S. Hrg. 105–639

S. 1710—RETIREMENT COVERAGE ERROR CORRECTION ACT OF 1998

HEARING

BEFORE THE

SUBCOMMITTEE ON INTERNATIONAL SECURITY, PROLIFERATION, AND FEDERAL SERVICES

OF THE

COMMITTEE ON GOVERNMENTAL AFFAIRS UNITED STATES SENATE

ONE HUNDRED FIFTH CONGRESS

SECOND SESSION

ON

S. 1710

TO PROVIDE FOR THE CORRECTION OF RETIREMENT COVERAGE ERRORS UNDER CHAPTERS 83 AND 84 OF TITLE 5, UNITED STATES CODE

MAY 13, 1998

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WEDNESDAY, MAY 13, 1998

U.S. SENATE
SUBCOMMITTEE ON INTERNATIONAL SECURITY,
PROLIFERATION, AND FEDERAL SERVICES
OF THE COMMITTEE ON GOVERNMENTAL AFFAIRS,
Washington, D.C.

The Subcommittee met, pursuant to notice, at 2 p.m. in room 342, Senate Dirksen Building, Hon. Thad Cochran, Chairman of the Subcommittee, presiding.

Present: Senators Cochran and Levin.

OPENING STATEMENT OF SENATOR COCHRAN

Senator COCHRAN. The Subcommittee will please come to order.

Today we are conducting a hearing on S. 1710, the Retirement Coverage Error Correction Act of 1998, a bill which I introduced in March of this year at the request of the administration.

The Retirement Coverage Error Correction Act is designed to provide an appropriate remedy for approximately 20,000 Federal employees who have been placed by the government in an incorrect retirement system. To give you some background on this situation, let me try to explain that this erroneous pension problem stems from the government's transition to the Federal Employees Retirement System, FERS, in 1984. Some employees hired since 1984 were erroneously placed in the older Civil Service Retirement System, CSRS, and later informed that they should be in FERS.

Retirement coverage errors generally resulted from the difficulties government agencies experienced in applying two sets of transition rules. The CSRS is a traditional defined benefit program; participants receive an annuity based on age, years of service, and average compensation. FERS is a hybrid plan; FERS participants receive a substantially smaller annuity than CSRS participants, but they are covered by Social Security and are eligible for greater benefits under the Tax-deferred Savings Plan, TSP.

To provide benefits equivalent to those payable under CSRS, it is generally considered necessary to contribute to the TSP and enhance retirement benefits by obtaining government matching. Employees erroneously placed in CSRS or CSRS-Offset, a plan which combines CSRS coverage and Social Security coverage, for a substantial period may be disadvantaged with respect to TSP benefits. For example, due to erroneous coverage they may not have contributed to the TSP in the belief that they would obtain a CSRS or

CSRS-Offset benefit. Since the TSP began in 1987, employees whose erroneous coverage was detected have been allowed to obtain TSP benefits retroactively, with makeup contributions, but they may not have used the makeup opportunity for a variety of reasons, including lack of income available for savings.

To remedy the situation, the administration's proposal, S. 1710, allows individuals affected by an error lasting at least 3 years to choose between being retroactively placed in FERS, which current law provides or requires, or CSRS-Offset, whichever the individual prefers. CSRS-Offset coverage provides benefits that employees expected during erroneous coverage through annuity and Social Security.

Providing choice allows the equivalent of choosing FERS or CSRS, but does not disturb Social Security coverage rules. The CSRS-Offset choice makes the remedy administratively feasible for employees already placed in FERS and participating in Social Security, including retirees already receiving Social Security benefits. Employees, retirees, survivors, and certain salaried employees will have a window of opportunity to choose, and there will be an outreach program to explain this change. As Chairman of the Subcommittee with jurisdiction over this subject, I will try to ensure a careful review of all of the options for dealing with this issue.

This afternoon we will hear from two panels of witnesses. The first panel will include William E. Flynn, Associate Director for Retirement and Insurance at the U.S. Office of Personnel Management, and the Hon. Roger W. Mehle, Executive Director of the Federal Retirement Thrift Investment Board. The second panel will include Dallas Salisbury, President of the Employee Benefit Research Institute, and Daniel F. Geisler, President of the American Foreign Service Association.

Our first panel is at the table. We have received statements from you; we will include those in the record as if read. We also have statements from Robert Tobias, President of the National Treasury Employees Union, Thomas O'Rourke of the law firm of Shaw, Bransford and O'Rourke, and from Linda Oakey-Hemphill, U.S. Department of Treasury, which also will be included in our hearing record.[1]

We invite you, Mr. Flynn and Mr. Mehle, to proceed with any comments or summary description of your views on this issue, as you like.

Mr. Flynn, we will begin with you.

STATEMENT OF WILLIAM E. FLYNN,[2] ASSOCIATE DIRECTOR FOR RETIREMENT AND INSURANCE, U.S. OFFICE OF PERSONNEL MANAGEMENT

Mr. FLYNN. Thank you, Mr. Chairman. We appreciate very much the opportunity to be here today.

You provided, I think, a very good summary of the proposal that is before the Subcommittee, so I might shorten my introductory remarks even further and just talk about a couple of very brief issues regarding it.

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[1] The prepared statements of Mr. Tobias, Mr. O'Rourke, and Ms. Oakey-Hemphill appear in the Appendix on pages 59–74 respectively.

[2] The prepared statement of Mr. Flynn appears in the Appendix on page 75.

I think the first thing that I would like to say, Mr. Chairman, is that in dealing with this issue of the incorrect retirement coverage, we worked closely with the Federal Retirement Thrift Investment Board, the Social Security Administration and the Treasury Department. We also sought, Mr. Chairman, the views of other major employing agencies where these errors have occurred around government. What we tried to do was put together, in consultation with all those parties, a proposal that represents a consensus position on resolution of what are, quite honestly, very intricate and intertwined issues dealing with being in the correct or incorrect retirement system.

In putting forth the proposal, we tried to satisfy four primary objectives.

First, we thought it absolutely essential that this remedy should demonstrate that the government cares about Federal employees who have been disadvantaged by an error in their retirement coverage, and that the government is committed to an equitable solution not only for them, but for their families as well.

Second, we wanted to make sure that employees had a choice between corrected coverage—i.e., in most cases, being in the Federal Employees Retirement System—or a benefit the employee expected to receive, without disturbing Social Security coverage laws, as you've mentioned.

Third, we wanted to make sure that these options would be easy to understand for affected employees.

And finally, we wanted to minimize the administrative complexity that can be associated with situations like this in order to keep the solutions simple and timely as we move forward.

We believe the proposal that is before the Subcommittee meets these objectives. During our study of this matter we also considered the option of placing individuals in the Federal Employees Retirement System and making a compensatory payment to the Thrift Savings Plan to make up for the period of time of their erroneous classification.

In very short order, Mr. Chairman, we realized that there were intractable basic problems that limit the feasibility of going down that road. More importantly, we concluded that the approach of offering CSRS-Offset coverage provides a make-whole solution to affected individuals. Under this approach, as you have pointed out, no one would get less than they believed they were going to receive prior to the discovery of the error.

Your bill, Mr. Chairman, is largely based on the administration's proposal. Most importantly, both proposals would provide a solution for all affected groups, as you've mentioned. Many people have worked hard to develop a solution to this problem; however, none of us can move forward until legislation is enacted, and our hope is that we can move forward quickly in order to begin the work of actually delivering relief to people who have been adversely affected.

Thank you, Mr. Chairman. I would be happy to answer any questions you might have.

Senator COCHRAN. Thank you, Mr. Flynn.

Mr. Mehle.

STATEMENT OF HON. ROGER W. MEHLE,[1] EXECUTIVE DIRECTOR, FEDERAL RETIREMENT THRIFT INVESTMENT BOARD

Mr. MEHLE. Yes, Mr. Chairman, thank you. As you noted, my name is Roger Mehle, and I am the Executive Director of the Federal Retirement Thrift Investment Board.

I have been invited to present the Board's views on S. 1710, the Retirement Coverage Error Correction Act of 1998. The proposed legislation addresses the longstanding problem of retirement system coverage errors of what the Board understands may be thousands of Federal employees.

Unfortunately, upon discovery of these coverage errors, the only legal avenue for agencies at present is to reclassify the affected individuals into the correct retirement system, often entailing serious financial consequences and special problems for those about to separate from Federal service.

The most common error, apparently, was misclassification of newly-hired employees into the Civil Service Retirement System when those employees should have been placed into the Federal Employees Retirement System. In that regard, Mr. Chairman, S. 1710 and H.R. 3249, comparable legislation pending in the House, wisely provide complete relief for such errors by allowing the affected employees to elect coverage under a retirement system virtually equivalent to CSRS—that is, CSRS-Offset.

Since all such employees had much earlier, by law, already been offered and had rejected FERS coverage, absent any newly-legislated inducements to do otherwise, practically all such employees should opt for the retirement coverage which they already thought they had.

It is difficult to conceive a more equitable and principled result, both for the employee and for the government. Both proposals, S. 1710 and H.R. 3249, however, also permit employees misclassified as CSRS to select FERS coverage, thereby triggering makeup contributions and lost earnings procedures.

To implement this choice, S. 1710 adopts the well-understood makeup processes now used when TSP contributions are missed, either as a result of employing agency error or hiatus from civilian employment to perform military service. In contrast, H.R. 3249 would create special, new error correction procedures requiring complex new Board regulations and provisions to implement.

In permitting employees misclassified as CSRS to select FERS coverage and to make up missed contributions, S. 1710 retains the same lost earnings calculations currently embedded in TSP mainframe computer programs, thus error correction under S. 1710 could be accomplished immediately.

S. 1710 does authorize agency-paid lost earnings on makeup employee contributions, a benefit not in current law. However, lost earnings on employee contributions are now paid by agencies if, having withheld these contributions, they failed to forward them timely for investment. The computer programs that calculate such lost earnings can easily be applied to makeup contributions by misclassified employees who select FERS coverage.

[1] The prepared statement of Mr. Mehle appears in the Appendix on page 84.

In contrast, H.R. 3249 would mandate an option radically different from existing law. Most notably, misclassified employees would no longer make up their own missed contributions. Instead, agencies would be required to pay an amount equal to a kind of "proxy" for missed employee contributions, as well as missed agency contributions, together with much differently-calculated lost earnings on the whole.

There are practical limitations on the Board's ability to implement the error correction procedures of H.R. 3249, both in the manner and within the time it contemplates.

First, the Board is currently halfway through a complete redesign of its entire computer software system. The existing system is to be replaced by a state-of-the-art design to permit daily valuation of participant accounts, investment in two additional funds, and greatly improved service to participants. The resources of the Board and its recordkeeper, the National Finance Center of the Department of Agriculture, not devoted to new system design and current system maintenance are committed to the exigency of making the current system Year 2000 compliant.

The Board, therefore, would not be able to program or run the calculation of lost earnings called for by the House proposal which, as I said, is completely different from the calculations that would be used under S. 1710 or current law, on the mainframe computers at the National Finance Center. To do so would jeopardize both our current system integrity and our timetable for Year 2000 compliance and new system implementation.

The Board, moreover, is not in a position, as contemplated by the House bill, to perform the new lost earnings calculations in some other way, nor is its recordkeeper. The potentially thousands of payroll and personnel records needed to do so, to say nothing of the myriad individual circumstances of misclassified employees, dictate that the calculations of H.R. 3249 be accomplished by employing agencies with personal computer software and guidance furnished by the Board. This accords with current agency statutory responsibility for the calculation and correctness of TSP contributions submitted by the agencies for their employees.

Finally, one full year would be required to develop the new approach contemplated in the House bill, rather than the 6 months that it would allow.

Chairman Mica of the House Civil Service Subcommittee invited the Board to submit legislative language that would resolve these concerns. We did so, but unfortunately the changes were not incorporated into H.R. 3249, and thus the Board continues strongly to oppose the House bill.

The legislation considered by this Subcommittee creates no administrative problems for the Board nor, for that matter, should it do so for agencies as they correct retirement misclassification errors under it. Thus we would be able to implement the TSP provisions of S. 1710 soon after its enactment.

We have appreciated the opportunity to work with your staff on this legislation, and we look forward to working with the staff and Members of the Subcommittee in the future.

Thank you, Mr. Chairman.

Senator COCHRAN. Thank you very much, Mr. Mehle.

Let me ask Mr. Flynn some questions.

One, for background, how have you gone about identifying erroneously-placed Federal workers in these programs, and how will you identify them in the future?

Mr. FLYNN. Mr. Chairman, as you pointed out in your opening statement, the problem of misclassification actually began in the transition to the Federal Employees Retirement System in the late 1980's. We believe, quite honestly, that virtually all of the misclassification problems that occurred, occurred during that time period. Virtually all new Federal employees hired today are automatically placed in the Federal Employees Retirement System.

So you have two groups of people, the majority of whom were misclassified during this transition period. We believe that about half of them have been identified and have had, under current law, their situations corrected. We believe that there is another group, about half again, who have not yet been discovered who will need to be identified. But the provisions of this legislation would enable relief to be given to an individual at the point in time that an error is discovered, even if it is yet, prospectively, 5, 10, or 15 years from now. We hope that would not occur.

