local taxes. The District has about 58,000

employees, of which approximately 31,000 participate in the civil service retirement system.

In 1976, District employees contributed about \$28.8 million to the civil service retirement system, and the District matched employees' contributions. Using dynamic costing, we estimate that in 1976 the District was subsidized more than \$72 million through the retirement system.

This underallocation of civil service retirement costs to the District is in sharp contrast to the manner in which the Federal Government finances benefits for the 1,500 U.S. Park Police, Executive Protective Service, and Secret Service Federal employees who participate in the District of Columbia's policemen and firemen retirement system. That system is financed essentially on a pay-as-you-go basis. Employees covered by it are required to contribute 7 percent of their basic pay, which passes into the general revenue of the District of Columbia. The Federal Government reimburses the District for all Federal annuitant benefit payments in excess of the amounts contributed to the District by active Federal employees.

## CONCLUSIONS

Failure to recognize and allocate the full cost of the civil service retirement system results not only in an understatement of the cost of Government operations, but also in subsidies to certain agencies and instrumentalities whose operations the Congress intended to be self-supporting. The understatement of operational costs and the subsidies will continue until the full dynamic normal cost of the system is recognized and allocated to those agencies and instrumentalities whose employees are covered by the retirement system.

## AGENCY COMMENTS AND OUR EVALUATION

Eight of the agencies identified in the report as being wholly or partially self-supporting provided written comments. They generally agreed that the full cost of the civil service retirement system was not being paid by agency and employee contributions, and pointed out that charges to the users of their services would have to be increased if higher retirement contributions were required. Some of the agencies expressed concern that a retirement cost factor reflecting Government-wide experience might not properly reflect their specific experience. They suggested that

separate actuarial valuations should be performed in determining their retirement contributions. One agency also suggests that the retirement fund could receive a higher rate of return if the law were changed to allow investments in other than Federal Government securities.

In our opinion, these observations and suggestions regarding cost calculations and investment policies may be worthy of consideration in future refinements of the system. However, they should have little bearing on the need to fully recognize and allocate the accruing cost of retirement benefits. To calculate costs by individual agency, it would be necessary to assemble data on the demographic characteristics of the personnel employed by each agency in the system. We are unaware that any such data is available, and even if it were there is no reason to believe that the results would appreciably differ from those achieved by using Government-wide data.

The Postal Service agreed in principle with the concept of dynamic costing and also agreed that agencies should be charged with all costs not covered by employee contributions. It maintained, however, that the Postal Service should not be required to pay the cost of its retirees' cost-of-living adjustments since they were authorized in law by the Congress and were beyond the Postal Service's control. Similarly, the District of Columbia questioned whether employee pay raises and retiree cost-of-living adjustments provided by law should be included in the contribution formula, because agencies can do little to influence the direction of costs in these areas.

We believe the lack of control by individual agencies over the retirement system's provisions is a separate issue from cost recognition and allocation. All of the system's provisions are established in law, and if agency control were used as a criterion for determining retirement contributions, most agencies would be required to make no contribution to the retirement fund regardless of whether costs were calculated on a static or dynamic basis. It is true that most agencies have no voice in determining the amount of employee pay increases, and no agency has any involvement in establishing retiree cost-of-living adjustments. Nevertheless, these factors have a direct effect on retirement system costs, and we continue to believe that these costs should be recognized and allocated to participating agencies.

## CHAPTER 4

### INEQUITIES AND INCONSISTENCIES

#### OF FEDERAL RETIREMENT PROGRAMS

Different committees of the Congress have legislative jurisdiction over various retirement systems, and there is no overall Federal retirement policy to guide the development of Government retirement systems. In the absence of a coherent, coordinated Federal policy, the benefit structures of Federal retirement programs have evolved and continue to develop on a piecemeal basis. Federal personnel may be treated quite differently depending upon which Government retirement system is applicable to their employment.

#### RETIREMENT ELIGIBILITY

Age and service requirements that Federal employees must meet to become eligible for a retirement annuity vary. Some systems have minimum age and service requirements, while others have only a minimum service requirement. Requirements range from no age restriction and 20 years' service to age 70 and 10 years' service.

In addition to optional and disability retirement, some systems provide for involuntary, deferred, and mandatory retirements. The table on the following page summarizes the general eligibility provisions for various types of retirement under each system.

#### SERVICE CREDITS AND PORTABILITY

Generally, an employee is permitted to transfer credit from one Federal retirement system to another. However, several inconsistent practices exist.

- The military retirement system does not permit any credit for Federal civilian service. However, military service is generally creditable under Federal civilian retirement systems without contributions from the employee, with the following exceptions: (1) the TVA retirement system grants credit for military service only if it is performed between two contiguous periods of coverage under the TVA retirement system--the employee must make contributions to cover such service; and (2) the Federal



## RETIREMENT ELIGIBILITY

(A) MINIMUM AGE REQUIREMENT.  
 (B) MINIMUM SERVICE REQUIREMENT

TYPE OF RETIREMENT	CIVIL SERVICE		UNIFORMED SERVICES		FOREIGN SERVICE		FEDERAL JUDICIARY		U.S. TAX COURT JUDGES		FEDERAL RESERVE BOARD			TENNESSEE VALLEY AUTHORITY		
	(A)	(B)	(A)	(B)	(A)	(B)	(A)	(B)	(A)	(B)	(A)	(B)	(A)	(B)	(A)	(B)
OPTIONAL	62	5	NONE	20	50	20	65	15	65	15	62	5	b/55	10		
	60	20					70	10			60	20				
	55	30									55	30				
DISCONTINUED SERVICE (INVOLUNTARY)	a/NONE	25	NO PROVISION		DEPENDS ON CLASS OF OFFICER c/		NO PROVISION		NONE	15	a/NONE	25	NONE	5		
	a/50	20									a/50	20				
DEFERRED	PAY-ABLE AT AGE 62	5	NO PROVISION		PAY-ABLE AT AGE 60	5	NO PROVISION		NO PROVISION		PAY-ABLE AT AGE 62	5	PAY-ABLE AT AGE 55b/	10		
MANDATORY	70	15	VARIES DEPENDING ON AGE, RANK, PROMOTION RECORD, AND LENGTH OF SERVICE		60	NONE	NO PROVISION		70	NONE	65	ANY	65	NONE		
DISABILITY	NONE	5	NO AGE OR SERVICE REQUIREMENTS		NONE	5	NO AGE OR SERVICE REQUIREMENTS		NO AGE OR SERVICE REQUIREMENTS		NONE	5	NONE	5		

a/BENEFIT IS REDUCED IF UNDER AGE 55.  
 b/BENEFIT IS REDUCED IF UNDER AGE 65.

c/CLASSES 1, 2, and 3 — IMMEDIATE ANNUITY UPON SELECTION OUT REGARDLESS OF AGE OR SERVICE; CLASSES 4 AND 5 ARE RETAINED IN SERVICE UNTIL AGE 50 AND 20 YEAR REQUIREMENT MET TO RECEIVE AN ANNUITY; CLASSES 6 AND 7 — SEVERANCE PAYMENT ONLY.

judiciary and U.S. Tax Court judges retirement systems do not permit retirement credit for other Federal civilian or military service; however, such service is creditable in computing survivorship benefits.

- Employees entering the service of the Board of Governors of the Federal Reserve System on or after January 1, 1944, are covered by the Federal Reserve Board retirement system unless they are members of the civil service system. However, a member who has had prior service with a Federal Reserve bank is permitted to withdraw his contributions from the civil service retirement system and become a member of the Federal Reserve Board retirement system.
- Employees covered by the civil service retirement system at the time of their transfer to TVA are required to continue participating in the civil service retirement system, provided the break in service is 3 days or less. If the break is of more than 3 days, employees under the civil service retirement system transferring into TVA must join the TVA retirement system. These employees do not receive TVA retirement credit for civil service employment. However, an employee transferring from TVA to a position under the civil service retirement system receives credit for his TVA service provided he makes contributions to cover those years of service.
- Employees under the Foreign Service retirement system who perform duty at certain designated "unhealthful posts" may receive 1.5 years of retirement credit for each year of service at such posts unless the employee elects to receive the differential payable for that post of assignment. Employees under the civil service retirement system working at the same posts receive no extra retirement credit. They do, however, draw the differential payable for that post of assignment.
- Military service generally may not be used to earn retirement credit under both the uniformed service retirement system and a civilian retirement system. However, military reservists who receive credit for any active military service in their annuity calculations are given credit for that same service toward annuities under civilian systems.

--An employee in the civil service retirement system who is appointed as a U.S. Tax Court judge has the option of remaining in the civil service retirement system and crediting his service as a judge to that system, or he may withdraw his contributions from the civil service retirement system and be covered under the U.S. Tax Court judges retirement system. This decision, once made, is irrevocable.

--Under the military retirement system, service is credited on a yearly basis. That is, for any service of 6 months or more up to a year, 1 year's service is credited toward retirement. In contrast, the civil service retirement system credits service on a monthly basis but does not give credit for periods of less than 1 month.

### BENEFIT FORMULAS

The general benefit formula used to determine the amount of a retiring employee's annuity (pension) varies from system to system and within the civil service system. There are different formulas for specific groups of employees. The general formulas for each system are shown below.

