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UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

FEDERAL PERSONNEL AND
COMPENSATION DIVISION

FEBRUARY 26, 1981

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The Honorable Arch S. Ramsay
Acting Director
Office of Personnel Management

Dear Mr. Ramsay:

Subject: Changes Needed in Calculation of Reduction in Civil Service Annuities for Survivor Benefits (FPCD-81-35)

We have completed our review of how the Office of Personnel Management (OPM) reduces the civil service annuities of retired Federal employees who have elected survivor benefits for their spouses. We believe that changes need to be made to more properly calculate the annuity reduction when cost-of-living adjustments are granted. The changes would eliminate monetary inequities which are now being created between prior and new retirees. They would also reduce expenditures from the civil service retirement fund and permit more efficient records processing. These modifications would not change the annuities payable to survivors.

Our objectives were to evaluate the propriety of OPM's method of calculating the survivor benefit reduction when applying cost-of-living adjustments and to determine what the effects would be if the method were changed.

Our conclusions are based on a longitudinal study of selected retirement records in which the survivorship option was elected and a comparison of methods for applying cost-of-living adjustments to such retirement annuities. A description of our sampling methodology and estimated savings is contained in the enclosure. At OPM's headquarters in Washington, D.C., we reviewed procedures for maintaining retirement accounts pertinent to the survivor program and the laws governing survivor benefit reductions and cost-of-living adjustments. We

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informally discussed the results of our work with OPM program officials and considered their views in preparing this report.

BACKGROUND

As of July 1980, 767,172 of the 1,281,763 civil service retirees (60 percent) received reduced annuities to provide survivor benefits. When they retire, married Federal employees may elect that upon their death an annuity will also be payable to a surviving spouse. The survivor's annuity is 55 percent of the retiree's annuity, or a smaller base if desired. The law (5 U.S.C. 8339(j)) specifies that for this coverage the retiree's full annuity (or smaller base if elected) is reduced by specific percentages stated in the law--2.5 percent of the first $3,600 and 10 percent of any amount in excess of $3,600. The reduction is usually much less than the equivalent actuarial value of the survivor's annuity; thus, most retirees who elect survivor coverage choose the maximum benefit. If a retiree's marriage ends by death or divorce, survivor coverage also ends and the annuity is increased to its full amount.

Cost-of-living increases apply to all annuities payable from the fund, but the law authorizing them (5 U.S.C. 8340) does not specifically state whether they are to be applied to the reduced annuities or the unreduced annuities. OPM has elected to apply the increases to the reduced annuities which results in a higher cost to the Government, as discussed below.

ONE-TIME ONLY CALCULATION OF THE REDUCTION RESULTS IN INEQUITIES AND ADDED COSTS

OPM calculates the reduced annuity by the legislative formula only once for an individual--when he or she retires and elects survivor coverage. Thereafter, the reduced annuity is adjusted by semiannual cost-of-living increases. This creates a situation where for identical survivor benefits new retirees pay more than earlier retirees who subsequently received cost-of-living increases.

The difference that occurs between a prior and a new retiree under OPM's method is illustrated by the following example.

An employee retired on January 1, 1976, with a monthly annuity of $515 and elected maximum survivor benefits for a reduction of $29, thus receiving a reduced annuity of $486. Through March 1980, the annuitant received eight cost-of-living adjustments which increased the reduced annuity and the amount of the reduction as follows:

Date of adjustment	Percentage increase	Adjusted gross annuity	Monthly reduced annuity	Amount of reduction
3/1/76	5.4	$543	$512	$31
3/1/77	4.8	569	537	32
9/1/77	4.3	593	560	33
3/1/78	2.4	608	573	35
9/1/78	4.9	637	601	36
3/1/79	3.9	662	624	38
9/1/79	6.9	708	667	41
3/1/80	6.0	750	707	43

However, a new retiree in March 1980 with a $750 monthly annuity would have a reduction of $52, or $9 more each month for the same survivor coverage.

We believe a more equitable method is to recalculate the annuity reduction each time there is a cost-of-living increase. This would insure that past and future retirees pay the same amount for the same coverage. Applying this method to the above illustration, both retirees would have reduced annuities of $698. Under either method, the survivor benefits would be identical.