Nonetheless, when these errors first began to be identified in the late 1980's and early 1990's, we worked very hard with departments and agencies across government, providing them guidance and information so as to work through their employment rolls to identify people who were in the wrong retirement system and effect these corrections. Many of the people who have not yet been discovered have been missed in that process. Some people have separated from Federal service, and so their records aren't currently subject to review, but they might come back to Federal service. Some people, quite honestly, have retired, and that error hasn't been discovered and I suspect it probably never will at this point.

But what this legislation would allow is for those residual problems that are yet to be discovered to be corrected as they are found, although I do think, in terms of an ongoing basis as new appointments are made today, very, very few errors, if any, are occurring today.

Senator COCHRAN. I know that everybody would like to be able to figure out a way to make up for any losses that anybody incurred so that no one would have been harmed by being misclassified. Is that possible? And if that is not possible, why not?

Mr. FLYNN. Mr. Chairman, we believe that in crafting the administration's proposal and in the elements of S. 1710 there is a make-whole provision, and that make-whole provision consists of two components: one, a component which provides any affected employee, whether they were corrected in the past or whether they are yet to be discovered and offered this opportunity, a choice. And the choice is between a retirement system that, up to that point, they thought they were in, and they've been doing their career planning, their life planning, their savings for retirement and things like that, on the basis of that understanding. So one aspect of the choice is to enable that individual to stay with that retirement system with a known, defined benefit that they have used as a basis for their planning up to that point.

On the other hand, the second component of the choice involves understanding, particularly for people whose error has been discovered in the past and who have now been in the Federal Employees Retirement System—perhaps unwillingly at first, but employees pretty much figured that was the situation that they had to deal with—may have aggressively done makeup contributions, may have aggressively invested prospectively, so as to make for themselves the best of what started out as a bad situation, but which may now, after 5, 6 or 7 years, be preferable.

But in providing that choice, to enable the choice to be made under existing provisions of law—not disturbing Social Security coverage, not disturbing the tax code, and things of that nature—so that employees could see clearly how they could make themselves whole, one, by providing a known, defined benefit that was what they thought they had; two, if they believe it preferable, to remain where they are and continue to invest toward their retirement that way.

We think that's an appropriate way to move forward.

Senator COCHRAN. You described in your statement how the 1990 FERS Technical Correction Act and the Thrift Board rules provide for limited lost earnings protection to misclassified employees. Why does the government require employees to make up their contributions to trigger these provisions?

Mr. FLYNN. That particular provision of the 1990 law was given careful consideration by both the Congress and the administration as it was approved. The fundamental rationale behind that was that this represented, for all practical purposes, money that individuals had already earned, and in order for an individual to receive the benefit of a matching contribution and lost earnings on that matching contribution by the government, it was appropriate for the individual employee, from their own resources, to make up what they otherwise would have contributed during the period of time that the erroneous coverage was there.

To do otherwise, Mr. Chairman, would essentially provide dual compensation to the individuals because they have already had use of that money during the period, and any other way would not really recognize that.

Senator COCHRAN. Can you explain how and why erroneous misclassifications affect those who have been misclassified for long periods of time and are nearing retirement?

Mr. FLYNN. We'll try to do that very simply. I was thinking the other day—I heard someone say that someone had asked Albert Einstein what was the greatest invention of mankind, and he said, "Compound interest." And I think that goes to the heart of answering your question.

In order for savings to accumulate in ways over a lifetime that provide—or provide a portion of—one's retirement income security in their nonworking years, contributions have to be made regularly over a long period of time. Earnings on those contributions have to be given time to accumulate and to compound. And over time, the magic of compound interest produces a substantial benefit.

If one is nearing retirement or separates from the service, or has a very long period during which an individual, through no fault of their own, didn't believe they needed to make those contributions

or were prevented from making those contributions, then the ability of that investment to grow in size and value is essentially truncated. Makeup contributions can only be made prospectively, and if you only have 6 months to go until you retire, or you are caught in a situation where you don't have a government job, you essentially have no opportunity over a long period of time to get yourself back to where you otherwise should have been.

Senator COCHRAN. Does OPM believe that there is any justification for the government to help employees make up their own missed contributions? One argument, for example, is that although an employee received compensation that was not deferred, they may have spent it under the false assumption that their pension benefit alone would be sufficient to assure an adequate retirement. Do you agree with that?

Mr. FLYNN. Well, I think there is no question but that through an inadvertent error on the part of government, as employer, employees' expectations about their need to save for their retirement weren't what they should have been.

By the same token, by providing an opportunity for an individual to choose to be in the retirement system that he or she thought up to that point they were in, you preclude the requirement of making a compensatory payment to the individual because you are able to guarantee them a benefit that they reasonably expected.

Senator COCHRAN. The FERS Act gave all CSRS and CSRS-Offset employees an opportunity to transfer to FERS during an open season between July 1 through December 31, 1987. To what extent does the government have an obligation to provide a FERS option to those employees who had an opportunity to transfer and chose not to do so?

Mr. FLYNN. Well, I think one could argue, Mr. Chairman, that there is not an obligation per se, but I would mention two points in response to that question.

First, as we know, when the Federal Employees Retirement System was introduced, we can look back in hindsight and see that actually very few employees chose it, when in fact rational economic financial analysis would suggest that a larger number of people should have chosen it than did.

I think the reason many people did not at the time was because there was great uncertainty about the program. It was new. There was a great deal of certainty about the old program, and it was well known.

Second, because the government has erred here, it seems that in the process of constructing a make-whole remedy, providing people with a choice—again, that gives them the benefit they thought they were going to have, but also particularly for people whose error has been corrected and where they've got some investment experience, where they may feel it preferable to stay in FERS—it just seems that in recognition of an error committed by the government, it seems appropriate to give people a second choice this time around as we move forward in correcting this issue.

Senator COCHRAN. One approach to the erroneous enrollment problem, it has been suggested, may be to simply allow the misclassified employees to remain in CSRS and amend the Social Security laws as necessary to accomplish this. Why was this ap-

proach not taken? And do you think it would be a better solution than either of the alternatives currently being considered?

Mr. FLYNN. Well, Mr. Chairman, during the period of time when the Federal Employees Retirement System was created, one very important part of that debate was the application of universal Social Security coverage to Federal employees. Even though the numbers here are small in proportion to the total number of people involved, I don't believe that creating a little carve-out to Social Security coverage would be appropriate, particularly given the fact that we have this hybrid system, this CSRS-Offset system, that replicates the benefits of the Civil Service Retirement System without requiring an amendment to Social Security coverage law.

Senator COCHRAN. Now, do you think, given the fact that there are less than 20,000 individuals involved, this would affect the principle of universal coverage under Social Security?

Mr. FLYNN. Well, I think it does affect the principle. As I said, it's not a large number of people, but I also believe it would create a situation where unknown situations that might occur in the future with other groups of employees—perhaps not even public employees—would look to this as a precedent and would look to, perhaps, find a way to skirt around or come out from under coverage of Social Security law. Even though the numbers are small, I think the policy issue is a large one, Mr. Chairman.

Senator COCHRAN. The bill that we've introduced at the administration's request suggests the requirement that an error must have existed for at least 3 years at any time after January 1, 1987.

Why did OPM recommend that? And what might be the effect of lowering the length of time from 3 years to 1 year?

Mr. FLYNN. We chose the 3 years as of 1987 for two primary reasons, Mr. Chairman. First, you had to pick some point in time. Errors that last for a very brief period of time, generally speaking in the context of a long career, are not going to be very consequential. So in choosing a point, we chose the 3-year point because that's the point at which the Thrift Savings Program's vesting provisions go into effect, and it seemed appropriate to parallel that.

We chose 1987 because that was the start date for the beginning of the Thrift Savings Program.

Senator COCHRAN. I have some other questions, but I am prepared to yield to my friend whenever he would like to ask some questions. We have been joined by the distinguished Senator from Michigan, as you can see; Senator Levin is the Ranking Minority Member of this Subcommittee.

Are you prepared to ask some questions now? I'd be glad to yield to you.

Senator LEVIN. I only have a few questions, but I'm happy to listen to yours. You're asking the right questions, as always. [Laughter.]

So let me follow your line of questions.

Senator COCHRAN. Okay. Well, let me ask one or two more, then.

Some experts say that the Thrift Savings Plan, TSP, could account for as much as 50 percent of the retirement benefits for FERS employees. Do you agree with this? And how does this share of FERS retirees' total retirement benefits—how is this accounted

for, or compared to the share expected at the time of FERS enactment?

Mr. FLYNN. I will try to do that in a couple of ways, Mr. Chairman.

First, I think it is important to sort of point out at the outset that the Federal Employees Retirement System does consist of three primary components. It has a Social Security base; it has a FERS defined benefit component that sits on top of that; and then the Thrift Savings Program, which is a defined contribution savings vehicle, sits on top of that.

The three together, at the point in time that the system was enacted in 1987, were in fact designed to more or less approximate the benefit that the older Civil Service Retirement System—a single, defined-benefit program—provided. And the TSP component, if I have it correctly, was considered, given rates at which employees save and rates of return of the fund, to account for approximately 20 percent of that replacement benefit.

Now, if you look at the record of the Thrift Savings Program over the past 10 or 11 years, particularly the record of the Stock Fund, clearly the rate of return is beyond those predictions at that point. And so the benefit that might be payable out of the TSP in retirement could be larger, could be potentially as large as some commentators have suggested, but I want to emphasize that it is additive to the Social Security benefit and the FERS basic benefit that are the first two components of the system.

So in effect, it is gravy on top more than it is a replacement for the first two components of that FERS benefit.

Senator COCHRAN. Given the fact that that is a large difference, is it fair to employees without contribution histories to use G Fund rates of return in calculating agency contributions for lost earnings, as would be done under S. 1710 and is now done under current law?

Mr. FLYNN. Well, I would make one comment, and then perhaps defer to Mr. Mehle also on that one.

I think the thing that I would say there, Mr. Chairman, is that the G Fund, which of course is invested in Treasury securities, will always have a positive rate of return. That's not guaranteed with either the C Fund, which is the stock index fund, or the F Fund, which is the bond fund. And while we have seen reasonably good rates of return over the past 11 years on average, there have been some years in the Stock Fund, for example, where there has been at least a negative return, and then at least 1 or 2 years of relatively poor returns vis-a-vis the rest. So there is risk.

And just as we can look back on 10 years and see good performance, one could also look back, perhaps in another 10 years, and see poor performance. And so because of the risk associated with that, using the G Fund, which always guarantees a positive rate of return, seems appropriate.

Senator COCHRAN. Mr. Mehle, what is your reaction to that question?

Mr. MEHLE. I couldn't have said it better. [Laughter.]

Senator COCHRAN. Okay. We hadn't forgotten you; we know you're there, and I've got some questions specifically for you, as a matter of fact.

Mr. MEHLE. I'm ready.

Senator COCHRAN. Let me ask you this. There is a House bill, and you referred to it, Mr. Flynn—or Mr. Mehle did—would it be more advantageous to the misclassified employees to use the aggregate investment experience of FERS participants as contemplated in the House bill? Have any cost estimates been prepared on that bill, to your knowledge?

Mr. FLYNN. Looking at H.R. 3249, clearly, if one is using as a basis of comparison the G Fund rate of return versus the composite rate of return, it is more advantageous to look at the composite rate of return. However, that's true in the aggregate. For some employees, perhaps, who have invested aggressively, even the composite rate of return is a smaller return than their actual rate of return. By the same token, you could have some employees who have invested very conservatively for whom the composite rate of return would be advantageous. That's one of the difficulties of trying to figure out averages and then apply them to everyone. It clearly creates winners and losers, and that's one of the difficulties, I think, with that particular bill.

Senator COCHRAN. It has been suggested that litigation be used in determining a proper remedy for employees who have been misclassified. Is that justified in the legislative history, to your knowledge? What's been the experience of the litigation avenue?

Mr. FLYNN. First of all, Mr. Chairman, there is no central repository of information on litigation. I do think, though, from what we have seen anecdotally in our discussions with agencies, the occasions of litigation are really quite minimal.

I guess the point that I would like to make, and perhaps emphasize, is that we are here representing government as employer. I think the last thing that we want government employees and government retirees to do is to come in, sue their employer for an error that their employer inadvertently made; or, if that is to be the case, that we minimize as much as we possibly can through responsible, caring actions on our part, the grounds for future litigation.

I think that the 1990 amendments were a positive step in the right direction. I think we have seen that while we have covered a lot of cases, there are some particularly sympathetic cases that still need to be dealt with, and it just strikes me that asking employees to sue their employer to get something that they really are entitled to is something that we ought to avoid as much as possible.

Senator COCHRAN. Senator Levin.

Senator LEVIN. Thank you, Mr. Chairman.

This is kind of a complicated issue and I'm trying to get my arms around it as best I can without squeezing it to death. [Laughter.]

The estimate is that about 20,000 people, as I understand it, were by mistake put into—new employees, is that correct, almost exclusively new employees?

Mr. FLYNN. Well, these, Senator Levin, were primarily employees who had prior Federal service. Most new employees hired since 1984 are automatically covered under the Federal Employees Retirement System.

Senator LEVIN. Weren't the 20,000 people put into CSRS by mistake?