#### Civil service:

General formula	1.5 percent for each of the first 5 years of service, plus 1.75 percent for each of the next 5 years, plus 2 percent for each year thereafter, multiplied by the employee's average salary for the 3 consecutive highest pay years ("high-3"). The maximum annuity is 80 percent of high-3 plus any additional percent produced by crediting unused sick leave.
Members of Congress and congressional employees	2.5 percent of high-3 for each year of service. The maximum annuity for retired Members of Congress is 80 percent of final salary. For congressional employees, the maximum is 80 percent of high-3.
Air traffic controllers	General benefit formula and maximum but no less than 50 percent of high-3.

Law enforcement and firefighter personnel	2.5 percent of high-3 for each of the first 20 years, and 2 percent for each year thereafter. The maximum annuity is the same as under the general formula.
Foreign Service	2 percent of high-3 for each year of service, with a maximum of 70 percent of high-3 plus the percent due to unused sick leave.
Uniformed services	2.5 percent of basic pay <u>1/</u> being received at the time of retirement for each year of service, with a maximum of 75 percent.
Federal judiciary	Members retiring receive the current salary of their office. Members resigning receive the salary earned at the time of resignation.
U.S. Tax Court judges	Current salary of former position multiplied by the ratio of years of service to 10 years. The benefit may not exceed the current salary of the former position.
TVA	1.3 percent of high-3 multiplied by years of service, with credit for unused sick leave; reduced by the social security offset plus annuity based on actuarial equivalent of member's contributions. There is no maximum on benefit amounts.
Federal Reserve Board	Same as civil service general formula.

The differences are illustrated in the following table, which shows the benefit under each system for an employee who

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1/Does not include nontaxable subsistence and quarters allowances and the tax advantage thereon, which when added to basic pay represents Regular Military Compensation, considered to be the equivalent of a civilian employee's salary.

retires with 30 years' service and meets the minimum age requirement. The benefits range from 56.25 percent of high-3 average salary up to the full salary of the position.

<u>System</u>	<u>Benefit</u>		
Civil service:			
Regular employee	56.25	percent	of high-3
Congressional employee	75	"	" "
Member of Congress	75	"	" "
Law enforcement and firefighter personnel	70	"	" "
Foreign Service	60	"	" "
Uniformed services (note a)	75	percent	of final basic pay
Federal judiciary	100	percent	of the salary of the office
U.S. Tax Court judges	100	"	" "
Federal Reserve Board	56.25	percent	of high-3
TVA (note a)			(b)

a/Also covered under social security.

b/Varies depending on the actuarial value of the employee's contributions.

### SURVIVOR BENEFITS

While all Federal retirement systems provide for some form of survivor benefits, there is a wide variation in the benefits, the time required for vesting, and in the amount employees must contribute for those benefits. A few of these differences are as follows:

- In the TVA system, survivorship rights for new employees begin immediately, while the civil service system requires 18 months' service and the military system requires 20 years.
- The minimum annuity for the surviving spouse of a participant who dies in service ranges from a lump sum payment made up of the employer's and employee's contributions with interest, to an annuity amounting to 55 percent of the deceased employee's earned annuity.

- The U.S. Tax Court judges system and the Federal judiciary system require a 3- and 4.5-percent contribution, respectively, from the member both before and after retirement in order to provide a survivor benefit. Other systems use a formula to reduce the annuity of a retired employee who elected survivorship coverage.
- While most systems provide for the adjustment of survivor benefits in line with increases in the CPI, the Federal judiciary system adjusts such benefits on the basis of active judges' pay increase percentages, and the Tax Court judges system has no provision for adjusting survivor benefits.

The survivorship provisions under each system are outlined in appendix II.

#### REEMPLOYED ANNUITANTS

Federal retirees reemployed by the Government are treated quite differently under the various retirement systems. The differences vary from a reduction in salary or annuity to a suspension of annuity to no reduction in either salary or annuity. Examples of some of these differences are discussed below.

1. When a civil service retiree whose retirement was voluntary is reemployed by the Federal Government, his annuity continues but his salary is reduced by the amount of his annuity. However, Federal employees who retire under the District of Columbia's policemen and firemen retirement system (see p. 21), whether retired optionally or for disability, may be reemployed in a position covered by the civil service retirement system without a reduction in either salary or annuity. For example, recently a former Federal employee who retired under the policemen and firemen system was reemployed in a position covered under the civil service system and is receiving a full salary of \$43,923 and full annuity of about \$18,000 a year. In contrast, the salary of a civil service retiree who is reemployed in a position covered by the District's system would be reduced by the amount of his civil service annuity.

2. An annuitant under the Foreign Service system who is recalled to duty in the Foreign Service receives the full salary of the position in which he is serving, but his annuity is suspended. If a Foreign Service annuitant is reemployed in another Federal agency, he receives the full

salary of his new position plus a portion of his annuity which when combined with his salary does not exceed in any one year the salary he was receiving on the date of his retirement from the Foreign Service.

3. A retired regular military officer who is reemployed in a civilian position of the Federal Government receives a portion of his military retirement plus the full salary of his position. The retiree receives the first \$4,045 of his military retirement plus one-half of any remainder. The amount of \$4,045 became effective with the March 1, 1977, adjustment of 4.8 percent and will increase in direct proportion to each cost-of-living adjustment granted to all retirees. Retired enlisted personnel and retired reserve officers continue to receive their full military retirement plus the full salary of their new position when reemployed in a civilian capacity.

The Civil Service Commission reported that as of June 30, 1975, approximately 142,000 uniformed services retirees were employed in the Federal civilian service, including 111,793 retired enlisted personnel and 27,682 retired officers of whom 2,641 retired as colonels or above. Of the former officers, 5,164 retired as regulars and 22,518 as nonregulars. The majority (66 percent) of the total reemployed uniformed services retirees had Federal civilian salaries of \$10,000 to \$18,000, as shown in the following table.

Civilian salary	Reemployed retirees	
	Number	Percent of total
Under \$6,000	1,505	1.06
\$ 6,000 to \$ 9,999	24,648	17.38
\$10,000 to \$17,999	93,309	65.79
\$18,000 to \$28,999	19,225	13.56
\$29,000 to \$35,999	2,154	1.52
\$36,000 and over	796	.56
Unspecified	180	.13
Total	<u>141,817</u>	<u>100.00</u>

Approximately 8,000 retirees, or about 5 percent, were under age 40, while slightly more than 9,000, or about 6 percent, were 60 and over. Forty-six percent were between 40 and 50, and 41 percent were between the ages of 50 and 60. The average uniformed services retirement benefit being received was \$9,701 for officers and \$5,147 for enlisted personnel.

4. Federal judges and justices are entitled to receive their full salary in addition to any annuity they may have earned under the civil service retirement system.

5. Retirees under the civil service retirement system who become Tax Court judges may remain in the civil service system and receive no benefits under the Tax Court system. If they elect to be covered by the Tax Court system, they must waive their rights to future civil service retirement benefits. The law makes no provision regarding retirees from other Government retirement systems who may become Tax Court judges.

6. Annuitants under the TVA retirement system can be reemployed by TVA with no reduction in salary or annuity, provided their reemployment is for a predetermined period of not more than 6 months; if more than 6 months, retirement benefits are discontinued. TVA retirees who are hired by other Federal agencies are not subject to reduction in pay or annuity. However, the salaries of retirees from the civil service retirement system who are reemployed by TVA are reduced by the amount of their annuity. Retired regular military officers while reemployed by TVA forfeit a portion of their retired pay, as under the civil service retirement system, while enlisted personnel and reserve officers continue to receive their full retired pay and salary.

#### DISABILITY RETIREMENT

Each of the systems discussed in this report provides some form of benefits to employees who become disabled before retirement.

- Definitions of disability: under the various retirement systems these definitions range from totally disabled or incapacitated for useful and efficient service to the inability to perform efficiently in the specific position occupied.
- Periods of coverage: all systems provide life-long benefits to individuals who remain disabled, although some impose earnings restrictions.
- Benefit levels: benefits are computed on various bases such as salary at time of retirement, pay for the 3 highest paid years, or percentage of disability.



--Establishment of disability: some programs require documentary evidence and medical examinations by designated physicians, and some allow the employee to provide his personal physician's report. However, some programs require only that the employee certify his own disability.

The disability provisions for each system are contained in appendix III.

#### SOCIAL SECURITY COVERAGE FOR FEDERAL EMPLOYEES

As a general rule, Federal civilian employees are not covered by the social security program. As such, they are the only major group of employees in the United States who cannot participate in the program. However, active and reserve military personnel and most employees of TVA are covered by social security in addition to their Government retirement systems. Military retirement benefits are paid in addition to social security; benefits paid to survivors of retired military personnel and to TVA retirees are reduced by partial social security offsets.

#### CONCLUSIONS

Many inconsistencies and inequities exist among Federal retirement systems. While there may be legitimate reasons for providing particular benefits to certain types of employees, many of the differing benefit provisions are without apparent explanation. We believe that many of the differences are caused by the lack of an overall policy to guide the development and improvement of Federal retirement systems. The fact that different committees of the Congress have legislative jurisdiction over each of the systems has probably contributed to the situation.

#### RECOMMENDATION TO THE CONGRESS

We recommend that the Congress establish an overall Federal retirement policy to guide retirement system development. Centralization of committee jurisdiction over all Federal employee retirement systems would facilitate the establishment and implementation of such a policy.