We sampled retirement records of individuals who retired between November 1969 and July 1980 and recalculated their reduced annuities for each cost-of-living adjustment using the legislative formula. For all retirees who have elected survivor benefits, we estimate the total annual difference in their reduced annuities between the two methods ranges from $76.8 million to $91.2 million. (See the enclosure.) Since the recomputation of annuities for cost-of-living adjustments is automated, we believe the cost of changing methods would be minimal.

Under OPM's method, each cost-of-living increase adds to the difference between what previous and new retirees pay for the same survivor coverage. The following shows that the differences are greater for earlier retirees who have received more increases.

Retiree	Date of retirement	Monthly reduced annuity being paid	Monthly reduced annuity of a new retiree	Difference
A	6/70	$673	$643	$30
B	12/72	781	764	17
C	7/73	930	911	19
D	9/74	785	772	13
E	5/75	551	540	11
F	2/76	871	862	9
G	7/77	540	531	9
H	11/78	968	963	5
I	4/79	906	903	3
J	12/79	937	936	1

Cases of marriage dissolution further demonstrate inequities

The law (5 U.S.C. 8339) provides that if a retiree's marriage ends, the survivor reduction stops and the retiree's full annuity is restored. It also provides that if such a retiree remarries and elects new survivor coverage, the reduction in effect for the first marriage shall also be in effect for the second marriage. Accordingly, when OPM is advised that a marriage has ended, it (1) recomputes and restores the full annuity and (2) maintains a record from that time forward of the adjusted reduced annuity and survivor benefit payable in case the retiree remarries. The latter procedure preserves the potential for inequity among single retirees in the event of their subsequent marriage.

To identify the effects of the above procedure, we examined 166 annuity accounts where marriages were dissolved and full annuities restored in May 1980. Since these accounts were not sampled on a statistical basis, our findings are not projectable but indicate the effects of OPM's procedure.

--The unreduced annuities for these individuals averaged $962 a month; if they remarried, their annuities would be reduced by $57. However, if these same individuals were retiring at the time of our review and electing survivor benefits, or were retired and marrying for the first time, their annuity reductions would be $74 a month, or $17 more for the same survivor coverage.

--Two individuals in our sample had identical unreduced annuities, but one retired in 1964 and the other in 1965. The 1964 retiree, if remarried, would have a $13 survivor reduction and the 1965 retiree an $18 reduction. A married person retiring at the time of our review with the same unreduced annuity would have a reduction of $48. In all three cases, the survivor benefit payable would be $386.

MARRIAGE DISSOLUTION CASES CAN BE MORE EFFICIENTLY HANDLED

When a marriage is dissolved, OPM reconstructs the retiree's full annuity by determining what the full annuity was at the time of retirement and adjusting this amount by all subsequent cost-of-living increases. This research back to the time of retirement is done because current retirement records indicate only the amount of the reduced annuity and not what the full annuity would be if there was no reduction for survivor benefits. Because the retirement files are not fully automated, reconstruction of the full annuity requires OPM to manually search permanent retirement records and transmit information back and forth between the retirement records center in Boyers, Pennsylvania, where the permanent files are kept, and OPM's headquarters.

OPM's administrative process can be streamlined in most cases by computing (reestablishing) the up-to-date full annuity amount from other information on the current retirement record. Specifically, the record shows the survivor benefit payable which remains constant at 55 percent of the unreduced annuity. Thus, simply dividing the survivor benefit payable by 55 percent determines the unreduced annuity, making the manual reconstruction process unnecessary. 1/

We tested our suggested method and determined that it is reliable. Whether annuity reductions are adjusted for cost-of-living increases as OPM does now, or are recalculated as we propose, the survivor benefit payable will remain at 55 percent of the unreduced annuity. To verify this, we compared the total of the monthly annuities of our sample of 166 cases as calculated by OPM with the value calculated by our method. Slight differences occur due to rounding in the multiple calculations required under the OPM method; however, these are minor and largely offset each other. According to OPM, the total monthly value was $159,688--according to our method, it was $159,640, for a difference of $48, or only $0.29 per individual.

OPM does not know exactly how many of these cases there are, but on the basis of our limited test which showed over 200 cases in a 2-week period, we believe they amount to at least several hundred a month and a significant administrative workload.