Mr. FLYNN. By mistake, that's correct, sir.

Senator LEVIN. New employees?

Mr. FLYNN. Usually upon reappointment, as opposed to being a new employee.

Senator LEVIN. All right. Well, I wasn't using the word technically. They were newly hired?

Mr. FLYNN. That's correct.

Senator LEVIN. Now, after they were newly hired and put in CSRS by mistake, at some point—1 year or 2 or 3 years afterward—all CSRS people were given an opportunity, were they not, to switch to FERS?

Mr. FLYNN. That's correct, the original Federal Employees Retirement System open season in 1987.

Senator LEVIN. How many of these 20,000 people would have been given that opportunity?

Mr. FLYNN. The easiest way to say this is that all employees who are currently in CSRS or CSRS-Offset have been given the opportunity at least once to switch, some during the open enrollment period that occurred in 1987, others upon reappointment because they have that election opportunity at any point if they meet certain conditions. But most of them are 1987——

Senator LEVIN. Let's assume there are 20,000 people out there who were put into a category by mistake. How many of them would have been given an opportunity at least some point after that mistake was made of putting them in the wrong category, would have been notified that they were in CSRS and they could switch to FERS?

Mr. FLYNN. All of them have had that opportunity at least once.

Senator LEVIN. They weren't told that they were put in CSRS by mistake, they said, "You are in CSRS"——

Mr. FLYNN. That's correct.

Senator LEVIN [continuing]. "You can switch to FERS should you choose to do so"?

Mr. FLYNN. That is correct.

Senator LEVIN. And the people we're talking about are exclusively those who did not use that opportunity, is that correct? Or would this legislation also in some way make up some funds or benefits to people who did use that opportunity and switch to FERS?

Mr. FLYNN. You are correct, Senator Levin, in that all of these people believed they were in CSRS or Offset, and had the opportunity to switch to FERS with full knowledge of the provisions of that system.

Senator LEVIN. But that's not quite my question.

Mr. FLYNN. Sorry.

Senator LEVIN. My question is, does this bill provide a correction only for people who did not switch from CSRS to FERS when they had that opportunity?

Mr. FLYNN. Only those who did not switch? Yes. Anybody who switched to FERS is now in FERS, and so would not be benefitted by this.

Senator LEVIN. Even though they may have switched a number of years after they came in?

Mr. FLYNN. That's correct.

Senator LEVIN. And even though the mistake would have perhaps cost them for that period of time that they were erroneously in the CSRS system?

Mr. FLYNN. With the exception, Senator Levin, of anybody who, for whatever reason, was in the wrong system erroneously for a period of 3 or more years after January 1, 1987. So it is conceivable that you could have employees who were in the wrong system for 3 years who at some point later were given the opportunity to voluntarily switch to FERS—in other words, they didn't know there was an error—who did, and who are now there of their own volition. If that prior error is discovered and it meets those two conditions, then they would also have an opportunity to make an election under this proposal, that's right.

Senator LEVIN. And about how many of the 20,000 would fall into that category? Could it be as much as 10 or 20 percent of the 20,000?

Mr. FLYNN. Well, let me try to comment on the 20,000 just for a second. The numbers have grown over the course of the past year from an estimate that I provided to the Civil Service Subcommittee a year or so ago, of about 10,000, to about 20,000 now.

I think the important point to make here is that no one really knows how many people have had themselves placed in the wrong retirement system.

Senator LEVIN. Have had themselves placed in it? Were placed in it.

Mr. FLYNN. Well, were placed in the wrong system, you are correct.

We know that based on the activities that agencies have engaged in to identify those that they could identify, that several thousand people have been identified and corrected. In order to provide some rough order of magnitude, we figured there might be as many as twice that number who were put in the wrong system, because there are obviously, then, some people that you don't know about, plus we have individuals who have come into government service and who have since separated. So that will affect the number, and that got us to about 10,000.

Then, because the House bill has differing standards for eligibility for its provisions, the number—for example, the period of error in the House bill is 1 year, and in this bill it is 3 years. If it is 1 year, you have a larger number of people who might be affected by the bill's provisions, and so the number grew from there.

But whether it's 20,000 or 10,000, the provisions of the bill would apply if anybody was ever erroneously covered during the period of time defined by the bill.

Senator LEVIN. My question, though, is whether you can give us an estimate of the percentage, roughly, of people who switched from CSRS to FERS on their own?

Mr. FLYNN. There is no way that I would know an internal number to that, Senator Levin. But I will say that this bill will cover them if they have the error——

Senator LEVIN. I understand that. You don't know whether it's a small minority or a majority or what?

Mr. FLYNN. Off the top of my head, I would suspect that that's a relatively small number. The reason for that is because as we have seen, most people—except those who have aggressively invested in the Thrift Savings Program—are going to believe that the Civil Service Retirement System, or its hybrid, the Offset, is going to provide them with a well-known, defined, reasonable benefit. So I would suspect that very few people would have switched to FERS because of that.

Senator LEVIN. The next question is this. What percentage of Federal employees who were given the option to switch from CSRS to FERS exercised that option?

Mr. FLYNN. I believe the correct number in 1987 is about 4 percent during that open enrollment period.

Senator LEVIN. That was in 1987?

Mr. FLYNN. That was in 1987, yes.

Senator LEVIN. And then, say, in the next 5 years, how many would have switched?

Mr. FLYNN. I really can't answer that. We may be able to get at that by looking at some Central Personnel Data File numbers, and I will try and go back and see if we can get to that.

INFORMATION FOR THE RECORD

Workforce Information has advised us that there were 12,208 individuals employed during the 5-year period following the 1987 FERS Open Season who would have had an opportunity to elect to switch to FERS. Of these 12,208 total employees, 893 (or 7.3 percent) actually did switch to FERS. (Source: Central Personnel Data File.)

Senator LEVIN. Would it be a majority?

Someone is shaking their head "no" behind you, I want you to know—I think she's shaking her head "no," or maybe it's that she doesn't know. I'm not sure.

No way of knowing? All right. Anyway, she's shaking her head; I want to put you on judicial notice here that somebody is shaking their head behind you. [Laughter.]

Mr. FLYNN. The only thing that I would say is that if someone had gained title, if you will, to a Civil Service Retirement System benefit, they would have to be looking at a pretty substantial career ahead of them under FERS in order for them to select FERS and to have that selection be advantageous to them.

Senator LEVIN. Okay, if you could get us a figure for how many made the original switch and how many, say, 5 years after, made that switch, that might be helpful to us, too.

Finally, could you give us a couple examples of what the difference in benefit this bill would make to an average employee? How much of a benefit would they get without this change? Or if it were not made retroactively, how much they would get if they were placed in FERS retroactively now? Could you somehow or other give us a feel? The CBO estimate apparently is that this bill will cost—the House bill, excuse me—would cost around $240 million. We don't know what the cost of the Senate bill, if any, would be; apparently we are still waiting for the CBO estimate. Is that correct?

Mr. FLYNN. I have not seen a CBO estimate. I know that our own internal estimates would be that both this bill and the administration's bill, for all practical purposes, are essentially budget-neutral, particularly in comparison to the $200-million-some.

Senator LEVIN. This bill and the administration's bill? What bill? The bill that we're having the hearing on?

Mr. FLYNN. There's a very slight difference between——

Senator LEVIN. I thought this was the administration's bill, the one that we're having the hearing on.

Mr. FLYNN. This has a provision for payment of lost earnings on employee contributions that was not part of the administration's original bill. But other than that, that's the only difference.

Senator LEVIN. All right. In any event, could you put this in kind of "layman's terms" for me? What would a typical Federal employee—under the House bill, what difference would it make? Under the Senate bill, what would that benefit be? Could you give us an estimate?

Mr. FLYNN. I will try to do this as quickly as I can.

Senator LEVIN. Just dollar figures, that's all I want. [Laughter.]

Take all the time you want, but at the end of it, it will be $300 a month this way, and $250 this way.

Mr. FLYNN. Okay.

Senator LEVIN. So we'll wait until you get to that, if you get to that.

Mr. FLYNN. Okay. Well, I'll do the best I can.

Senator LEVIN. Well, you may not be able to do it. You can do it for the record.

Mr. FLYNN. I am going to try and give a sense of this, and then maybe I'll want to amplify it for the record.

Both bills offer employees choices——

Senator LEVIN. Both bills?

Mr. FLYNN. Both the House bill and S. 1710 offer employees choices. If the employees choose to remain in Civil Service Retirement System-Offset and get the benefit they always expected to receive, there are no differences between the two bills in that regard.

Where the difference comes in is if an employee under S. 1710 chooses to be in FERS, the Federal Employees Retirement System, and makes that same choice under the House bill.

Under S. 1710, the individual employee would then be placed in the Federal Employees Retirement System, would be given an opportunity to do makeup contributions on the basis of current law, and on the basis of their choice for makeup contributions under S. 1710, would have deposited to their account the 1 percent automatic agency contribution, any matching contributions authorized given the employee's makeup contribution, lost earnings on the government contribution, and lost earnings on the employee's contribution.

Under the House bill, in lieu of that, a payment would be made to the individual's Thrift Savings Program that attempts to replicate, in a composite way, what the employee would have contributed had he or she been in the FERS all along; the lost earnings on those contributions; all of the government matching contributions; and the lost earnings on that. So over time, the benefits produced by either of those choices would more or less approximate

one another, although it is also true that depending upon the investment performance, the net retirement result could be higher in the long run.[1]

That's the best I can do right now. I don't know that I can say that it works out to $200 per month per individual because so much of that is a function of what is deposited on the individual's behalf for retroactive contributions, and the choice that an individual makes then in terms of prospective contributions to the Thrift Savings Program—which, I might add, probably need to be somewhere in the 5 to 10 percent range going forward, and if they're not doing that now, that could be a difficult issue for them.

Senator LEVIN. Well, I won't ask you about a prediction of the future. It is difficult enough to figure out, looking backward, what difference this would make.

So for the record, if you would, tell me this. A person who is retiring tomorrow, if this bill passed—retiring tomorrow, was rehired in 1987 or 1983 or whatever that year was, if that person stayed in the CSRS, give me a typical person—take an average length of time that they previously were on the payroll, however you want to do it in a way that you think is fairly illustrative. How much would that person get if they stayed in the CSRS system, how much would they get under the Senate bill, how much would they get under the House bill? Just that one person.

And then one other thing I would like you to tell me for the record is this. The Senate bill uses the G Fund, is that correct? It assumes that the person who is going back into FERS was a G Fund person, 100 percent?

Mr. FLYNN. Unless that person has a contribution history, in which case the contribution history of that person would be used. The G Fund is the default——

Senator LEVIN. Excuse me. How long does the contribution history have to be?

Mr. FLYNN. I'd defer to Mr. Mehle on that. I think it's any contribution.

Mr. MEHLE. Any history.

Mr. FLYNN. Right.

Senator LEVIN. Well, so if somebody has a contribution history of 1 month, they were smart enough to go into the Stock Fund—or presient enough, whatever that word is, to go into the Stock Fund—and it had a 25 percent annual jump during that month or whatever it is, that's a contribution history, and then that would mean they would be in the Stock Fund all the way back to 1983 or 1987?

Mr. FLYNN. No. It's the actual history. In other words, if an employee who was CSRS—mistakenly, CSRS—nevertheless chose to contribute to the Thrift Savings Plan, as CSRS employees can do——

Senator LEVIN. I see. But for how long would that history be, then?

Mr. FLYNN. His employment period.

Senator LEVIN. Okay. Well, I may be a little bit confused——

[1] The charts containing examples 1 to 4 appear in the Appendix on pages 55–58.

Mr. FLYNN. I might be able to shed some light on that. There are actually two issues. One is the allocation itself; the other is the investment performance.

Senator LEVIN. Okay. Well, I think I probably missed something here in terms of my understanding, but let me not take up the Subcommittee's time with that.

We are using a G Fund unless there's a different history——

Mr. FLYNN. Right.

Senator LEVIN [continuing]. And then we're assuming that if there is no such history, that that is what the typical person would have used? Why G Fund?

Mr. FLYNN. The G Fund default is a provision of current law, and it is there because it is the only fund that guarantees a positive rate of return. The Bond Fund and the Stock Fund don't provide such guarantees, and it is at least arguably just as likely that there could be a negative rate of return.

So use of the G Fund as a default was guaranteed always to provide a positive rate of return.

Senator LEVIN. So that's not a new provision of this bill, that we use the G Fund?

Mr. FLYNN. No. That's correct.

Senator LEVIN. This bill doesn't make that choice? It builds on existing law?

Mr. FLYNN. It builds on existing law, that's correct, Senator.

Senator LEVIN. Okay. Thanks so much.

Senator COCHRAN. Let me ask you to assume that Congress surprises everybody and passes this bill. What difficulties, if any, do you foresee in implementing it?

Mr. FLYNN. If this bill were to be implemented, clearly, we would have some work ahead of us in terms of correcting and giving election opportunities to people who have already been corrected, and then in terms of those that are discovered prospectively.

I do think, however, that this bill meets those objectives that I talked about earlier in terms of simplicity of understanding and simplicity of administration. So I would not foresee any problem in terms of moving forward, providing people with the information they need to make an informed election, processing those elections, and then letting those individuals sort of get on with their lives and their retirement planning on the basis of knowns rather than unknowns.