#### AGENCY COMMENTS AND OUR EVALUATION

The Department of Defense did not respond to our request for comments, and most of the agencies responsible for administering the six other retirement systems discussed

in this report made no specific comments on whether the many different provisions and practices followed by the various systems were justified.

The Civil Service Commission stated that it believed some of the differences were reasonable and suggested that any action by the Congress to establish an overall retirement policy and centralize committee jurisdiction should keep in mind the need for some differences in the systems.

The Administrative Office of the U.S. Courts questioned the propriety of considering the Federal judiciary retirement system in the same context as other retirement systems because "retired" judges continue to perform substantial judicial duties. Likewise, the U.S. Tax Court believed there must be a distinct retirement system for Federal judges and maintained that Tax Court judges should continue to receive retirement benefits comparable to the Federal judiciary. The Tax Court stated that its system's provision of paying full salary after retirement is needed to attract qualified persons to hold judicial positions and to induce retired judges to carry a substantial caseload.

We are not suggesting in this report that there is no justification for providing differing retirement benefits to certain groups of employees when necessary. A determination of whether differences are justified could be made only after careful and thorough study of the provisions of each system, identifying and evaluating the reasons for the differences, and ascertaining whether they serve legitimate purposes. In fact, as discussed on page 1, we are currently performing such a review at the request of three House committee and subcommittee chairmen. It remains our opinion at this time, however, that many of the differing policies and practices of the various systems in areas such as disability and survivor benefits, service credits and portability, reemployment of annuitants, and employee contribution rates are without apparent explanation and demonstrate the need for an overall Federal retirement policy.

FINANCING PROVISIONS

<u>Retirement system</u>	<u>Employee contribution</u>	<u>Agency contribution</u>	<u>Other Government contributions</u>	<u>Investment policy</u>
Civil service	7 percent of base pay (note a)	Matches employee contribution	Direct appropriations for (1) interest on the unfunded liability, (2) the cost of crediting military service, and (3) amortization of certain increases in the unfunded liability over 30 years	Required to invest in U.S. Treasury obligations
Foreign Service	7 percent of base pay	Matches employee contribution	Same as civil service, plus an additional amount to fund the difference between normal cost and agency and employee contributions	Same as civil service
Uniformed services (note b)	None	Amount needed to pay benefits	None	(c)
U.S. Tax Court: Judges	None	Amount needed to pay benefits	None	(c)
Survivors	3 percent of pay both before and after retirement	Estimate of appropriations necessary for maintenance and operation of fund submitted annually to OMB	None	Required to invest in U.S. Treasury obligations and Federal farm loan bonds
Federal judiciary: Judges	None	Amount needed to pay benefits	None	(c)
Survivors	4.5 percent of pay both before and after retirement	Matches employee contribution	None (note d)	U.S. Treasury obligations and Federal farm loan bonds
Federal Reserve Board	7 percent of base pay	Difference between employee contributions and normal cost (note e)	None	U.S. Treasury obligations and private sector investments
TVA	6 percent (note f)	Difference between employee contributions and normal cost (note e) plus annual amount necessary to amortize the unfunded liability and annuity cost-of-living adjustments	None	U.S. Treasury obligations and private sector investments

a/Members of Congress contribute 8 percent of their pay. Congressional employees and certain law enforcement and firefighter personnel contribute 7.5 percent of their pay.

b/Also covered under social security, which currently requires employees and employers to contribute 5.85 percent of the first \$16,500.

c/Not applicable.

d/Public Law 94-554, approved Oct. 19, 1976, authorized a lump sum payment to fund the unfunded liability as of Jan. 1, 1977.

e/A factor for future general pay increases is included in the normal cost calculation.

f/Employees may choose to reduce their contributions by 3 percent on that part of their salary not in excess of the social security base (currently \$16,500).

SURVIVOR BENEFITSCIVIL SERVICE RETIREMENT SYSTEMSurvivors of deceased employees

Eligibility--18 months' service.

Spouse's benefit--55 percent of the deceased employee's earned annuity.

The law guarantees a minimum annuity equal to 55 percent of the smaller of (a) 40 percent of an employee's high-3 or (b) the regular annuity obtained after increasing the deceased employee's service by the period of time between his date of death and the date he would have reached age 60.

Children's benefit, amount per child--

(i) If survived by a widow(er), lesser of

(a) 60 percent of high-3 average salary divided by the number of children,

(b) \$4,860 divided by the number of children, or

(c) \$1,620.

(ii) If no widow(er), lesser of

(a) 75 percent of high-3 average salary divided by the number of children,

(b) \$5,832 divided by number of children, or

(c) \$1,944.

Survivors of deceased annuitants

Eligibility--spouse receives an annuity if annuitant accepts a reduced annuity at retirement. Reduction is 2.5 percent of the amount, up to \$3,600, the retiree specifies as a base for the survivor benefit, plus 10 percent of any amount over \$3,600 so specified. Eligible children receive an annuity in any event after death of annuitant.

Spouse's benefit--55 percent of all or whatever portion of the retiree's annuity that the retiree specifies as a base for the survivor benefit.

Children's benefit--same as for children of a deceased employee.

Other beneficiary--an unmarried annuitant in good health may accept a reduced annuity and designate an individual with an insurable interest to receive a benefit of 55 percent of the reduced amount. The annuity is reduced by 10 percent, and by an additional 5 percent for each full 5 years younger the beneficiary is than the retiring employee. The total reduction cannot exceed 40 percent.

#### FOREIGN SERVICE RETIREMENT SYSTEM

With enactment of Public Law 94-350 on October 1, 1976, survivor benefits under the Foreign Service system are substantially the same as those of the civil service system.

#### UNIFORMED SERVICES RETIREMENT SYSTEM

Eligibility--20 years of service; if a member's death results from the performance of active duty or a service-connected disability, survivor benefits are payable from the Veterans Administration regardless of the member's length of service.

Benefit--the benefits received under the Survivor Benefit Plan and the reduction in the retired pay of the member to provide these benefits are essentially the same as under the civil service retirement system except for the following:

- The survivor benefits are reduced by any Veterans Administration dependency and indemnity compensation payments and social security survivor benefits attributable to military service.
- The reduction in retired pay to provide a survivor annuity that flows to the spouse until he or she becomes ineligible (death or remarriage before age 60) and then to the children is the same as for the spouse, plus an actuarial charge. The charge depends on the age of the member, the spouse, and the youngest child.
- The reduction in retired pay to provide an annuity for children only is based on an actuarial charge that depends on the age of the member and the youngest child.

FEDERAL JUDICIARY RETIREMENT SYSTEM

Eligibility--18 months of creditable service for which contributions have been made. Participation is elective and those who choose to participate must contribute 4.5 percent of salary both before and after retirement.

Spouse's benefit--1.25 percent of the participant's high-3 average salary multiplied by the total years of judicial service, military service, service as a Member of Congress, and other Government employee service not exceeding 15 years, plus .75 percent of high-3 multiplied by any remaining years of service. The annuity cannot exceed 40 percent of high-3.

Children's benefit, annual amount per child--

- (i) If survived by a widow(er), lesser of
  - (a) \$1,548 or
  - (b) \$4,644 divided by the number of children.
- (ii) If no widow(er), lesser of
  - (a) 100 percent of the annuity to which a surviving spouse would have been entitled, divided by the number of children;
  - (b) \$1,860; or
  - (c) \$5,580 divided by the number of children.

U.S. TAX COURT JUDGES RETIREMENT SYSTEM

Eligibility--5 years of creditable service for which contributions have been made. Participation is elective, and those who choose to participate must contribute 3 percent of salary both before and after retirement.

Surviving widow's benefit with no dependent child--upon reaching age 50, the widow receives an annuity equal to the sum of (1) 1.25 percent of the participant's average annual salary for the 5 consecutive highest paid years of service ("high-5") multiplied by the sum of his years of judicial service, military

service, service as a Member of Congress, and congressional employee service not exceeding 15 years, and (2) .75 percent of the high-5 multiplied by all other creditable service. The annuity cannot exceed 37.5 percent of high-5.

Surviving widow's benefit with a dependent child or children--an immediate annuity as determined above.

Children's benefit, annual amount per child--

- (i) If survived by a widow, lesser of
  - (a) 50 percent of the amount of the widow's annuity,
  - (b) \$900 divided by the number of children, or
  - (c) \$360.
- (ii) If no widow(er), lesser of
  - (a) the amount of the annuity to which a widow(er) would have been entitled or
  - (b) \$480.

The survivor benefits under the U.S. Tax Court judges and Federal judiciary systems were substantially identical before the enactment of Public Law 94-554 (90 Stat. 2603) in October 1976 which made major improvements in the Federal judiciary system. Legislation was introduced in the 94th Congress to make similar changes to the U.S. Tax Court judges system. The Tax Court plans to have the same bill reintroduced in the 95th Congress.

#### FEDERAL RESERVE BOARD RETIREMENT SYSTEM

The survivor benefits and the amount the employee must pay for these benefits are the same as under the civil service retirement system.

#### TVA RETIREMENT SYSTEM

Eligibility--survivorship rights begin accruing immediately.

Benefit--if death occurs before retirement, a benefit is payable to the designated beneficiary. This

benefit may be in the form of (1) a lump sum payment consisting of the employee's contributions, with full credited interest, plus (from TVA) a percent of final salary which is based on length of service including credit for unused sick leave; or (2) a life annuity which must be actuarially equivalent to the lump sum credit.