CONCLUSIONS

If retirees have comparable annuities, and thus comparable survivor benefits, we believe that they should pay the same amount for those benefits. However, under current procedures, this occurs only among those who retire at about the same time.

Since the history of the law on cost-of-living increases does not indicate specifically how the reduction should be applied, we cannot say OPM's method is contrary to law. It is, however, inequitable because prior retirees are always charged less than new retirees for similar survivor benefits.

1/It should be noted that this shortcut procedure cannot be used for the infrequent cases where retirees have elected less than maximum survivor benefits--that is, 55 percent of an amount lower than the full annuity. According to a random sample, this occurred in 6 percent of survivor benefit cases. The retirement records are coded to identify these cases.

The provision of the law which states that in cases of remarriage the reduction in effect during the first marriage shall also be in effect for the second marriage helps perpetuate inequities among retirees and should be changed.

Recalculating survivor reductions with each cost-of-living increase would also greatly reduce expenditures from the retirement fund. Since the reduction is, in most cases, less than what it would be if it were actuarially determined, such a change would help preserve the financial integrity of the retirement fund.

Also, OPM's method of restoring full annuities when marriages are dissolved is more administratively burdensome than necessary. Procedures in this area could be streamlined, possibly freeing resources to reduce work backlogs in other areas.

RECOMMENDATIONS

We recommend that the Acting Director, OPM:

--Determine reduced annuities for survivor coverage by first adjusting the full annuities for cost-of-living increases and then applying the reduction formula.

--Propose a change to section 5 U.S.C. 8339 so that upon remarriage a retiree's survivor reduction would be determined according to the reduction formula applicable to other retirees.

--Change the method of reestablishing full annuities in cases of marriage dissolution to the method described in this report.

Recalculations in accordance with these recommendations should be concurrent with a cost-of-living increase to preclude annuitants from having a loss of income due to recalculations.

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As you know, section 236 of the Legislative Reorganization Act of 1970 requires the head of a Federal agency to submit a written statement on actions taken on our recommendations to the House Committee on Government Operations and the Senate Committee on Governmental Affairs not later than 60 days after the date of the report and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report.

We are sending copies of this report to the Director, Office of Management and Budget; the Chairmen of the above Committees; and the Chairman of the House Committee on Post Office and Civil Service.

Sincerely yours,

Clifford I. Gould

Clifford I. Gould
Director

Enclosure

METHODOLOGY FOR ESTIMATED SAVINGS IF SURVIVOR REDUCTIONS WERE RECALCULATED WHEN COST-OF-LIVING INCREASES OCCUR

We selected a random sample of 189 accounts from the records of 590,236 individuals who retired on or after November 1, 1969, and who had elected survivor benefits. The sample was drawn on an interval basis with a random start. We examined 178 of the accounts in detail, representing 94.18 percent of the records selected, where the annuitants had elected the maximum survivor benefits. In the remaining 11 cases, the annuitant elected less than the maximum. We estimate that 555,884 of the 590,236 (94.18 percent) annuitants with survivor reductions elected the maximum coverage. 1/

Our detailed examination of the 178 civil service annuity records showed that the retirees received reduced annuities averaging $1,009 monthly. If survivor reductions were recalculated at the time of our review for cost-of-living adjustments using the legislative formula, these annuitants would receive reduced annuities averaging $996 or $13 a month less. 2/ On this basis, we estimated that the 555,884 annuitants, from which the 178 accounts were selected, are receiving about $7 million more each month, 3/ or between $76.8 million and $91.2 million annually under the OPM method than under the alternate method of applying cost-of-living increases.

The above projection does not include differences in survivor reductions for about 211,000 annuity accounts involving 176,936 annuitants who retired before November 1, 1969, and about 24,000 annuitants who elected less than maximum survivor benefit coverage. We cannot estimate the amount of the annual differences for this group because they were not part of our sample.

1/This estimate could range from 539,357 to 572,410 under accepted sampling procedures at the 90-percent confidence level.

2/Actual difference is $12.65 monthly, rounded to $13.

3/This amount could range from $6.4 to $7.6 million under accepted sampling procedures at the 90-percent confidence level.