Senator COCHRAN. Mr. Mehle, what is the logic for and the evolution, if you can tell us, of the Thrift Board's rules to provide for correction of misclassification errors by agencies?

Mr. MEHLE. Well, Senator, when the Thrift Savings Plan was created, effectively in 1987, we recognized that there were going to be mistakes made as to employees' contributions by their employing agencies, and these mistakes would be discovered subsequently, and there had to be some mechanism whereby the missed contributions that the employee did not get to make would be made up.

So we adopted a regulation in 1987 that called for employing agencies to give their employees an opportunity to make up their missed contributions; and, in connection with the employees making up their missed contributions, for the agencies to contribute the appropriate matching contributions that would have gone with

those if the employee had been able to make them; as well as, in the instances that the employee was not even recognized as being a FERS participant, the 1 percent automatic contribution that every FERS employee is entitled to receive, regardless of whether he or she contributes any money voluntarily.

At that time, we also recognized that there was the issue of earnings on those contributions that had been foregone. Because the monies had not been put on account when they should have been, they did not earn anything. So at the time the error was to be corrected, there should be also a payment made by the agency, equitably, to make up for the lost earnings on the contributions.

However, the General Accounting Office in 1989 issued an opinion of the Comptroller General that there was no authority in existing law for Federal agencies to make up earnings on missed contributions, whether they be earnings on the 1 percent automatic amount, whether they be earnings on the matching contributions that were not made, or indeed—but it's sort of a different fundamental proposition—on the employee amounts.

We noted that problem, and we at the Thrift Investment Board forwarded draft legislation to Congress, asking Congress to pass a law that would permit agencies to make up the lost earnings on the 1 percent amount and on the matching contributions. Congress passed this law, and agencies thereby were permitted at the time that they make up the matching contributions and the 1 percent contributions, to make up the earnings attributable to those amounts.

The law that was passed by Congress, however, did not call for agencies to make payments in respect of earnings on foregone or missed employee contributions. The rationale for that was that the employee, however unfortunately not having had the contributions taken from his paycheck and deposited into the Thrift Savings Plan, nevertheless got the money; it was in his or her paycheck, and the employee did something with it, spent it or saved it. Therefore it was thought that equitably it would not be appropriate for the government to pay any lost opportunity costs on these monies as it would be, conversely, on the 1 percent and on the matching contributions, because the employee actually had the money to spend or to save, as the case may be.

That rationale is invested, imbedded, in our current regulations, which reflect that Congressional decision in 1990 when the legislation was passed, authorizing agencies to make up lost earnings.

Senator COCHRAN. You mentioned in your statement the different approaches in these bills, S. 1710 as compared with the House bill. Would you say that the largest difference or the most significant difference between the two bills is found in the triggers for makeup contributions and lost earning procedures? And if that's right, does the Thrift Board have a preference for either approach?

Mr. MEHLE. Clearly the most significant difference between the House bill and S. 1710 is the requirement under the House bill that the agencies—the Federal Government itself—make a payment that is a kind of a proxy for the contributions that the employee himself would have made, but did not. That is, I think, the heart of the difference between the two bills. In the one case, S. 1710 calls for employees to choose—if they like, CSRS, which is

what they thought they had and which, as I noted in my prepared testimony, seems like perfect equity, certainly for those whose errors have not yet been discovered, but they do have a choice. They are given the choice to take CSRS or to stay with—or to go with—FERS.

If they go with FERS, rather than going with CSRS—the system you would intuitively think they would go with because that's the one they thought they had, and that's the one that denial of membership in is promoting all of the hardship for—you would think that unless they were biased some way, induced in some way, perhaps financially, to go into FERS, they wouldn't. But if you look at S. 1710, you can see that, with the single exception of the notion of the agency paying lost earnings on employee contributions—lost earnings, not the contributions themselves, but earnings on the contributions—it is neutral. S. 1710 is neutral. It won't bias an employee to game between two retirement systems by saying, "Maybe there's something that I can exploit in making my choice." If one chooses to be in FERS, under H.R. 3249, as I have observed in my testimony in the House and a bit here, there is an enormous amount of money potentially that the employee may get in making that choice. It is the debated double payment that we're talking about.

I do have some examples of that. We have furnished these examples in the past, as requested, and I can give you some figures that would indicate why an employee might be biased, if you like. But I think at the heart of the two is the notion that under H.R. 3249, payments will be made by the agency that otherwise, under current law and S. 1710, are called for to be made by the employee. And then, of course, there are the very significant administrative provisions with which we are quite vitally concerned that I outlined in my prepared remarks.

Senator COCHRAN. There's one aspect of the House bill that is unclear to me. It involves the situation of the misplaced employee who elects the FERS option and has a history of participating in TSP, the Thrift Savings Plan. As we understand the proposal, in the case that the employee has an investment history, that history is to be used in determining the rate of return or makeup contribution. If there is no participation history, a proxy is to be used that reflects the aggregate investment history of all participants. Is that correct?

Mr. MEHLE. Yes.

Senator COCHRAN. What happens to an employee, then, who has made poor investment decisions resulting in a lower rate of return than an average investor? Will any difference be made up? And if so, by whom?

Mr. MEHLE. This may be reaching the question that Senator Levin asked. If an employee who thought he was in CSRS ignored the Thrift Savings Plan, even though he has an opportunity to invest in it up to 5 percent—if he ignored it because he was comfortable with the prospect of the ample defined benefit, he would have no investment history in the Thrift Savings Plan. H.R. 3249 gives to such an individual an amount of money that is calculated upon the investment behavior—that is to say, the deferral rate, the amount of savings from one's paycheck—that the broad FERS and

CSRS Federal employee group historically had, together with the historic rates of return associated with that investment history of all CSRS and FERS employees.

As to the individual himself, I can't perceive any relationship between the amount of money he will get and any judgment that the individual had that influenced him not to contribute to the Thrift Savings Plan. It's a great windfall, in a sense. He made no investments in the Thrift Savings Plan, so he has no history in it. Consequently, the history of all will be used, and the investment results associated with the history of all.

If, however, the employee, despite the generosity or the adequacy of the defined benefit due him under CSRS, decided that he would save even a little bit in the Thrift Savings Plan—let's say, in the G Fund—and he put away 1 percent of his paycheck into the G Fund every payday, as he certainly could do, that is his investment history. And in that case, that employee, who wanted to go into FERS under H.R. 3249, would have the rate of the G Fund used with the deferral rates of the average employee experience. It's a lower rate.

So the differences between the two are quite arbitrary, depending on the individual employee's behavior, and certainly his behavior foresaw absolutely none of this. Our view is that this works some very arbitrary results. I thought that they were unintentional when I testified in the House, and I raised them as apparent unintentional consequences, or unintended consequences. But I think that these consequences are, in fact, expected or intended, or at least they are tolerated under H.R. 3249. So it creates quite a disparity.

Senator COCHRAN. What about the employee who contributed the maximum allowed as a CSRS or CSRS-Offset participant? Would this individual receive the historical average contribution also? And will any difference between this amount and the maximum allowable under the FERS be returned to the individual, along with any earnings?

Mr. MEHLE. No. As I understand H.R. 3249, the individual who contributed 5 percent, which is the maximum amount a FERS employee may contribute, will receive this payment that I outlined based on his investment history, but limited by 10 percent per annum, because that's the FERS limitation. So that person will not get the same amount of money from his agency that a person who had not contributed 5 percent would get from his agency.

Senator COCHRAN. What would the tax treatment of such a distribution be?

Mr. MEHLE. Well, in that case there would not be any distribution. It would simply be that the amount of payment made to him by his agency under H.R. 3249 would be reduced relative to the amount the agency would pay to a person who had not contributed 5 percent. Therefore there would be no necessity for any distribution to that person. In short, there would not be an overpayment made to him. The agency payment would be adjusted, so that together with his payment it would not exceed 10 percent.

Senator COCHRAN. An employee who participated while in FERS might make different investment decisions than he or she would have made if they had been a CSRS participant. The decisions might be more or less conservative.

How can using the investment history for an individual while that individual was a CSRS participant be an accurate reflection of what the individual's FERS participation might have been?

Mr. MEHLE. Well, I honestly don't think it can. I don't think you can turn back the hands of time, put the individual in a position with no ability to predict the future, what the markets would have done. And likewise, you cannot say that that person who was looking to a CSRS defined benefit would or would not have saved the same amount. Presumably, a person who was in FERS—since the message is very strong to such persons that they need to contribute to the Thrift Savings Plan to have adequate retirement benefits or the same kinds of retirement benefits that CSRS participants do—it's very likely that a TSP participant as a FERS employee would have contributed more, maybe contributed in different proportions.

So I don't think you can just flatly say that this is what the individual would have done if he knew he was in FERS to begin with.

Senator COCHRAN. If you assume that the House bill is adopted, do you think that those who made the effort to participate, on average, are going to be worse or better off than those who didn't participate in TSP?

Mr. MEHLE. Well, what I can say is that those who did not participate in the TSP would have a return, as we calculated it, given what we understand H.R. 3249's prescriptions are, of about 9.5 percent over the period of 1987 to 1997. Of course, a person whose error wasn't that long would not necessarily have that rate of return because it's applicable to that period, 1987 to 1997, about 9.5 percent.

By the same token, a person who had contributed, let's say, to the G Fund only—in other words, he had an investment history—would have about 7.5 percent over that same time span.

So the vicissitudes of contributing or not contributing work quirky results under H.R. 3249.

Senator COCHRAN. Senator Levin.

Senator LEVIN. Just a couple more questions.

I'm a little unclear on a very basic point that I probably should know, and that is, putting aside your choice under the Thrift Savings Plan, do you also make a choice which affects your FERS benefit as to whether you go G Fund or C Fund or S Fund or F Fund?

Mr. MEHLE. You may choose among the three funds to make your contribution.

Senator LEVIN. Not just on your thrift savings, but also as it relates to the non-thrift savings part of FERS?

Mr. MEHLE. No.

Senator LEVIN. Am I speaking your language or not?

Mr. MEHLE. I think I know what you are getting at. Whether you are a CSRS-covered employee or a FERS-covered employee, you may participate in the Thrift Savings Plan, and in either case you may make choices among the three funds.

Senator LEVIN. But how does your choice among the three funds for the Thrift Savings Fund affect your FERS benefit?

Mr. MEHLE. It does not. It does not explicitly affect the defined benefit or annuity portion of your FERS benefit.

Senator LEVIN. Then how does the investment history in the Thrift Savings Fund affect your FERS benefit for the purpose of this bill?

Mr. MEHLE. It affects your FERS benefit in a global sense, if you think of your FERS benefit as comprising the basic annuity, the Thrift Savings Plan balance that you have when you leave government, and your Social Security payments. That's the total benefit package that you have as a FERS employee. It affects that benefit because you may well have, based on your investment history, a FERS TSP balance that is lower than it would have been if you knew you were in FERS to begin with and you contributed more to it.

Senator LEVIN. In other words, you might have contributed more to your Thrift Savings Plan had you known——

Mr. MEHLE. Had you known you were in FERS. It is important that you contribute to your Thrift Savings Plan, because the defined benefit portion of the total FERS package is much smaller than that under CSRS.

Senator LEVIN. And if under the bill we give people the option to switch to FERS, what are we assuming their contribution to the Thrift Savings Plan is? Not whether it's bonds or stocks or government securities, but—up to 5 percent, what are we assuming that contribution was for those people?

Mr. MEHLE. Actually, what H.R. 3249 does is invent a contribution.

Senator LEVIN. What percent contribution?

Mr. MEHLE. It is the average history of all Federal employees.

Senator LEVIN. So if that's 2 percent, they assume it's a 2 percent contribution?

Mr. MEHLE. That's right.

Senator LEVIN. And does the House bill assume the return on that?

Mr. MEHLE. It uses the return for the periods—the actual returns for the periods in question.

Senator LEVIN. The average return of the three funds?

Mr. MEHLE. Yes, as reflected by broad Federal employee investment behavior.

Senator LEVIN. The total return of Federal employees on the average contribution.

Mr. MEHLE. Yes. That's H.R. 3249. So it has nothing to do with an employee's own choices or pocketbook decisions that the employee might actually have made if he knew he were in FERS back then.

Under S. 1710, in contrast, when the error is discovered, the employee is given a choice to stay in CSRS or be in FERS. In other words, he was mistakenly in CSRS, the juncture comes, the error is found, he is told "You can be in CSRS, you can stay in it; you thought you were in it, you can stay in it or you can be in FERS." That person then is given the opportunity to make payments, contributions, that he could have made, as the present system calls for it, and get matching contributions that he's entitled otherwise to get, and the 1 percent automatic agency contributions, together with, in the case of the 1 percent and the matching contributions,

earnings as if earned from the date that his contribution would have been made.

The employee chooses to make up to the Thrift Savings Plan as much as 10 percent—that's the limit—of his paycheck in respect of the year in question.

Senator LEVIN. I just have one other question. Can you conceive of somebody who is retiring tomorrow, on whom this mistake was made, who would not be better off under either the House or Senate bill than under—exercising the option to join FERS under either bill, can you imagine anyone who would not exercise some option to get into FERS, who is retiring tomorrow? Could someone be better off under CSRS?