There are several options available to the employee upon retirement to provide a survivor benefit to a designated beneficiary. These options, each of which is the actuarial equivalent of the maximum benefit, are as follows:

1. The retiring employee accepts a reduced benefit with the insurance that at death the designated beneficiary will receive the balance left from the employee's contributions with interest at retirement after deducting the benefit payments the employee has received from his contributions.

2. The retiring employee accepts a reduced benefit and the designated beneficiary will continue to receive the same benefit at the death of the retired employee. The amount of the reduction depends on the assumed life of the retiring employee and his designated beneficiary.

3. The retiring employee accepts a reduced benefit with one-half of the reduced amount continuing to the surviving beneficiary. The reduction of course would be smaller than under option 2.

4. This option offers the retiring employee more flexibility than the other options. The retiring employee may specify the amount of the survivor benefit; however, the total value of the employee's reduced benefit plus the survivor benefit must be actuarially equivalent to the employee's earned benefit without reduction. Settlements under this option are subject to approval by the retirement system board.



DISABILITY RETIREMENTCIVIL SERVICE RETIREMENT SYSTEM

Basic eligibility--5 years' creditable service.

Definition of disability--inability to perform useful and efficient service in the specific position occupied at the time application for retirement is made.

Establishment of disability--application by the employee or employing agency accompanied by a statement from the employee's superior officer showing how the employee's condition affects job performance and a report from the employee's doctor fully describing the disability. The Civil Service Commission may also require the employee to undergo an additional medical examination by an approved physician. The employee's disability is rated either temporary or permanent.

Periodic reexamination--for temporary disabilities, the Commission reviews the case annually until the retiree reaches age 60 or is reclassified permanently disabled.

Payments for partial disability--none.

Length of coverage--until death, medical recovery, or restored earning capacity before reaching age 60. If the retiree recovers, payment of the annuity continues for 1 year. Earning capacity is deemed restored if in each of 2 succeeding calendar years the annuitant's income equals at least 80 percent of the current rate of pay of the position occupied immediately before retirement. However, the annuity is restored if the earnings fall below 80 percent in a later calendar year.

Computation of annuity--the larger of amounts derived from the general formula or the guaranteed minimum.

(1) General formula--larger of the following two amounts:

(a) 1.5 percent of the high 3 average pay for each of the first 5 years of creditable service, plus 1.75 percent for each of the second 5 years of service, plus 2 percent for each year over 10 years; or

- (b) substitute 1 percent of the high-3 average pay plus \$25 for any or all of the percentages in (a) where it will yield a larger amount, multiplied by the years of service as shown in (a).
- (2) Guaranteed minimum--the lesser of the following two amounts:
- (a) 40 percent of the high-3 average pay or
  - (b) the amount obtained under the general formula after increasing the employee's actual creditable service by the time remaining between the date of separation and the date he attains age 60.

#### FOREIGN SERVICE RETIREMENT AND DISABILITY SYSTEM

Basic eligibility--5 years' creditable service.

Definition of disability--totally disabled or incapacitated for useful and efficient service by reason of disease, illness, or injury not due to vicious habits, intemperance, or willful misconduct on employee's part.

Establishment of disability--application by employee accompanied by a description of the disability and a full explanation of the manner in which it affects the performance of duties; must inform immediate supervisor of application for disability retirement and undergo medical examination. Disability is determined by the Secretary of State, or his designated representative, on the basis of advice provided by one or more duly qualified physicians or surgeons designated to conduct examinations. The employee's disability is rated either temporary or permanent.

Periodic reexamination--unless the disability is rated permanent at the time of retirement or at a later date, examinations by duly qualified physicians or surgeons designated by the Secretary are made annually until annuitants reach the mandatory retirement age for their class in the service.

Payments for partial disability--none.

Length of coverage--remainder of lifetime unless annuitant recovers to the extent that he can return to

duty. If the retiree recovers, payment of the annuity continues 6 months after the date of examination.

Computation of annuity--2 percent of average basic salary for the high-3 consecutive years, times years of service not exceeding 35. The average high-3 years do not have to be consecutive for a Chief of Mission whose service in that capacity was interrupted. For retirees with less than 20 years' service, the annuity is computed as though the employee has 20 years' service; but the additional service credit may not exceed the difference between the employee's age at time of retirement and the mandatory retirement age.

#### UNIFORMED SERVICES RETIREMENT SYSTEM

Basic eligibility--20 years' service, or at least 30-percent disability and (1) 8 years' service, (2) disability being the proximate result of performing active duty, or (3) disability being incurred in line of duty during war or national emergency.

Definition of disability--unfit to perform the duties of office, grade, rank, or rating because of a physical disability which did not result from the member's intentional misconduct or willful neglect and was not incurred during a period of unauthorized absence.

Establishment of disability--report to sick bay and request physical evaluation board's ruling on physical fitness to maintain duties in the military. Physical evaluation board makes decision on disability on the basis of medical advice from military doctors. The disability is rated either temporary or permanent.

Periodic reexamination--if the disability is temporary, the retiree must undergo a physical examination at least every 18 months. If the disability still exists after 5 years, it is considered permanent.

Payments for partial disability--yes. If member has less than 20 years' service, disability must be at least 30 percent.

Length of coverage--remainder of lifetime unless retiree recovers from disability or fails to report to an examination without just cause.

Computation of retired pay--monthly basic pay on day before retirement multiplied by either (1) 2.5 percent times years of service or (2) the percentage of disability. The retired pay cannot exceed 75 percent of the monthly basic pay. Those temporarily disabled receive at least 50 percent of the monthly basic pay.

#### FEDERAL JUDICIARY RETIREMENT SYSTEM

Basic eligibility--judges and justices of the United States: appointment to position of judge or justice of the United States. Judges of the District Court of Guam, Canal Zone, and the Virgin Islands: 10 years' creditable service.

Definition of disability--unable to discharge all duties efficiently because of permanent mental or physical disability.

Establishment of disability--written certification to the President signed by the chief official of the court. The President may retire any judge or justice whom he finds to be mentally or physically incapable of discharging all the duties of his office.

Periodic reexamination--none.

Payments for partial disability--no provisions.

Length of coverage--remainder of lifetime.

Computation of annuity--justices and judges of the United States: if 10 years' service, the salary of the office; if less than 10 years' service, one-half the salary of the office. Judges of the District Court of the Canal Zone, Guam, and the Virgin Islands: if 16 years' service, salary of the office at the time of relinquishment; if 10-15 years' service, salary times years of service, divided by 16.

#### U.S. TAX COURT JUDGES RETIREMENT SYSTEM

Basic eligibility--appointment to a U.S. Tax Court judge position.

Definition of disability--unable to discharge efficiently all the duties of the office by reason of permanent mental or physical disability.

Establishment of disability--written certification to the President. The President must concur with the Chief Judge's disability retirement. The Chief Judge must sign any other judge's disability certification. The President shall declare any judge retired if he finds the judge to be permanently disabled from performing duties.

Periodic reexamination--none.

Payments for partial disability--none.

Length of coverage--same as Federal judiciary.

Computation of annuity--if 10 or more years' judicial service, 100 percent of the salary payable to a judge; if less than 10 years' judicial service, 50 percent of the salary payable to a judge.

#### TVA RETIREMENT SYSTEM

Basic eligibility--5 years' creditable service.

Definition of disability--inability to continue in present position because of a physical or mental disability that is likely to be permanent and a lack of another available TVA position for which the employee is qualified. The determination must be made by the TVA Retirement System Board of Directors on the basis of a report either by the medical board (three physicians independent of TVA) or by the director of the TVA division of medical services and information from the TVA employment branch.

Establishment of disability--application by TVA or by employee, who authorizes the retirement system to obtain reports from his personal physician(s), the TVA physician, his supervisor, and the TVA division of personnel. The completed file is then reviewed by the Director of the TVA division of medical services and, if appropriate, by the medical board, and approved by the TVA retirement system board of directors.

Periodic reexaminations--as may be determined by the board of directors.

Payments for partial disability--none.

Length of coverage--until death, reemployment in a position covered by TVA retirement system, or until earnings plus regular disability benefit exceed his prior position's salary, which initiates a reduction. Obligated upon request by the directors to file, within 30 days, a proper application for social security disability insurance benefits or, at age 65, a social security old-age benefit; if he does not, the TVA disability pension may be discontinued.

Computation of disability retired pay--disability benefit consists of two parts:

- (1) An annuity--the actuarial equivalent of the employee's accumulated contributions.
- (2) A pension from TVA's contributions to the system. The pension is equal to 1.1 percent of the member's average compensation for each year of creditable service. However, an alternative formula is used if this results in less than a 30-percent pension. Under the alternative formula a 30-percent minimum is provided, except for older employees with short service.

If the member becomes entitled to social security disability insurance or old-age benefits, the TVA pension is subject to reduction.

#### FEDERAL RESERVE BOARD RETIREMENT SYSTEM

Basic eligibility--5 years' creditable civilian service.

Definition of disability--inability to perform useful and efficient service in specific position occupied at the time application for retirement is made.

Establishment of disability--application accompanied by a report from member's personal physician fully describing the disability. A medical examination is also made by a physician designated by the employer. Decision of disability is made by the

medical board, based on the examination reports of the physicians. The disability is rated temporary or permanent.

Periodic reexamination--if the disability is rated temporary or subject to improvement, a reexamination is required annually until retiree reaches age 60.

Payments for partial disability--none.

Length of coverage--same as civil service.

Computation of annuity--same as civil service.



## UNITED STATES CIVIL SERVICE COMMISSION

WASHINGTON, D.C. 20415

IN REPLY PLEASE REFER TO

YOUR REFERENCE

MAY 16 1977

Mr. H. L. Kreiger  
 Director  
 Federal Personnel and Compensation Division  
 U. S. General Accounting Office  
 Washington, D.C. 20548

Dear Mr. Kreiger:

This is in response to your request for comments on the GAO draft report "Federal Retirement Systems: Unrecognized Cost, Inadequate Funding, and Inconsistent Benefits".

Cost of Retirement Programs: Understated and Underfunded

This section of your report summarizes the financing of the Civil Service Retirement (CSR) system, and six other Federal systems. The current funding provisions of the CSR system were included in Public Law 91-93 passed in 1969.

Funding before 1969 was on a sporadic basis with the government contribution limited to 6.5% of payroll in the 1960s. Projections made then showed that the fund would be depleted if strong funding measures were not enacted. The law went a long way toward providing stable financing. Recently, however, there has been concern that the current funding is not adequate.

We have undertaken an extensive study of the financing of the CSR system and have found that current law financing is adequate to assure continuation of the fund in the foreseeable future under any reasonable economic assumptions. As you point out, current financing measures do not directly show the long range cost of the CSR system or proposed amendments. Since the CSR fund is part of the total Federal budget there may be no real way to charge higher costs to current taxpayers and a change in the law to reflect dynamic costs may have little real effect. We do believe, however, that it is necessary to at least publicize the true long term cost of the system and alternatives whether or not the law is changed.

THE MERIT SYSTEM—A GOOD INVESTMENT IN GOOD GOVERNMENT



Understated Civil Service Retirement costs results in hidden subsidies

Except for the Postal Service, agency contributions are limited to 7% of payroll. The Postal Service is also required to pay the cost of retirement liabilities resulting from their union negotiations. All of the rest of the government contributions are paid from general revenues. This section of your report concludes that the full dynamic normal cost in excess of the employee contribution should be charged to the agencies.

As administrators of the CSR system our primary concern is that adequate allowance be made for financing the benefits. Allocation of the government cost among various sources is primarily a consideration and decision for other agencies and the Congress. We note that the Office of Management and Budget has already suggested use of the dynamic normal cost, less the employee contribution, in comparing the cost of doing business between government sources and outside contracts. OMB has also stated that the balance of the dynamic cost should be charged to agencies beginning in 1979. These positions appear to be consistent with your conclusion.

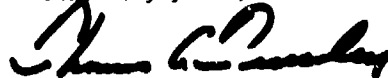
Inequities and Inconsistencies of Federal Retirement Programs

As the report notes, there are many differences among the various Federal Retirement systems. Some of these differences are reasonable. For instance, a typical military career is much different than a typical civil service career and the retirement eligibility provisions need to reflect this. Other major differences are attributable to the fact that participants in some of the systems are covered by Social Security while participants in others are not.

Your recommendation is that Congress establish overall policy on retirement systems and centralize committee jurisdiction. If this does happen, the committee(s) involved should keep in mind the need for some differences in the systems.

We agree generally with the conclusions of your report. Our staff work on financing and advice received from consultants, however, indicate that there are other possible approaches to introducing dynamic cost measures into the financing of the CSR system. Our study is very near completion and should be available in the not too distant future. Your report, our study, and other comments should provide a good basis for Congressional consideration of CSR financing this year.

Sincerely yours,



Thomas A. Tinsley  
Director  
Bureau of Retirement, Insurance,  
and Occupational Health



DEPARTMENT OF STATE

Washington, D.C. 20520

April 28, 1977

Mr. J. K. Fasick  
Director  
International Division  
U.S. General Accounting Office  
Washington, D. C. 20548

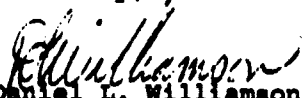
Dear Mr. Fasick:

I am replying to your letter of April 6, 1977, which forwarded copies of the draft report: "Federal Retirement Systems: Unrecognized Cost, Inadequate Funding, and Inconsistent Benefits."

The enclosed comments were prepared by the Deputy Assistant Secretary for Personnel.

We appreciate having had the opportunity to review and comment on the draft report. If I may be of further assistance, I trust you will let me know.

Sincerely,

  
Daniel L. Williamson, Jr.  
Deputy Assistant Secretary  
for Budget and Finance

Enclosure: As stated

April 27, 1977

**GAO DRAFT REPORT: "FEDERAL RETIREMENT SYSTEMS:  
Unrecognized Cost, Inadequate Funding, and  
Inconsistent Benefits"**

Thank you for the opportunity to review your draft report on the costs, benefits and funding of the Federal retirement systems.

In the course of our review we discovered a few minor technical errors. Corrections and/or clarifications have been made on pages 14, 31 and 32 and they are attached for your information.

  
Arthur I. Wortzel  
Deputy Assistant Secretary  
for Personnel

**Attachments:**

Pages 14, 31 and  
32 of draft report

- GAO notes:
1. Appropriate technical changes were made to the report as suggested.
  2. Page references in appendixes V through XVI refer to the draft report and may not correspond to pages in this final report.

UNITED STATES TAX COURT  
WASHINGTON

COURT EXECUTIVE

April 27, 1977

Mr. Victor L. Lowe  
Director, General Government Division  
General Accounting Office Building  
Room 3866  
441 'G' Street, N. W.  
Washington, DC 20548

Dear Mr. Lowe:

Enclosed are the U. S. Tax Court's comments on your draft report on the costs, benefits, and funding of Federal retirement systems.

Enclosure (1) contains general remarks justifying the need for a distinct retirement system for Federal judges.

Enclosure (2) consists of comments on specific references made in your report concerning the Tax Court judges' retirement and survivor benefit systems.

Sincerely yours,

  
WILLIAM P. CREWE  
Court Executive

Enclosures

GAO note: Enclosure 2 to this letter contained suggested technical changes to the report which have been made.

Enclosure (1)

NEED FOR DISTINCT RETIREMENT  
SYSTEM FOR FEDERAL JUDGES

Although there may be reasons for re-evaluating the inconsistencies among many of the Federal retirement systems, it should be recognized that there must be a distinct retirement system maintained for Federal judges.

The judges who serve on courts created under Article III of the Constitution have the constitutional right to remain in office for life. The initial retirement system created for Federal judges applied only to the judges serving on Article III courts, and it is not surprising that such retirement system permitted such judges to continue to receive the pay of the office after they retired. Since such judges could remain in office as long as they wished, it is clear that if they had been compelled to accept any substantial reduction in compensation as a result of retirement, many of them would not have elected to retire. Although the Tax Court is created under Article I, not Article III, of the Constitution, the Congress decided in 1969 that the judges of this Court should be treated in the same manner as those judges serving on Article III courts, and for that reason, it decided to provide a retirement plan for Tax Court judges which is substantially identical to the plan available to Article III judges.

There are two additional reasons for providing different retirement plans for Federal judges: In designing most retirement plans, it is assumed, or hoped, that employees will commence working for the employer at a young age and remain with the employer throughout their working lifetime. Employees who do remain with the employer for such a substantial period are provided substantial retirement benefits. However, no similar period of service can be expected of a Federal judge. Unlike other employees, a person is not suitable to be selected as a judge until he has acquired extensive experience and maturity. Ordinarily, a person chosen as a judge has already reached the zenith of his professional career. In the case of the Tax Court, most judges are in their 40's or 50's when appointed to the court. A person who has already reached such an age cannot be expected to serve for more than 10, 15, or 20 years, and if a retirement plan requires more service than that to qualify for significant benefits, it simply will not help judges and will not assist in attracting the most qualified persons to hold judicial positions.

The other reason for a different retirement plan for judges involves the nature and the extent of the judicial work. In all courts, including the Tax Court, the volume of judicial work has increased spectacularly in recent years. The number of cases commenced each year and the total number of cases pending before the court are both at all-time highs. The size of the Tax Court has not been increased since 1926, and it is hoped that such size will not have to be increased. One significant method of coping with this increased workload is to call upon the retired judges for continued judicial services.

Since the judicial work involves mental efforts and calls for the exercise of judgment, mature persons can often continue to perform the work beyond the ages when they might have to discontinue other types of work. Thus, retired judges are often capable of continuing to carry a substantial caseload, and by doing so, they can assist materially in the performance of the court's work. To provide a sufficient inducement for the retired judges to work, to the extent they are capable of doing so, it is appropriate and sound to continue to pay them the salary of the office.



BOARD OF GOVERNORS  
OF THE  
FEDERAL RESERVE SYSTEM  
WASHINGTON, D. C. 20561

May 20, 1977

Mr. H. L. Krieger, Director  
Federal Personnel and Compensation Division  
U.S. General Accounting Office  
Washington, D. C. 20548

Dear Mr. Krieger:

As requested in your letter of April 4, 1977, members of the Board's staff have reviewed your proposed report to the Congress on the costs, benefits, and funding of Federal retirement systems. Messrs. Peter Lynn and Bud Santee met on May 17 with Mr. C. W. Wood, Assistant Director of Personnel for the Board, and Mr. Merritt Sherman, former Secretary of the Board and presently Consultant on benefits matters.