Mr. MEHLE. Absolutely. I would actually expect that it's almost inconceivable—unless you offer them a pot of gold to retire under FERS. He thinks he's in CSRS; he's going to retire tomorrow; he hasn't contributed a nickel to the Thrift Savings Plan. If he is forced into FERS, he has an annuity that's half of the amount, starting tomorrow, that he thought he was going to have.

It's quite plain that such a person, if given the opportunity to be in FERS or CSRS, would say, "Well, I want to be in CSRS. I want the generous annuity. The fact that I don't have a TSP account and I don't have enough time to make it up, if I'm going to retire tomorrow, means I clearly want CSRS."

If on the other hand you say, "Well, we've got a different deal; we're going to give you $1 million if you retire under FERS tomorrow. We're going to give it to you. How about that?" He says, "Well, let me think about it." That's the kind of choice that I think H.R. 3249 is presenting, because the employee does not have to pay any of his own money.

Senator LEVIN. Okay, but I want to assume an employee who can put the money in, make up the money.

Mr. MEHLE. Who can do it?

Senator LEVIN. Who can do it. Would any of those employees be better off staying in CSRS?

Mr. MEHLE. If you retire tomorrow?

Senator LEVIN. I'm talking about just retiring tomorrow.

Mr. MEHLE. If you retire tomorrow, you plainly don't have enough time under S. 1710 or under current law to put in money of your own to earn and to fetch in the match, over the 1 percent. You don't have enough time left.

A person, let's say, who might retire in 10 years, on the other hand, is given the opportunity to choose between CSRS or be in FERS. Looking forward, knowing that there is a difference between the annuities—much heavily weighted toward CSRS—he might say, "Well, I want to be in FERS. The reason I want to be in FERS is that I think the markets are really going to do well. I like the idea of getting the 1 percent contribution. I like the idea of getting the matching contribution, and I like the idea of putting in 10 percent of my own money—not just 5, but 10 percent—and relying on the markets for the next 10 years." So that would not be an irrational choice, to stay in FERS.

One complicates these——

Senator LEVIN. To stay in FERS, you say?

Mr. MEHLE. Yes. I say it would not be irrational for such a person to want to be in FERS for——

Senator LEVIN. You said to go to FERS.

Mr. MEHLE. I'm sorry, to go to FERS, stay in FERS—it's a little difficult to say where the person is. He was mistakenly, by hypothesis, told he was in CSRS.

Senator LEVIN. I understand.

Mr. MEHLE. So the question is, is he staying in FERS or going into FERS, or exactly what.

Senator LEVIN. Thanks a lot.

Senator COCHRAN. Thank you both for being an excellent panel of witnesses for our hearing. We appreciate your being here, Mr. Flynn and Mr. Mehle, and your contributions to our understanding of these issues.

Mr. FLYNN. Thank you, Senator

Mr. MEHLE. Thank you, Senator.

Senator COCHRAN. Our next panel will include Dallas Salisbury, President, Employee Benefit Research Institute, and Daniel F. Geisler, President, American Foreign Service Association.

We welcome you and thank you for your attendance. We have copies of your statements, which we will place in the record. We encourage you to make whatever summary comments as introductory remarks that you would like to make, and then we will have a chance to ask you some questions.

Mr. Salisbury, we will start with you.

STATEMENT OF DALLAS SALISBURY,[1] PRESIDENT, EMPLOYEE BENEFIT RESEARCH INSTITUTE (EBRI)

Mr. SALISBURY. Mr. Chairman, Members of the Subcommittee, it is a pleasure to be here. Since the full statement is being included in the record, I will be even more brief than my summary.

I was asked to deal with the question of private sector practices. One of the primary issues in this legislative issue relates to Social Security, and I would note that in the private sector the Social Security coverage/noncoverage would be a nonissue. It might be in a few State and local situations, but given the inability currently of States to opt out of Social Security, we were unable to find any situations, in looking up research on the States, of a similar situation.

Second were issues related to employee contributions and whether the catch-up contribution issues would normally arise in the private sector. On the one hand, there is nothing in the law that would disallow an employer, as best as we can tell, from making these catch-up contributions and allocations. In fact, we did find, as is documented in my full testimony, provision in revenue procedures that would allow employers to do so. On the other hand we were unable, in going through data bases, to find any situations or evidence where that had in fact been done.

The second set of questions dealt with the issue of Federal employees being given a chance to switch, and whether there would be a private sector counterpart. Again, we were unable to find situations where that type of a situation in the private sector would generally occur. Employers in the private sector frequently find

[1] The prepared statement of Mr. Salisbury appears in the Appendix on page 88.

themselves freezing a given defined benefit plan, and then doing a replacement plan; or totally terminating one defined benefit plan and creating replacement plans, but seldom would they be running simultaneously, the two systems, as is done in the Federal case.

One could also ask questions about the benefit accrual and employee choices. I would prefer, rather than going through all that, to deal with it in the Q&A period. But one can find history, particularly in situations like the Unisys case, on issues of litigation where employers have chosen to essentially make some makeup of investment earnings or contributions where they felt that an action was as a result of their own fiduciary action. But again, the number of cases that we were able to document in the private sector was relatively limited.

Finally, one would ask the question of the most complicated issue being related to the participant's asset allocation. You've had a substantial discussion of that. I will simply note that in the extensive work that we've done, what one finds in most defined contribution plans is a relatively skewed distribution; about 25 percent of participants put all of their money into the equivalent of the G Fund, about 25 percent of participants put all of their money in the equivalent of the Equity Fund, and the vast majority do some mix. So to do it based on averages would not generally represent what public or private employees have done.

The equitable treatment issue that was discussed at some length in terms of what one would do and what a private employer would generally do, is they would generally try to have an approach that treated all employees, should we say, equally, rather than some of the treatments that can arise under these pieces of legislation, where an individual who did choose to save, as was documented in the last panel, could find themselves penalized relative to individuals who had not chosen to save in the Federal Thrift Plan.

Employers in the private sector generally would try very hard to avoid that type of what they would deem to be inequitable treatment.

Finally, I would simply note vis-a-vis the last testimony and the question that Senator Levin was asking, if one takes the revenue-neutral legislation being discussed in the Senate bill, the estimate of roughly $240 million as the revenue cost of the House bill, and the estimate of 20,000 affected parties, it would appear that the average dollar value of the House bill is about $12,000 per participant, if you assume that everybody went over, which is substantially larger than the hypothetical $300 or $400 as the Senator was trying to get at that number. But I believe, as the representative of OPM noted, that's the type of number that they could readily go back and calculate.

Thank you for the opportunity to be here.

Senator COCHRAN. Thank you, Mr. Salisbury, for your statement.

Mr. Geisler.

STATEMENT OF DANIEL F. GEISLER,[1] PRESIDENT, AMERICAN FOREIGN SERVICE ASSOCIATION (AFSA)

Mr. GEISLER. Thank you, Senator.

[1] The prepared statement of Mr. Geisler appears in the Appendix on page 96.

Senator, I am here to speak on behalf of the 23,000 retired and active duty foreign service officers and specialists that we represent. We appreciate the opportunity to testify before you today on this issue.

We alerted our members to this situation over the past couple of months, asking them to let us know if they think they've been misclassified. We also warned them that if they alert their agency that they've been misclassified, they may have to be switched immediately, so we've told them to "tell, but don't ask." [Laughter.]

I can report to you that so far the number of people who have come back to us has been quite modest. We don't anticipate a large-scale corrective action for the foreign service agencies.

Mr. Chairman, I personally experienced the sort of situation that this legislation deals with. I joined the government back in 1984 as an engineer in the Civil Service, and I was put into the interim system at that time. Three years later I was serving abroad in the foreign service, and I wanted to switch into the new system. I guess I was one of the 4 percent that Mr. Flynn said were "rational," and I was told that I didn't have to do that, that it was automatic. I had no choice, I had to be in FERS—or the Foreign Service Pension System, equivalent.

In November of 1987 I got my first statement from the Thrift Savings Plan and I saw that I wasn't getting government matching, and I went into the administrative section of the Embassy and asked them why. They said, "Oh, you didn't tell us that you wanted to be switched." I said, "You told me that I didn't have to tell you, that I had no choice."

I was lucky that they made that correction right there, so I didn't suffer any damage. But some other people in the foreign service haven't been so lucky. I think, in our case, one of the reasons people were misassigned is that because 60 percent of our people are serving abroad, while the foreign service agencies run these retirement issues out of headquarters here in Washington. Washington is where they have the specialized personnel who know how to deal with these issues. In embassies, we don't have that kind of expertise.

Ten years ago, when these big changes were taking place, nobody had fax machines; nobody had e-mail; international calls were very expensive. You generally weren't allowed to make them if you were a staff person. And in some of the countries—like where I served, in Zaire, in Jamaica—the connections were hard to make. So it was very hard to get that kind of information out in the field.

Today it's a little bit easier to do that, so we don't think we're getting classification problems now in the foreign service.

Mr. Chairman, from our point of view corrective legislation should have three features.

First, it should include the foreign service. H.R. 3249, the House corrective measure, does include the foreign service, and we thank Congressman Mica for acceding to our request that it do so. And we also ask you, Mr. Chairman, as you mark up S. 1710, that you also include our people.

Second, like the people who spoke before, Mr. Flynn and Mr. Mehle, we think that employees who have been victims of administrative error should have options. And this bill, S. 1710, does give

options to employees, as does the House bill, H.R. 3249. We think that's important.

But third, Mr. Chairman, we think that the option should be financially viable, and in particular this means providing corrective measures for employees who opt for the new system. It seems that on this point, as people have said, the Senate bill diverges from the House bill, particularly with respect to the Thrift Savings Plan contributions.

We have seen examples of how this operates now. A couple months ago I got an electronic mail from one of our officers who is serving in a developing country in Africa. He has been on duty since 1987 in the foreign service, and he was in the Offset system. Last year his agency told him that they had misclassified him, and that they had to put him immediately into the new system. Under the current law, to catch up on TSP, he would have to come up with somewhere between $65,000 and $70,000 very quickly in order to make up his retroactive contributions, and he would have to do that while he is also putting aside money to make his current contributions.

Mr. Chairman, most of our people don't have that kind of cash available to them. In fact, in the foreign service we have an "up or out" system where if you are not promoted at regular intervals, you have to retire, like they do in the uniformed military services. So we have a lot of people who are retiring in their mid-50's. They have children in college, and if they are asked to make this kind of switch without any kind of relief, we are essentially asking them to choose between their retirement and their children's education. We think that's unfair.

Mr. Chairman, we think that the changes that you are proposing to the current law do much to correct this situation. Certainly, the proposal to pay to the TSP an amount equal to the earnings on makeup contributions will bring the TSP to a healthy balance faster than the current law does.

As to the differences on TSP between the two bills, Mr. Chairman, I will confess that we do not have a lot of institutional expertise in the financial area in my organization, so we are going to leave that up to the experts. We are happy to see that Members of the House and the Senate are taking this problem seriously and that they're trying to do something to correct it quickly. I am happy to have had the opportunity to testify before you on how important it is.

My main point, Mr. Chairman, for being here today is to ask you to include the foreign service in whatever you come up with as corrective legislation.

Senator COCHRAN. Thank you very much, Mr. Geisler, for your comments.

Let me ask Mr. Salisbury, if there is any history in the private sector that is similar with what we're confronting now with this issue in the government retirement programs.

Mr. SALISBURY. Not on any point-by-point type of basis. Most private employers would not, if you will, have "companion" comprehensive retirement systems.

The one real of similarity would be that there are, in fact, at times problems of benefit calculation and classification. Senator

Grassley has held hearings here in the Senate on that topic. In those cases, the most common private sector practice would be basically to try to follow a policy of "do no harm" and a policy to help those to whom harm had been done. If I put that into the situation of this legislation and the discussions here, that would fall in the category, but it would be quite unlikely that a private employer, if they had a legal option, would, upon discovering 10 or 15 years after the fact that someone was in a situation and was "misclassified," that the employer would move them out of that situation against, in essence, their desire, to their disadvantage. That's the type of thing in the private sector that would lead to bad headlines and, potentially, to lawsuits.

Senator COCHRAN. Does ERISA have requirements that are more costly to employers or more generous to employees than those provided in the legislation that we're considering?

Mr. SALISBURY. First, you would note, as one of the cost items here—a private employer under ERISA would never face the Social Security issue that you face here, which is one of the cost items.

Beyond that, there really is not a comparison in the private sector, and ERISA would not create that type of a situation.

Senator COCHRAN. You mentioned that employees in the private sector may consider litigation to try to redress their grievances if they have been wronged in any way. Is there any proof that granting employees a specific right to sue the employer for lost contributions is a useful or valid option?

Mr. SALISBURY. There's no real record on that that we were able to find as we researched all of these issues. We do believe that if you were to ask that question of the Department of Labor, which engages directly in litigation related to ERISA, they might be able to find you essentially a count of how aggressively those litigation options have been used.

Senator COCHRAN. What considerations should be taken into account when you're trying to correct erroneous pension coverage? How do you meet the individual employee's expectations? Why can't we allow misclassified employees to remain in the wrong system?