I regret that we were not able to send you our comments by April 29, but your original letter apparently failed to reach the Board's offices, and it was not until May 10 that a duplicate with a copy of the draft report came into my hands.

The reaction of our staff to your draft report is that its main thrust is very good and long overdue. A realistic valuation of the true costs and liabilities of a benefits program is a basic essential to a sound financing program. In our opinion, it is important to consider both present and prospective benefit levels and their costs, and out of such study to develop a funding program adequate to meet current and future liabilities. We are glad to know that serious reviews along these lines regarding all Federal retirement programs are currently underway, and we hope they will be pursued to a logical conclusion.

Insofar as the report refers to the Federal Reserve Board Plan, Messrs. Wood and Sherman gave your representatives a few suggestions which we understand will be taken into account in preparation of your final report. A copy of the suggested changes in the text of page 16 of your draft is enclosed for your convenient reference. You will note that in this revision we have suggested the use of 1976 cost data, which

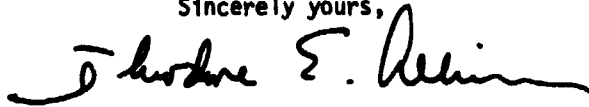
GAC note: The suggested technical changes were made to the report.

indicate realistically the current normal funding costs of the Board Plan on a dynamic basis, including terminal funding of the 5.4 per cent cost of living supplement granted retirees and beneficiaries effective March 1, 1976. (As your draft report indicates, the Board Plan benefits are essentially the same as those of the Civil Service Retirement System except for one or two relatively minor differences, and the contribution rate of the Board's employees is the same as that for employees who are members of the Civil Service retirement fund.)

You may also wish to consider adding a footnote to Appendix I (pages 41 and 42 in our copy) which now describes Board contributions as the "difference between employee contributions and normal cost." The Board Plan normal cost has always included an economic assumption for a career salary progression rate, the level of that allowance for future cost increases being about 1-1/2 or 2 percentage points lower than the assumed rate of interest on invested reserves.

We appreciate having had an opportunity to review your draft report and will be glad to receive several copies of the completed document when it is available.

Sincerely yours,



Theodore E. Allison  
Secretary of the Board

Enclosure



**ADMINISTRATIVE OFFICE OF THE  
UNITED STATES COURTS**SUPREME COURT BUILDING  
WASHINGTON, D.C. 20544ROWLAND F. KIRKS  
DIRECTORWILLIAM E. FOLEY  
DEPUTY DIRECTOR

May 10, 1977

Mr. Victor L. Lowe  
Director, General Government  
Division  
General Accounting Office  
Washington, D.C. 20548

Dear Mr. Lowe:

Reference is made to your letter of April 4, 1977, with which you enclosed copies of your proposed draft report to the Congress on the costs, benefits and funding of Federal retirement systems.

I question the propriety of including in such a study the compensation payable to a Federal justice or judge who takes senior status in accordance with the provisions of sections 371 and 372 of Title 28 of the United States Code. These sections provide that any justice or judge of the United States, appointed to hold office during good behavior, may retain his office but "retire" from regular active service. Under Article III of the Constitution, such justices and judges are appointed for life during good behavior and their salary cannot be diminished. A justice or judge who "retires" from regular active service under subsections 371(b) or 372(a) may continue to perform such judicial duties as he is willing and able to undertake under the provisions of section 294 of Title 28 of the United States Code. Therefore, a justice or judge does not "retire" as that term would be applied to other civilian officers or employees of the Federal Government. Actually, they continue to perform substantial judicial services. It has been possible to meet the heavy caseload of the courts by the willingness of such senior justices or judges to continue to perform judicial duties. At this time, our records show that more than 90 percent of the judges who have "retired" are performing substantial services and accordingly are provided office space and staff. They may not engage in the practice of law and are subject to the same restrictions as any active judge. It is therefore apparent that senior justices or judges should not be compared with other civilian officers and employees of the Federal Government who are completely separated from their position upon retirement. The compensation paid to senior justices or judges is not a "pension"; it is subject to the same payroll deductions that were made from their salary as an "active justice or judge."

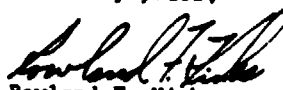
It should be stressed that any proposed legislation could be in conflict with Article III of the Constitution. This matter has not been referred to the Judicial Conference of the United States but I am certain there will be considerable opposition to any changes. I would like to transmit your final

report to the members of the Judicial Conference for consideration in the event you include the senior justices or judges in your study.

I have no problem with your references to the Judicial Survivors' Annuity System but the Judicial Conference of the United States has previously approved the retention of the administration of that system by this office. On page 17 of the report, you speak of the unfunded liability of the Judicial Survivors' Annuity System. Recent legislation (Public Law 94-554, approved October 19, 1976) provides for a direct appropriation to the Judicial Survivors' Annuities Fund to cover the unfunded liability as of January 1, 1977. In connection with this system, I am enclosing a corrected page 42 (Appendix 1) in view of the recent changes in the system that were made by Public Law 94-554.

With kind regards, I am

Sincerely yours,

  
Rowland F. Kirks  
Director

Enclosure

GAO note: The suggested technical change was made to the report.

**TENNESSEE VALLEY AUTHORITY**  
KNOXVILLE, TENNESSEE 37902

May 12, 1977.

Mr. H. L. Krieger, Director  
Federal Personnel and Compensation Division  
United States General Accounting Office  
441 G Street, NW  
Washington, D.C. 20548

Dear Mr. Krieger:

In response to your request of April 29, our comments on your draft report on the costs benefits and funding of Federal retirement systems are enclosed.

We appreciate being given the opportunity to express our views. If we may be of further assistance, please let us know.

Very truly yours,



Lynn Seeber  
General Manager

Enclosure

GAO note: The enclosure was a copy of our draft report with suggested wording changes. Appropriate changes were made.

**Federal Home Loan Bank Board**



320 First Street, N.W.  
Washington, D.C. 20562

Federal Home Loan Bank System  
Federal Home Loan Mortgage Corporation  
Federal Savings and Loan Insurance Corporation

April 29, 1977

**Mr. H.L. Krieger, Director  
Federal Personnel and  
Compensation Division  
United States General Accounting Office  
Washington, D.C. 20548**

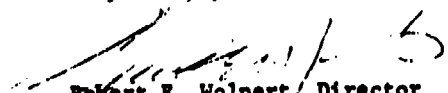
Dear Mr. Krieger:

Chairman Marston asked that I respond to your April 4, 1977 letter concerning the draft of a proposed report on Federal Retirement Systems.

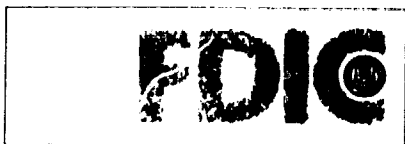
We have no problem with the two recommendations contained on page 40.

Our major concern is that if any changes are made in the required funding of the retirement system there must be appropriate changes to our Congressional and OMB limitations to allow us to fund the change.

Very truly yours,

  
**Robert E. Wolpert, Director  
Accounting & Fiscal Operations**

cc: Chairman Marston



FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, D.C. 20429

OFFICE OF THE CONTROLLER

May 6, 1977

Mr. H. L. Krieger, Director  
Federal Personnel and Compensation  
Division  
General Accounting Office  
Washington, DC 20548

Dear Mr. Krieger:

This is in response to your letter of April 4, 1977, with which you enclosed copies of your proposed report to the Congress on the costs, benefits, and funding of Federal retirement systems.

We found your report interesting and, particularly, examined Chapter 3. This was natural in light of the fact that the Corporation is and wishes to be substantially self-supporting. It contributes to the retirement system, as to any other employee benefit program, in the amounts which have been stated to be its obligation. If it is receiving large hidden subsidies, therefore, it is not because of necessity or desire on the part of the Corporation.

To say this, however, does not mean that the Corporation is searching out ways to add to its annual expenditures. Your draft report suggests OMB has recently recognized that the cost of the Civil Service Retirement System should be determined on a "dynamic" rather than "static" basis. Further, using economic assumptions derived from past pay and cost-of-living increase experience, OMB estimated the "dynamic" normal cost of the system to be 31.7 percent of pay. Thereafter, in October 1976, OMB issued a memorandum instructing Federal agencies to use a factor of 24.7 percent of base pay (31.7 percent less 7 percent employee contributions) when preparing cost analyses. The Corporation did not receive this memorandum and, as a self-supporting agency, would probably not be preparing such analyses.

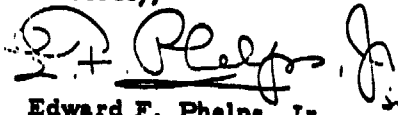
From this background, your report concludes that the FDIC may have received an estimated subsidy of \$9 million in 1976. This presumably represents the difference in computing contributions on a "static" versus "dynamic" basis.