Mr. SALISBURY. Well, as a practical matter, being the Congress of the United States, you have the unique power to do exactly that, should you choose to do so. And against the types of equity issues involved, one might argue that with some that would be an appropriate way to do it.

The issue that was raised earlier with the first panel in one of your questions about, "Well, what about the Social Security implications vis-a-vis universal coverage," the initiatives now in the States for seeking Congressional ability to opt out of Social Security, the precedent value—as a personal statement, not a lobbying statement but as a personal statement as a taxpayer, my comment would be that to essentially disadvantage large numbers of Federal workers through no fault of their own because of some discussion of precedent, when essentially workers hired before 1984 are still outside of the Social Security program, exceptions have always been made by the Congress. So I believe that you should make an effort to fairly accommodate the Federal worker.

As from a private employer experience perspective, probably the closest to this that we could think of as an application really relates to retiree medical areas, and litigation where an employer has implied, as in the General Motors litigation, has implied that there will be a retiree medical benefit, and then essentially it isn't there—that type of situation, the courts have come down and found in favor of the individual in the event that the employer was not very, very clear about the fact that these benefits might be taken away.

One could argue in this particular case that the Federal employee will not have been given fair warning as to the consequences of the misclassification.

Senator COCHRAN. What about the employees who have already been corrected? Are there any equity implications in providing further opportunities for correction or benefits?

Mr. SALISBURY. Not that we were able to clearly assess as we looked against the legislation. In the private sector it would normally be that once an individual had been given the option to change, that unless the Congress came and said, "You must give them another chance, or you have to tell them you made the wrong choice," you have to push them in one direction.

Senator COCHRAN. And is there any precedent for mandating an employer to make up the employee's contributions during the period of erroneous coverage?

Mr. SALISBURY. Not a precedent on a mandate basis that we were able to find.

Senator COCHRAN. So which one of these bills, if you had to make a comparison, would more closely follow private sector practice in correcting errors in coverage?

Mr. SALISBURY. For the most part, as we looked at that against private sector practice, it would most readily appear to be the Senate bill, with one potential exception, which is the issue of what type of investment crediting would be done, and that ends up being somewhat of a mix of the two bills, because in essence a private employer would generally attempt, in essence, to treat all of the affected parties with a totally consistent investment crediting as opposed to, if you will, one of the side effects of the House bill that was discussed by the last panel, that again, the individuals who chose to save might well find themselves being given a lower rate of return than the individual who had chosen not to save.

Senator COCHRAN. And is there any precedent in the private sector for making up for lost earnings attributable to the employee's share of contributions?

Mr. SALISBURY. As I noted in the full testimony, vis-a-vis revenue rulings, there is apparently the legal ability for employers to do that should they choose to do that. We were not able to find examples of cases in which they had done that.

Senator COCHRAN. Mr. Geisler, let me ask you your view about what could constitute immediate and complete relief for misclassified employees who elect FERS. We've heard about the measures that some of the employees have had to take because of harm that has been done to them.

Mr. GEISLER. Well, Senator, we think that people should be given the assurance immediately that when they reach the point where

they're ready to retire, they will be in the same position that they would have been had the government not made its mistake to begin with.

Senator COCHRAN. What do you think accounts for the majority of these misclassifications? Experiences like yours, where——

Mr. GEISLER. In the foreign service?

Senator COCHRAN. Right.

Mr. GEISLER. I think it's two things, Senator. I think the cases of people who entered during that period, between 1983 and 1987, who had prior Federal service added a new level of complexity to a difficult and somewhat confusing situation, and some of our retirement people—particularly those abroad—didn't know how to deal with those situations. I don't think it was widespread. I don't think there are many instances of just sheer administrative slip-up, people losing forms or writing dates wrong—I don't think we had much of that. I think it was mostly because people were serving abroad where there was not a lot of deep expertise in retirement issues, and we had people entered the foreign service with prior Federal experience that provided an added dimension to consider.

Senator COCHRAN. We have had some groups who say they prefer one proposal over the other. Why would different groups have conflicting views over the appropriateness or fairness of these two remedies? Some say that it is fair compensation for the harm that's been done, while others say that agencies should not be made to bear the financial burdens of other agencies' mistakes, and high agency costs might result in layoffs.

What's your impression of these concerns?

Mr. GEISLER. Well, I've heard both of those concerns, Senators. On the first one, about which agency should be made to bear the costs, frankly, sir, my members really don't care about that. This was a government mistake, and it's really irrelevant to us which organ or agency of the government is charged with rectifying the error.

In terms of this resulting in layoffs, I heard that when we were discussing H.R. 3249 2 months ago. I said then, and I still believe now, that that's simply not credible. I can't believe that the only way the U.S. Government can correct its own errors is by firing its employees to pay for it.

Senator COCHRAN. What is your impression of the bill we are introducing here in the Senate, S. 1710? Do you think that is a satisfactory resolution of the issue, or not?

Mr. GEISLER. Well, as it stands now, Mr. Chairman, I didn't find any mention of the foreign service, so from our point of view—— [Laughter.]

Senator COCHRAN. It needs the foreign service. Yes, we heard that. I've got that written down. [Laughter.]

Mr. GEISLER [continuing]. It seems that the nub of the matter here is, who is going to pay for the contribution that the employee would have made had they been put in FERS between 1987 and now? And that's a tough issue. It's a tough issue for us, too. There is an equity side to that; why should you give a windfall to these people who have not been contributing for 10 years, who had that

money available? They either consumed it or they saved it. If they saved it, they have it available, and they can invest it.

On the other hand, Mr. Chairman, if you look at the way people might reimburse the TSP, they're always going to be behind. It's sort of like if there is a race going on, and you are going to put somebody in that race in the middle, where do you put them? To us, it seems that H.R. 3249 puts them in the middle of the pack and says, "Go forward."

The way S. 1710 does it, where the employee has to make up all of his own contributions, given his current resources, you really put them a couple of steps behind, because their TSP balance is never going to be, today, where it would have been today had they been investing for the last 10 years. So they're never going to be getting the growth that they would have gotten.

Senator COCHRAN. And what about the question of fairness, having those who were misclassified and who elect FERS to receive earnings from contributions that they did not make? Is that a problem?

Mr. GEISLER. As I said, Senator, we understand that concern. It was a concern that I raised in the beginning when I first heard the proposal in H.R. 3249. I was concerned about that, but my feeling was, "Everybody in the Civil Service is going to get this; I can't see why we would want to exclude the foreign service."

Senator COCHRAN. Well, your presence has been helpful, and your testimony has been very helpful in our understanding of the issues involved. We will continue to review the legislation and the record, and hopefully we will come to some decision that will be fair and equitable for all concerned. Senator Durbin's questions and responses to OPM follows:

OPM RESPONSES TO ADDITIONAL QUESTIONS FROM SENATOR DURBIN

Tax Consequences

Question. To what extent will an employee [who was misclassified and then automatically shifted to FERS when the agency detected the error] who then elects, if this legislation becomes law, to go into CSRS Offset, incur tax consequences? Are the House and Senate bills different on this aspect?

S. 1710 follows current law in regard to excess TSP contributions. (Excess contributions are those that exceed the 5 percent contribution limit for CSRS employees.) Any excess contributions would be returned to the employee by the employing agency, and treated as taxable income in the year that the excess contributions are returned. Attributable earnings on all employee contributions would remain in the TSP account. Government contributions, and earnings attributed to government contributions, would be removed from the employee's TSP account.

H.R. 3249 would permit all FERS employees who elect retroactive CSRS Offset coverage to retain any excess TSP contributions, and earnings, in the TSP account. All government contributions, and earnings attributed to government contributions, would be removed from the employee's TSP account.

Question. For example, will such an individual be required as part of that election to withdraw any contributions previously made to TSP as a FERS enrollee that exceeded the 5 percent annual cap allowed for CSRS enrolless?

S. 1710 and current law require removal of excess TSP contributions from the employee's TSP account. The employing agency is required to determine the amount of any excess contributions and return that amount to the employeee.

Question. Will that transaction be a taxable event?

Contributions returned to the employee are taxed as income in the year the excess contributions are paid back to the employee. This transaction is

not, as H.R. 3249 incorrectly presumes, an early distribution from a qualified retirement plan that is subject to a penalty tax. Excess contributions are simply treated as salary.

Question. Might that aspect deter persons from shifting out of FERS into the CSRS Offset option?

Not necessarily. In choosing a retirement plan, employees must evaluate not only their current financial situation, but also their long term plans. The amount and taxability of any refunded excess TSP contributions would be among the many factors the employee must consider in choosing a retirement plan.

Likely Behavior

Question. Have any projections been made as to how many individuals who were shifted to FERS already (to correct the problem once their agency uncovered it) would elect to go into CSRS Offset?

Under H.R. 3249, we estimate that the percentage of previously corrected employees who elect to return to CSRS Offset would be 20 percent, as a result of the overcompensation under the TSP provisions of that bill.

Question. Does OPM (or others) presume that many persons whose misclassification has previously been detected and shifted to FERS as required under current law will elect the CSRS Offset option if it is made available under legislation such as S. 1710?

We believe that employees who were more recently corrected to FERS or have not had an opportunity to contribute large amounts to the TSP would be more likely to elect CSRS Offset. Given the performance of the TSP investment funds, it is less likely that an employee who has been covered by FERS for a longer period of time and maximizing TSP contributions would choose to leave FERS.

Question. What benefits are there to a corrected FERS employee making such an election rather than staying in FERS?

Certainly not all employees are able to substantially contribute to the TSP. To receive a comparable benefit under FERS, the employee must generally contribute 12–17 percent of salary. Under CSRS Offset, the employee need only contribute 7 percent of salary. For many employees, the additional 5–10 percent required under FERS makes CSRS Offset more attractive.

Improving Discovery of Problems

Question. Are there any mechanisms of "best practices" in place in any agency that would make it easier to locate those active, separated, or retired employees who may be in the universe of misclassified individuals so that necessary corrections can be made more promptly?

Retirement coverage determinations are made by reviewing all of the employee's service history and prior retirement coverage. Since this information is not automated, verifying a retirement coverage determination is usually done by reviewing individual employee records. There is, however, some information maintained in an automated format that will assist agencies in identifying groups of employees that are more likely to be affected by a coverage error, such as employees with prior service hired during the 1984–1987 transition period.

Because the employment records for separated or retired employees are not kept with the last Federal employer, it is very difficult to identify separated employees with a coverage error.

Question. Is this problem one that is government-wide in its range? Is it known whether particular agencies have significantly higher percentage of affected employees?

A retirement classification error can occur at any Federal agency. Generally, the larger the agency, the more opportunity for error.

With that, the hearing will stand adjourned. Thank you.

[Whereupon, at 3:50 p.m., the Subcommittee was adjourned, to reconvene at the call of the Chair.]

APPENDIX

105TH CONGRESS
2D SESSION

S. 1710

To provide for the correction of retirement coverage errors under chapters 83 and 84 of title 5, United States Code.

IN THE SENATE OF THE UNITED STATES

MARCH 4, 1998

Mr. COCHRAN (by request) (for himself, Mr. LEVIN, Mr. LEAHY, Mr. STEVENS, Mr. ROBB, Mr. WARNER, Mr. SARBANES, and Ms. MIKULSKI) introduced the following bill; which was read twice and referred to the Committee on Governmental Affairs

A BILL

To provide for the correction of retirement coverage errors under chapters 83 and 84 of title 5, United States Code.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*
3 That this Act may be cited as the "Retirement Coverage
4 Error Correction Act of 1998".

5 **SEC. 2. FINDINGS AND PURPOSE.**

6 The Congress finds that a number of Government
7 employees have been placed under erroneous retirement
8 coverage during the transition from the Civil Service Re-
9 tirement System to the Federal Employees Retirement

1 System. When these errors are of significant duration,
2 they adversely affect an employee's ability to plan for re-
3 tirement. It is the purpose of this Act to provide a remedy
4 that treats all such individuals fairly and reasonably, and
5 demonstrates the Government's concern for its employees
6 who have been disadvantaged by a Government error in
7 their retirement coverage. Affected employees should have
8 a choice between corrected retirement coverage and the
9 benefit the employee would have received under the erro-
10 neous coverage, without disturbing Social Security cov-
11 erage law.