Whether these estimates and arithmetic are valid is perhaps merely something to be proved out in due course. From the point of view of the Corporation, our conceptual position is that we want to pay our way wherever appropriate. If the Congress accepts the recommendation that the cost of Federal retirement systems be computed on a "dynamic" basis and the difference between currently accruing costs and employee

contributions be charged to agency operations, then we are quite willing to earmark the additional several million dollars annually which might be required. In fact, it may be that the burgeoning costs of Federal retirement systems can only be supported by recomputations on a "dynamic" basis. On the other hand, we are not at all anxious to increase our expenditures merely because OMB has "estimated" the costs on a "dynamic" basis and GAO has "estimated" the consequent increased expenditure to be charged to the Corporation's account.

If we can be shown it is the sense of the Congress, therefore, to use the "dynamic" cost basis and if reasonably provable arithmetic as to the amount of increased FDIC contributions flows therefrom, we are entirely able and willing to pay our proper share.

Sincerely,

A handwritten signature in cursive script, appearing to read "E. F. Phelps, Jr.", written in dark ink.

Edward F. Phelps, Jr.  
Controller



CANAL ZONE GOVERNMENT  
BALBOA HEIGHTS, CANAL ZONE  
OFFICE OF THE GOVERNOR

APR 25 1977

Mr. H. L. Krieger  
Director  
Federal Personnel and Compensation Division  
U.S. General Accounting Office  
Washington, D.C. 20548

Dear Mr. Krieger:

This is in reply to your letter of April 4, 1977, to Mr. Thomas Constant, requesting comments on the draft report entitled, "Federal Retirement System: Unrecognized Cost, Inadequate Funding, and Inconsistent Benefits."

The Panama Canal Company and the Canal Zone Government, commonly referred to as the Panama Canal enterprise, are separate and distinct Government entities. As prescribed by law (two Canal Zone Code sections, 62 and 412), the Panama Canal Company is designed to be self-sustaining. The Company finances its operations with revenue from its transit tolls and support services. The Canal Zone Government, on the other hand, receives annual appropriations to finance its operations. These appropriations are returned to the U.S. Treasury through recovery of charges for services rendered by the government and payments by the Company for the net cost of the Canal Zone Government, i.e., operating costs in excess of recoveries.

With the above financing of the entities in mind, the following comments are made concerning the draft report. Your recommendation on page 21 to require . . . "the cost of Federal retirement systems to be computed on a dynamic basis and the difference between currently accruing cost and employee contributions be charged to agency operations", if adopted, would have a significant impact on the rates for services, including tolls for use of the Panama Canal. The rates of tolls were increased an average of 19.7% in 1974, and 19.5% in 1976. In all probability, a similar increase in rates would be needed if additional retirement costs are required to be charged to the operations of the Panama Canal Company and the Canal Zone Government.

We appreciate the opportunity to comment on the draft report.

Sincerely yours,

Richard L. Hunt  
Acting Governor of the Canal Zone  
Vice President, Panama Canal Company

Enclosure



480 L'ENFANT PLAZA, S.W. WASHINGTON, D.C. 20578

May 4, 1977

Mr. Henry Eschwege, Director  
Community and Economic Development Division  
General Accounting Office  
Washington, D.C. 20548

Dear Mr. Eschwege:

We have reviewed the draft of your proposed report on Federal retirement systems. We believe that the report is based on fact and that the conclusions are essentially sound. We are in full agreement with the concept of dynamic funding and believe that Federal retirement systems should operate on funding principles similar to those in the private sector under the requirements of the Employee Retirement Income Security Act. We have the following comments regarding those sections of the report which relate to coverage of Farm Credit Administration and Farm Credit System employees under the Civil Service Retirement System:

1. Your report accurately points out that our operations are established on a self-supporting basis with expenses assessed against the banks of the Farm Credit System, rather than from tax revenues. Because of the static basis used to compute the normal costs of the Civil Service Retirement System, the report estimates that the agency received a subsidy of \$800,000 in 1976. This figure represents the difference between what is actually paid into the fund and the estimated normal cost calculated on a dynamic basis. However, when the normal costs of the Civil Service Retirement System are computed on a static basis as is currently the case, there is no subsidy at all. We do not think that a handful of agencies should be singled out for special treatment merely because they were intended to be self-supporting. The employees of Farm Credit Administration are competitively appointed from Civil Service registers and have the same pay and benefits as other employees of the Federal Government. We



believe it would be a gross inequity to calculate normal costs on a dynamic basis for Farm Credit Administration employees and on a static basis for other agencies.

2. As the report points out, the Farm Credit Banks are required by law to contribute the difference between their employees' contributions and the Civil Service Retirement System's normal cost as determined by the Civil Service Commission. What we stated above also applies to the Farm Credit Banks; there is no subsidy when normal costs are computed on a static basis and a dynamic calculation should be used uniformly or not at all. Additionally, we must point out that the number of bank employees covered by Civil Service Retirement is steadily declining. From approximately 1600 covered employees in 1959, the number has shrunk to approximately 270 employees today and will probably disappear within 20 years. This means that the liability for these employees and retired annuitants of the banks will continue to increase and that receipts for covered bank employees will continue to decrease. The significance of this "subsidy" will continue to decline as more of the bank employees reach retirement age.
3. Finally, we believe that the assets of the Civil Service Retirement fund should not be limited by law to investment in Federal Government securities. During the 1976 calendar year, long-term Treasury bonds ranged in price between 6.38 percent and 7.01 percent, and long-term new corporate bonds ranged between 7.90 percent and 9.00 percent. During this same period, intermediate securities of the Farm Credit System ranged from 7.10 to 7.45 percent, and long-term Farm Credit System securities ranged from 7.85 to 7.95 percent. When these rates are compared to the 5.75 percent rate paid on the Civil Service Retirement fund in 1976, we question if the fund is subsidizing the Federal Government with a cheap source of funds. We believe that if the Tennessee Valley Authority and Federal Reserve Board can diversify the investment of their retirement funds, the Civil Service Retirement fund should be allowed to do likewise. Health and life insurance benefits are handled by private carriers; perhaps a

consortium of private insurance companies and banks could act as trustee for a portion of the fund assets. As a minimum, the investment policy should be liberalized to permit investment in agency securities such as those issued by the Farm Credit Banks.

In summary, while we agree with most of the conclusions of your draft report, we oppose using a dynamic basis for estimating normal costs for Farm Credit Administration and bank employees, while a static basis is used for all other agencies. We also believe that consideration should be given to diversification of the Civil Service Retirement fund assets. We appreciate the opportunity to comment on your draft and hope that these comments will be useful.

Sincerely,

A handwritten signature in cursive script, reading "Donald E. Wilkinson".

Governor

## FEDERAL NATIONAL MORTGAGE ASSOCIATION

FNMA

F. G. GOBLING  
VICE PRESIDENT FOR ADMINISTRATION

April 29, 1977

Mr. Henry Eschwege  
Director, Community and Economic  
Development Division  
U. S. General Accounting Office  
Washington, DC 20548

Dear Mr. Eschwege:

We appreciate the opportunity to comment on your proposed report, "Federal Retirement Systems: Unrecognized Cost, Inadequate Funding and Inconsistent Benefits." Our partial participation in the Civil Service Retirement System is with definite restrictions, and our contributions to the Civil Service Retirement and Disability Fund are as set forth in Section 309(d)(2) of the Federal National Mortgage Association Charter Act (12 U.S.C. 1723a(d)(2)). There are now only 215 of our 1260 employees who are subject to this provision. FNMA's own retirement plan supplements the regular social security coverage for the majority (1045) of our employees.

We believe that your review is substantive and timely, but do not agree with the conclusions set forth in the proposed report. The concept of "dynamic cost" and the OMB estimate (emphasis added) is apparently based on federal agency experience, which should not include FNMA. The report incorrectly assumes that FNMA employees' wages are affected by or included in the General Schedule. However, since December 1, 1968, administrative adjustments for the GS schedules have increased 66% whereas FNMA adjustments have totalled 46%. This 43% difference would represent a potentially significant reduction in any actuarial computation of retirement liability. The OMB directed that the "dynamic" normal cost be used for cost accounting purposes under OMB Circular A076.1. It does not necessarily follow that the same calculation should be used in funding a retirement system. Cost accounting

for determining whether or not agency functions should be contracted out is not the same as determining how many actual dollars should be contributed to a retirement fund, and there is no reason why they should be treated alike. The dynamic cost figure of 31.7%, which apparently did not come from any independent actuarial study by GAO, should not be applied to all agencies and all retirement systems.

We were pleased to be able to review your draft report and thank you for considering our comments. We would appreciate your sending us a copy of the final report you will submit to Congress.

Sincerely,



F. G. Gosling



THE POSTMASTER GENERAL  
Washington, DC 20260

June 3, 1977

The Honorable Elmer B. Staats  
Comptroller General of the  
United States  
Room 7000  
441 G. Street, N.W.  
Washington, D.C. 20548

Dear Elmer:

Thank you for the opportunity to comment on the General Accounting Office's (GAO) proposed report to the Congress on Federal Retirement Systems.

Perhaps more than any other agency, the Postal Service is aware that funding retirement benefits is an expensive undertaking. As pointed out in your report, we are presently the only agency that is required to amortize the increases in the unfunded liability resulting from pay increases. We believe our retirement financing procedures are more prudent than the financing procedures followed generally. We feel very strongly that our financing procedures are indeed proper.