12 **SEC. 3. DEFINITIONS.**

13 For the purposes of this Act—

14 (1) "Annuitant" means an individual described
15 by section 8331(9) or 8401(2) of title 5, United
16 States Code;

17 (2) "CSRS" means the Civil Service Retirement
18 System established under subchapter III of chapter
19 83 of title 5, United States Code;

20 (3) "CSRS covered" means subject to the pro-
21 visions of subchapter III of chapter 83 of title 5,
22 United States Code, including full CSRS employee
23 deductions;

24 (4) "CSRS Offset covered" means subject to
25 the provisions of subchapter III of chapter 83 of

1 title 5, United States Code, including reduced CSRS
2 employee deductions;
3 (5) "Director" means the Director of Office of
4 Personnel Management;
5 (6) "FERS" means the Federal Employees Re-
6 tirement System established under chapter 84 of
7 title 5, United States Code;
8 (7) "FERS covered" means subject to the pro-
9 visions of chapter 84 of title 5, United States Code;
10 (8) "OASDI employee tax" means the Old Age,
11 Survivors and Disability Insurance tax imposed on
12 wages under section 3101(a) of the Internal Reve-
13 nue Code of 1986;
14 (9) "OASDI employer tax" means the Old Age,
15 Survivors and Disability Insurance tax imposed on
16 wages under section 3111(a) of the Internal Reve-
17 nue Code of 1986;
18 (10) "OASDI taxes" means the sum of the
19 OASDI employee tax and OASDI employer tax;
20 (11) "former employee" means an individual
21 who formerly was a Government employee, but who
22 is not an annuitant;
23 (12) "Office" means the Office of Personnel
24 Management;

1 (13) "Retirement coverage determination"
2 means the determination by an agency whether em-
3 ployment is CSRS covered, CSRS Offset covered,
4 FERS covered, or Social Security only covered;
5 (14) "Retirement coverage error" means an er-
6 roneous retirement coverage determination that was
7 in effect for a minimum period of 3 years of service
8 after December 31, 1986;
9 (15) "Service" means a period of civilian serv-
10 ice that is creditable under section 8332 or 8411 of
11 title 5, United States Code;
12 (16) "Social Security-only covered" means em-
13 ployment under section 3121(b) of the Internal Rev-
14 enue Code of 1986, subject to OASDI taxes, but not
15 CSRS covered, CSRS Offset covered, or FERS cov-
16 ered; and
17 (17) "Survivor" means an individual described
18 by section 8331(10) or 8401(28) of title 5, United
19 States Code.
20 **SEC. 4. ERRORS OF LESS THAN 3 YEARS EXCLUDED.**
21 Except as otherwise provided in this Act, an erro-
22 neous retirement coverage determination that was in effect
23 for a period of less than 3 years of service after December
24 31, 1986, is not covered by this Act.

1 **SEC. 5. SOCIAL SECURITY-ONLY COVERED EMPLOYEES**
2 **WHO WERE ERRONEOUSLY CSRS COVERED**
3 **OR CSRS OFFSET COVERED.**

4 (a) This section applies in the case of a retirement
5 coverage error in which a Social Security-only covered em-
6 ployee was erroneously CSRS covered or CSRS Offset cov-
7 ered.

8 (b)(1) This subsection applies if the retirement cov-
9 erage error has not been corrected prior to the effective
10 date of the regulations described in paragraph (3).

11 (2) In the case of an individual who is erroneously
12 CSRS covered, as soon as practicable after discovery of
13 the error, and subject to the right of an election under
14 paragraph (3), such a individual shall be CSRS Offset cov-
15 ered, retroactive to the date of the retirement coverage
16 error.

17 (3) Upon written notice of a retirement coverage
18 error, an individual shall have 6 months to make an elec-
19 tion, under regulations promulgated by the Office, to be
20 CSRS Offset covered or Social Security-only covered, ret-
21 roactive to the date of the retirement coverage error. If
22 the individual does not make an election prior to the dead-
23 line, the individual shall remain CSRS Offset covered.

24 (c)(1) This subsection applies if the retirement cov-
25 erage error was corrected prior to the effective date of the
26 regulations described in subsection (b)(3).

1 (2) Within 6 months after the date of enactment of
2 this Act, the Office shall promulgate regulations authoriz-
3 ing individuals to elect, during the 18-month period imme-
4 diately following the effective date of the regulations, to
5 be CSRS Offset covered or Social Security-only covered,
6 retroactive to the date of the retirement coverage error.
7 (3) If an eligible individual does not make an election
8 under paragraph (2) prior to the deadline, the corrective
9 action previously taken shall remain in effect.

10 **SEC. 6. SOCIAL SECURITY-ONLY COVERED EMPLOYEES NOT**
11 **ELIGIBLE TO ELECT FERS WHO WERE ERRO-**
12 **NEOUSLY FERS COVERED.**

13 (a) This section applies in the case of a retirement
14 coverage error in which a Social Security-only covered em-
15 ployee not eligible to elect FERS coverage under authority
16 of section 8402(c) of title 5, United States Code, was erro-
17 neously FERS covered.
18 (b)(1) This subsection applies if the retirement cov-
19 erage error has not been corrected prior to the effective
20 date of the regulations described in paragraph (2).
21 (2) Upon written notice of a retirement coverage
22 error, an individual shall have 6 months to make an elec-
23 tion, under regulations promulgated by the Office, to be
24 FERS covered or Social Security-only covered, retroactive
25 to the date of the retirement coverage error. If the individ-

1 ual does not make an election prior to the deadline, the
2 individual shall remain FERS covered, retroactive to the
3 date of the retirement coverage error.

4 (c)(1) This subsection applies if the retirement cov-
5 erage error was corrected prior to the effective date of the
6 regulations described in subsection (b)(2).

7 (2) Within 6 months after the date of enactment of
8 this Act, the Office shall promulgate regulations authoriz-
9 ing individuals to elect, during the 18-month period imme-
10 diately following the effective date of the regulations to
11 be FERS covered or Social Security-only covered, retro-
12 active to the date of the retirement coverage error.

13 (3) If an eligible individual does not make an election
14 under paragraph (2) prior to the deadline, the corrective
15 action previously taken shall remain in effect.

16 **SEC. 7. CSRS COVERED, CSRS OFFSET COVERED, AND FERS-**
17 **ELIGIBLE SOCIAL SECURITY-ONLY COVERED**
18 **EMPLOYEES WHO WERE ERRONEOUSLY FERS**
19 **COVERED WITHOUT AN ELECTION.**

20 (a) If an individual was prevented from electing
21 FERS because the individual was erroneously FERS cov-
22 ered during the period when the individual was eligible to
23 elect FERS under title III of the Federal Employees Re-
24 tirement System Act of 1986, the individual is deemed to
25 have elected FERS coverage and will remain covered by

1 FERS, unless the individual declines, under regulations
2 promulgated by the Office, to be FERS covered, in which
3 case the individual will be CSRS covered, CSRS Offset
4 covered, or Social Security-only covered; as would apply
5 in the absence of a FERS election, retroactive to the date
6 of the erroneous retirement coverage determination.

7 (b) In the case of an individual to whom subsection
8 (a) applies, who dies prior to discovery of the coverage
9 error, or who dies during the election period prescribed
10 in subsection (a) prior to making an election to correct
11 the error, without having the right to decline FERS cov-
12 erage, the individual's survivors shall have the right to
13 make the election under regulations promulgated by the
14 Office that provide for such election in a manner consist-
15 ent with the election rights of the individual.

16 (c) This section shall be effective retroactive to Janu-
17 ary 1, 1987, except that this section shall not affect indi-
18 viduals who made or were deemed to have made elections
19 similar to those provided in this section under regulations
20 promulgated by the Office prior to the effective date of
21 this Act.

1 **SEC. 8. FERS COVERED CURRENT AND FORMER EMPLOY-**
2 **EES WHO WERE ERRONEOUSLY CSRS COV-**
3 **ERED OR CSRS OFFSET COVERED.**

4 (a) This section applies to a FERS covered employee
5 or former employee who was erroneously CSRS covered
6 or CSRS Offset covered as a result of a retirement cov-
7 erage error.

8 (b)(1) This subsection applies if the retirement cov-
9 erage error has not been corrected prior to the effective
10 date of the regulations described in paragraph (2). As
11 soon as practicable after discovery of the error, and sub-
12 ject to the right of an election under paragraph (2), if
13 CSRS covered or CSRS Offset covered, such individual
14 shall be treated as CSRS Offset covered, retroactive to the
15 date of the retirement coverage error.

16 (2) Upon written notice of a retirement coverage
17 error, an individual shall have 6 months to make an elec-
18 tion, under regulations promulgated by the Office, to be
19 CSRS Offset covered or FERS covered, retroactive to the
20 date of the retirement coverage error. If the individual
21 does not make an election by the deadline, a CSRS Offset
22 covered individual shall remain CSRS Offset covered and
23 a CSRS covered individual shall be treated as CSRS Off-
24 set covered.

1 (c)(1) This subsection applies if the retirement cov-
2 erage error was corrected prior to the effective date of the
3 regulations described in subsection (b)(2).
4 (2)(A) Within 6 months after the date of enactment
5 of this Act, the Office shall promulgate regulations author-
6 izing individuals to elect, during the 18-month period im-
7 mediately following the effective date of the regulations,
8 to be CSRS Offset covered, retroactive to the date of the
9 retirement coverage error.
10 (B) An individual who previously received a payment
11 ordered by a Court or provided as a settlement of claim
12 for losses resulting from a retirement coverage error shall
13 not be entitled to make an election under this subsection
14 unless that amount is waived in whole or in part under
15 section 12, and any amount not waived is repaid.
16 (C) An individual who, subsequent to correction of
17 the retirement coverage error, received a refund of retire-
18 ment deductions under section 8424, or a distribution
19 under section 8433, of title 5, United States Code, shall
20 not be entitled to make an election under this subsection.
21 (3) If an individual is ineligible to make an election
22 or does not make an election under paragraph (2) prior
23 to the deadline, the corrective action previously taken shall
24 remain in effect.

1 **SEC. 9. ANNUITANTS AND SURVIVORS IN CASES WHERE**
2 **FERS COVERED EMPLOYEES WERE ERRO-**
3 **NEOUSLY CSRS COVERED OR CSRS OFFSET**
4 **COVERED.**

5 (a) This section applies to an individual who is an
6 annuitant or a survivor of a FERS covered employee who
7 was erroneously CSRS covered or CSRS Offset covered
8 as a result of a retirement coverage error.

9 (b)(1) Within 6 months after the date of enactment
10 of this Act, the Office shall promulgate regulations author-
11 izing an individual described in subsection (a) to elect
12 CSRS Offset coverage or FERS coverage, retroactive to
13 the date of the retirement coverage error.

14 (2) An election under this subsection shall be made
15 within 18 months after the effective date of the regula-
16 tions.

17 (3) If the individual elects CSRS Offset coverage, the
18 amount in the employee's Thrift Savings Plan account
19 under subchapter III of chapter 84 of title 5, United
20 States Code, at the time of retirement that represents the
21 Government's contributions and earnings on those con-
22 tributions (whether or not this amount was subsequently
23 distributed from the Thrift Savings Plan) will form the
24 basis for a reduction in the individual's annuity, under
25 regulations promulgated by the Office. The reduced annu-
26 ity to which the individual is entitled shall be equal to an

1 amount which, when taken together with the amount re-
2 ferred to in the preceding sentence, would result in the
3 present value of the total being actuarially equivalent to
4 the present value of an unreduced CSRS Offset annuity
5 that would have been provided the individual.

6 (4) If—

7 (A) a surviving spouse elects CSRS Offset bene-
8 fits; and

9 (B) a FERS basic employee death benefit
10 under section 8442(b) of title 5, United States Code,
11 was previously paid;

12 then the survivor's CSRS Offset benefit shall be subject
13 to a reduction, under regulations promulgated by the Of-
14 fice. The reduced annuity to which the individual is enti-
15 tled shall be equal to an amount which, when taken to-
16 gether with the amount of the payment referred to sub-
17 paragraph (B) would result in the present value of the
18 total being actuarially equivalent to the present value of
19 an unreduced CSRS Offset annuity that would have been
20 provided the individual.

21 (5) An individual who previously received a payment
22 ordered by a Court or provided as a settlement of claim
23 for losses resulting from a retirement coverage error shall
24 not be entitled to make an election under this subsection
25 unless repayment of that amount is waived in whole or

1 in part under section 12, and any amount not waived is
2 repaid.
3 (c) If the individual does not make an election under
4 subsection (b) prior to the deadline, the retirement cov-
5 erage shall be subject to the following rules—
6 (1) If corrective action was previously taken,
7 that corrective action shall remain in effect; and
8 (2) If corrective action was not previously
9 taken, the employee shall be CSRS Offset covered,
10 retroactive to the date of the retirement coverage
11 error.