Since our total payments to the retirement system were just over \$1 billion in Fiscal Year 1976, and we employ approximately 25 percent of all persons covered by the Civil Service retirement system, we are necessarily concerned about the impact of any changes to the existing retirement system. Moreover, since Postal Reorganization, we have paid approximately \$6 billion into the retirement fund. During that same period, retired postal employees have received approximately \$3 billion in benefits.

Since P.L. 93-349 was enacted in July 1974, the Postal Service has been regularly paying into the Civil Service Retirement and Disability Fund substantial amounts over and above the 14 percent so-called static normal cost of the retirement system required to be paid by other agencies and their employees. The law makes the Postal Service liable for additional amounts sufficient to discharge any unfunded liability attributable to

actions of the Postal Service in increasing, either through collective bargaining or by administrative action, the pay of postal employees on which benefits are computed.

It is quite clear from P.L. 93-349 itself, as well as from the legislative history, that the Postal Service was not to be made liable for any unfunded liability not caused by the Postal Service. As the Senate Committee on Post Office and Civil Service stated in its report on the bill that was subsequently enacted into law: "The Postal Service, however, would not be held responsible for unfunded liabilities which might be created by an Act of Congress". S. Rep. No. 93-947, 93d Cong., 2d Sess. 3 (1974). In the House report there is the following unequivocal statement: "The purpose of this legislation is to clearly establish the responsibility of the U. S. Postal Service to finance the increases in the unfunded liability of the Civil Service Retirement and Disability fund, caused by administrative action of the Postal Service, as apart from increases in unfunded liabilities which are incurred by Act of Congress". H.K. Rep. No. 93-120, 93d Cong., 1st Sess. 2 (1973) (Emphasis added.)

Even though the Congress clearly and unmistakably limited the Postal Service's unfunded liability to that caused by the Service through pay increases, and even though Congress specifically recognized the fact that there is other unfunded liability caused by acts of Congress, which Congress would fund, the GAO draft report characterizes this liability as an "unrecognized subsidy" to the Postal Service.

This characterization is not really apposite. The unfunded liability, which GAO recommends we fund, is caused largely by cost-of-living increases granted to annuitants pursuant to a statutory formula enacted by Congress. It discharges no legal obligation of the Postal Service under existing law.

We fully agree with the principle now embodied in the law that postal ratepayers should be responsible for all unfunded liability costs attributable to the actions of the Postal Service.

The Postal Service agrees in principle with the concept of using "dynamic" procedures in determining the amount of contributions it should make to the retirement fund. However, the latest draft of a Civil Service interagency task force report indicates that, under a dynamic funding approach, substantial

overfunding could be possible. Also, the assumptions used to compute dynamic costs, particularly the inflation factors, are subject to significant changes which could make contributions highly variable. <sup>1/</sup> Accordingly, we foresee major problems in any funding arrangement that could cause instability in the postal ratemaking process.

As pointed out on pages five and six of the draft report, there are a number of dynamic funding estimates that have been developed by both the Office of Management and Budget (OMB) and the Civil Service Commission. It appears that the draft report uses the OMB's estimate of 24.7 percent to illustrate the impact of dynamic funding. It would be helpful if the final GAO report were to state exactly which funding estimates and assumptions are recommended for adoption and explain clearly how the percentage figures were derived. This is obviously important for the Postal Service, since, according to page 27 of the draft report, the Postal Service under dynamic funding "would have had to come up with" an additional \$1.2 billion in 1976 to fund its share of the retirement costs.

We understand from discussions with GAO staff members that the \$1.2 billion figure includes unfunded liabilities resulting from cost-of-living annuity increases granted by Congress under 5 U.S.C. 8340. As discussed above, such liabilities should under present law be funded by taxpayers out of appropriated funds rather than by postal ratepayers. As to that part of the \$1.2 billion that would, under dynamic funding procedures, be payable by the Postal Service because attributable to pay increases, it would help if the exact dimensions of this amount were calculated and published in the GAO report. Otherwise, neither the Congress nor the Postal Service can take a fully informed position on the merits of dynamic funding as it would affect the Postal Service.

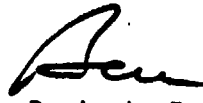
The GAO suggests that the difference between the currently accruing cost of Federal retirement systems computed on a dynamic basis and the employee contributions be charged to agency operations. We agree, but we also believe that it would be helpful if GAO would consider and incorporate into the report additional options to fund retirement liabilities.

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<sup>1/</sup> We assume that GAO has independently verified the validity of any actuarial data or assumptions made by the Civil Service Commission and recognizes this potential for overfunding on a dynamic basis.

The Postal Service shares the concern of the General Accounting Office about the rising costs and inequities in Federal retirement programs. Our concern is that no new inequities be created as a result of your report, which would affect postal customers. But we strongly agree that more responsible practices in regard to adequate financing of retirement plans should be developed, agreed upon by the Congress, and placed into effect forthwith.

Sincerely,



Benjamin F. Bailar





THE DISTRICT OF COLUMBIA

WALTER E. WASHINGTON  
MAYOR

WASHINGTON, D. C. 20004

MAY 19 1977

Mr. Victor L. Lowe, Director  
General Government Division  
U. S. General Accounting Office  
Washington, D. C. 20548

Dear Mr. Lowe:

Thank you for the opportunity to comment on your draft report entitled, "Federal Retirement Systems: Unrecognized Cost, Inadequate Funding, and Inconsistent Benefits."

The report examines a number of significant policy questions concerning the financing and benefit provisions of Federal pension plans. The District of Columbia is included in the study because about 60 percent of the District workforce -- employees hired under the General Schedule and Wage System -- are enrolled in the Federal Civil Service Retirement System. Thus, issues arising from that retirement program also impact the District Government by virtue of City employee membership in the Civil Service system.

The report notes that existing statutes require the Federal Government to make multi-billion dollar payments to the Civil Service fund each year to finance pension liabilities that are not being met through the seven percent matching contributions from Federal agencies and their employees. Even with the additional payments, the Civil Service Retirement System faces massive unfunded liabilities, estimated at \$107 billion during the last fiscal year alone.

While the unchecked growth in unfunded liabilities is the primary issue confronting the Civil Service program, the report questions whether current financing policies are fair, especially in the case of agencies like the District Government which derive a substantial portion of operating revenues from sources outside the Federal budget. Since those agencies are generally intended to be self-sustaining, the report suggests they should contribute the full cost of annual liability accruals through employer and employee payments. When those payments do not cover all benefits earned, as at present, Federal taxpayers must make up the difference, a situation that could produce inequities in the incidence of pension financing burdens. As a result, Federal funds used to meet a portion of annual pension costs may constitute a "hidden subsidy" to self-supporting agencies. The report estimates District contributions in fiscal 1976 fell \$72 million below the level required to cover all benefits earned by active employees.

This issue came to our attention in June of last year in a report to the Senate Committee on the District of Columbia prepared by the public accounting firm of Arthur Andersen and Company. That study also estimated the amount of Civil Service pension liabilities that are not being reflected in the normal matching contributions. However, the Andersen report cautioned against simply applying to the District the same actuarial factors developed for the entire Civil Service system. "To properly evaluate the actual normal cost for the District," the report concluded, "a separate actuarial study must be performed so that only actual District employee experience is considered" (Volume IX, page 45).

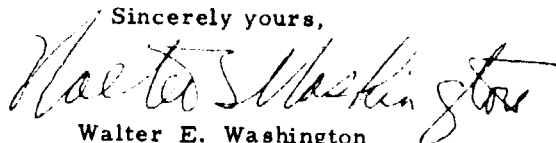
Herein lies one of our concerns with the draft report. Because employment and retirement practices are impacted by several factors resulting from inherent differences between the District Government and Federal agencies, it is questionable to assume that District employees are earning pension benefits at the same average rate as all Federal Civil Service employees. As the Arthur Andersen study noted, a complete actuarial analysis would be needed to verify that assumption. Thus, I urge you to include in this report a recommendation that separate actuarial statistics be developed for the District and other agencies in the Federal Civil Service before they are charged the full amount of currently accruing pension costs.

Aside from actuarial considerations, there is a broader policy question regarding the appropriate division of financing responsibility between the Federal Government and the individual agencies whose employees subscribe to the Civil Service system. While many provisions of the Civil Service retirement program should be financed entirely from employer and employee contributions, there are grounds for continuing to meet certain costs on a system-wide basis through direct Federal appropriations. One clear-cut example is the benefit giving employees Civil Service credit for prior military service. Since that benefit is for service to the nation as a whole, it is reasonable to pay for military service credits directly from the U.S. Treasury, rather than allocating those costs to individual agencies such as the District Government.

More difficult issues must be considered in dealing with the impact of pay raises, benefit liberalizations and cost-of-living pension adjustments, none of which is currently included in the formula for employer and employee contributions. There is merit in the argument that individual agencies, such as the District, can do little to influence the direction of costs in these areas. Since agencies typically do not have the option to accept or reject Congressionally approved pay and benefit improvements or the power to control inflationary trends, the Federal Government might well choose to continue treating these liabilities as a system-wide expense, not charged to employing agencies as part of the contribution formula. Extending Civil Service eligibility to new groups of employees could also be financed in this manner if it creates a substantial past service liability.

In conclusion, I found the report a comprehensive and thoughtful treatment of rather complex issues in Federal retirement policy. I appreciate the opportunity to comment on the draft report prior to its official release.

Sincerely yours,



Walter E. Washington  
Mayor