12 **SEC. 10. PROVISIONS RELATED TO SOCIAL SECURITY COV-**
13 **ERAGE OF MISCLASSIFIED EMPLOYEES.**

14 (a) REPORTS TO COMMISSIONER OF SOCIAL SECU-
15 RITY.—In order to carry out the Commissioner of Social
16 Security's responsibilities under title II of the Social Secu-
17 rity Act, the Commissioner may request the head of each
18 agency that employs or employed an individual erroneously
19 subject to CSRS coverage as a result of a retirement cov-
20 erage error and retroactively converted to CSRS Offset
21 coverage, FERS coverage, or Social Security-only coverage
22 to report in coordination with the Office of Personnel
23 Management, and in such form and within such time
24 frame as the Commissioner may specify, any or all of the
25 following—

1 (1) the total wages (as defined in section
2 3121(a) of the Internal Revenue Code of 1986) paid
3 to such individual during each year of the entire pe-
4 riod of the erroneous CSRS coverage;
5 (2) the excess CSRS deduction amount for the
6 individual; and
7 (3) such additional information as the Commis-
8 sioner may require for the purpose of carrying out
9 the Commissioner's responsibilities under title II of
10 the Social Security Act.
11 The head of an agency or the Office shall comply with
12 such a request from the Commissioner. For purposes of
13 section 201 of the Social Security Act, wages reported pur-
14 suant to this subsection shall be deemed to be wages re-
15 ported to the Secretary of the Treasury or the Secretary's
16 delegates pursuant to subtitle F of the Internal Revenue
17 Code of 1954. For purposes of this section, the "excess
18 CSRS deduction amount" for an individual shall be an
19 amount equal to the difference between the CSRS deduc-
20 tions withheld and the CSRS Offset or FERS deductions,
21 if any, due with respect to the individual during the entire
22 period the individual was erroneously subject to CSRS
23 coverage as a result of a retirement coverage error.
24 (b) ADJUSTMENT TO TRANSFERS UNDER SECTION
25 201 OF THE SOCIAL SECURITY ACT.—Any amount trans-

1 ferred from the General Fund to the Federal Old-Age and
2 Survivors Insurance Trust Fund and the Federal Disabil-
3 ity Insurance Trust Fund under section 201 of the Social
4 Security Act on the basis of reports under this section
5 shall be adjusted by amounts previously transferred as a
6 result of corrections made (including corrections made be-
7 fore the date of enactment of this Act), and shall be re-
8 duced by any excess CSRS deduction amounts determined
9 by the Director of the Office of Personnel Management
10 to be remaining to the credit of individuals in the Civil
11 Service Retirement and Disability Fund or in accounts
12 maintained by the employing agencies. Such amounts de-
13 termined by the Director in the preceding sentence shall
14 be transferred to the Federal Old Age and Survivors In-
15 surance Trust Fund and the Federal Disability Insurance
16 Trust Fund in the proportions indicated in sections 201
17 (a) and (b) of the Social Security Act.

18 (c) APPLICATION OF OASDI TAX PROVISIONS OF
19 THE INTERNAL REVENUE CODE OF 1986 TO AFFECTED
20 INDIVIDUALS AND EMPLOYING AGENCIES.—An individual
21 described in subsection (a) and the individual's employing
22 agency shall be deemed to have fully satisfied in a timely
23 manner their responsibilities with respect to the taxes im-
24 posed by sections 3101(a), 3102(a), and 3111(a) of the
25 Internal Revenue Code of 1986 on the wages paid by the

1 employing agency to such individual during the entire pe-
2 riod he or she was erroneously subject to CSRS coverage
3 as a result of a retirement coverage error. No credit or
4 refund of taxes on such wages shall be allowed as result
5 of the operation of this subsection.

6 **SEC. 11. FUTURE CSRS COVERAGE DETERMINATIONS.**

7 No agency shall place an individual under CSRS cov-
8 erage unless—

9 (1) the individual has been employed with
10 CSRS coverage within the preceding 365 days; or

11 (2) the Office has agreed in writing that the
12 agency's coverage determination is correct.

13 **SEC. 12. DISCRETIONARY ACTIONS BY DIRECTOR.**

14 (a) The Director is authorized to take any of the fol-
15 lowing actions—

16 (1) extend the deadlines for making elections
17 under this Act in circumstances involving an individ-
18 ual's inability to make a timely election due to cause
19 beyond the individual's control;

20 (2) provide for the reimbursement of necessary
21 and reasonable expenses incurred by an individual
22 with respect to settlement of a claim for losses re-
23 sulting from a retirement coverage error, including
24 attorney's fees, court costs, and other actual ex-
25 penses;

1 (3) compensate an individual for monetary
2 losses that are a direct and proximate result of a re-
3 tirement coverage error, excluding claimed losses re-
4 lating to forgone contributions and earnings under
5 the Thrift Savings Plan under subchapter III of
6 chapter 84 of title 5, United States Code, and all
7 other investment opportunities; and
8 (4) waive repayments otherwise required under
9 this Act.
10 (b) In exercising the authority under this section, the
11 Director shall, to the extent practicable, provide for simi-
12 lar actions in situations involving similar circumstances.
13 (c) Actions taken under this section are final and con-
14 clusive, and are not subject to administrative or judicial
15 review on any basis.
16 (d) The Office of Personnel Management shall pre-
17 scribe regulations regarding the process and criteria used
18 in exercising the authority under this section.
19 (e) The Office of Personnel Management shall, within
20 six months after the date of enactment of this Act, and
21 annually thereafter for each year in which the authority
22 provided in this section is used, submit a report to each
23 House of Congress on the operation of this section.

1 **SEC. 13. THRIFT PLAN TREATMENT FOR CERTAIN INDIVID-**
2 **UALS.**

3 (a) This section applies to an individual who—

4 (1) is eligible to make an election of coverage
5 under section 8 or section 9, and only if FERS cov-
6 erage is elected (or remains in effect) for the em-
7 ployee involved; or

8 (2) is an employee (or former employee, annu-
9 itant, or survivor, subject to conditions similar to
10 those in section 8 and 9) in the case of a retirement
11 coverage error in which a FERS covered employee
12 was erroneously Social Security-only covered and is
13 corrected to FERS coverage.

14 (b)(1) With respect to an individual to whom this sec-
15 tion applies, the Director shall pay to the Thrift Savings
16 Fund under subchapter III of chapter 84 of title 5, United
17 States Code, for credit to the account of the employee in-
18 volved, an amount equal to the earnings which are dis-
19 allowed under section 8432a of such title 5 on the employ-
20 ee's retroactive contributions to such Fund. Such amount
21 shall represent earnings, on such retroactive contributions,
22 during the period of the retirement coverage error and
23 continuing up to the date on which the amount is paid
24 by the Director (and based on distributions from the em-
25 ployee's Thrift Savings Plan account). Such earnings shall
26 be computed in accordance with the procedures for com-

1 puting lost earnings under such section 8432a. The
2 amount paid by the Director shall be treated for all pur-
3 poses as if that amount had actually been earned on the
4 basis of the employee's contributions.

5 (2) In cases in which the retirement coverage error
6 was corrected prior to the effective date of the regulations
7 under section 8(c) or section 9(b), the employee involved
8 (including an employee described in subsection (a)(2))
9 shall have an additional opportunity to make retroactive
10 contributions for the period of the retirement coverage
11 error (subject to applicable limits), and such contributions
12 shall be treated in accordance with the provisions of para-
13 graph (1).

14 (c) The Office, in consultation with the Federal Re-
15 tirement Thrift Investment Board, shall prescribe regula-
16 tions appropriate to carry out this section.

17 **SEC. 14. AUTHORIZATION AND APPROPRIATION.**

18 All payments permitted or required by this Act to be
19 paid from the Civil Service Retirement and Disability
20 Fund, together with administrative expenses incurred by
21 the Office in administering this Act, shall be deemed to
22 have been authorized to be paid from that Fund, which
23 is appropriated for the payment thereof.

1 **SEC. 15. SERVICE CREDIT DEPOSITS.**

2 (a) In the case of a retirement coverage error in
3 which—

4 (1) a FERS covered employee was erroneously
5 CSRS covered or CSRS Offset covered;

6 (2) the employee made a service credit deposit
7 under the CSRS rules; and

8 (3) there is a subsequent retroactive change to
9 FERS coverage;

10 the excess of the amount of the CSRS civilian or military
11 service credit deposit over the FERS civilian or military
12 service credit deposit, together with interest computed in
13 accordance with paragraphs (2) and (3) of section 8334(e)
14 of title 5, United States Code and regulations prescribed
15 by the Office, shall be a paid to the annuitant or, in the
16 case of a deceased employee, to the individual entitled to
17 lump-sum benefits under section 8342(c) or 8424(d) of
18 title 5, United States Code, as applicable.

19 (b)(1) This subsection applies in the case of an erro-
20 neous retirement coverage determination in which—

21 (A) the employee made a service credit deposit
22 under the FERS rules; and

23 (B) there is a subsequent retroactive change to
24 CSRS or CSRS Offset coverage.

25 (2) If at the time of commencement of an annuity
26 there is remaining unpaid any excess of the CSRS civilian

1 or military service credit deposit over the FERS civilian
2 or military service credit deposit, the annuity shall be re-
3 duced based upon the amount unpaid together with inter-
4 est computed in accordance with paragraphs (2) and (3)
5 of section 8334(e) of title 5, United States Code and regu-
6 lations prescribed by the Office. The reduced annuity to
7 which the individual is entitled shall be equal to an amount
8 that, when taken together with the amount referred to in
9 the preceding sentence, would result in the present value
10 of the total being actuarially equivalent to the present
11 value of an unreduced CSRS Offset annuity that would
12 have been provided the individual.
13 (3) If at the time of commencement of a survivor an-
14 nuity, there is remaining unpaid any excess of the CSRS
15 service credit deposit over the FERS service credit de-
16 posit, and there has been no actuarial reduction in an an-
17 nuity under the preceding paragraph, the survivor annuity
18 shall be reduced based upon the amount unpaid together
19 with interest computed in accordance with paragraphs (2)
20 and (3) of section 8334(e) of title 5, United States Code
21 and regulations prescribed by the Office. The reduced sur-
22 vivor annuity to which the individual is entitled shall be
23 equal to an amount that, when taken together with the
24 amount referred to in the preceding sentence, would result
25 in the present value of the total being actuarially equiva-

1 lent to the present value of an unreduced CSRS Offset
2 survivor annuity that would have been provided the indi-
3 vidual.

4 **SEC. 16. REGULATIONS.**

5 (a) In addition to the regulations specifically author-
6 ized in this Act, the Office may prescribe such other regu-
7 lations as are necessary for the administration of this Act.

8 (b) The regulations issued under this Act shall pro-
9 vide for protection of the rights of a former spouse with
10 entitlement to an apportionment of benefits or to survivor
11 benefits based on the service of the employee.

12 **SEC. 17. EFFECTIVE DATE.**

13 Except as otherwise provided herein, this Act shall
14 be effective on the date of enactment.

○

Example 1 - 0% Employee contribution rate before correction, electing to make up additional 3% contribution.

	Under Current Law		Under S.1710		Under H.R. 3249	
	Contributed by Employee	Paid by Agency	Contributed by Employee	Paid by Agency	Contributed by Employee	Paid by Agency
Initial CSRS Employee Contributions	$0		$0		$0	
FERS required make-up contributions						
Agency automatic (1%)		$3,300		$3,300		$3,300
Agency matching		$0		$0		$12,990
Agency payment in lieu of employee make-up contributions		n/a		n/a		$18,090
Lost earnings		$1,601		$1,601		$21,546
Optional additional make-up contributions						
Employee contributions	$9,900		$9,900		n/a	
Lost earnings with respect to employee optional make-up contributions	n/a	n/a		$4,804	n/a	n/a
Agency matching		$9,900		$9,900		n/a
Lost earnings on agency matching		$4,804		$4,804		n/a
Total	$9,900	$19,605	$9,900	$24,409	$0	$55,926
Corrected total account balance		$29,505		$34,309		$55,926

Notes: This example is based on the following assumptions:

a) The participant was erroneously covered by the Civil Service Retirement System for 11 years (1987-1997).

b) The annual salary was $30,000.

c) The historic annual investment return of the G Fund (for computation of lost earnings under current law and under S. 1710 in the absence of a participant election) was 7.65%.

d) For simplicity, lost earnings on employee make-up contributions (under S. 1710) and on agency payments (under current law and under S. 1710) are calculated as though all of these funds were deposited at once. The employee and associated matching contributions are made up over time, however.

e) Agency payments under H.R. 3249 are based on the actual annual average deferral rates of FERS contributors, the actual annual investment distribution of contributions, and the actual annual investment rates of return in the respective years as prescribed in that proposed legislation.

Example 2 - 0% Employee contribution rate before correction, electing to make up additional 5% contribution.

	Under Current Law		Under S.1710		Under H.R. 3249	
	Contributed by Employee	Paid by Agency	Contributed by Employee	Paid by Agency	Contributed by Employee	Paid by Agency
Initial CSRS Employee Contributions	$0		$0		$0	
FERS required make-up contributions						
Agency automatic (1%)		$3,300		$3,300		$3,300
Agency matching		$0		$0		$12,990
Agency payment in lieu of employee make-up contributions		n/a		n/a		$18,090
Lost earnings		$1,601		$1,601		$21,546
Optional additional make-up contributions						
Employee contributions	$16,500		$16,500		n/a	
Lost earnings with respect to employee optional make-up contributions	n/a	n/a		$8,007	n/a	n/a
Agency matching		$13,200		$13,200		n/a
Lost earnings on agency matching		$6,406		$6,406		n/a
Total	$16,500	$24,507	$16,500	$32,514	$0	$55,926
Corrected total account balance		$41,007		$49,014		$55,926

Notes: This example is based on the following assumptions:

a) The participant was erroneously covered by the Civil Service Retirement System for 11 years (1987-1997).
b) The annual salary was $30,000.
c) The historic annual investment return of the G Fund (for computation of lost earnings under current law and under S. 1710 in the absence of a participant election) was 7.65%.
d) For simplicity, lost earnings on employee make-up contributions (under S. 1710) and on agency payments (under current law and under S. 1710) are calculated as though all of these funds were deposited at once. The employee and associated matching contributions are made up over time, however.
e) Agency payments under H.R. 3249 are based on the actual annual average deferral rates of FERS contributors, the actual annual investment distribution of contributions, and the actual annual investment rates of return in the respective years as prescribed in that proposed legislation.

Example 3 - 3% Employee contribution rate before correction, electing to make up additional 2% contribution.

	Under Current Law		Under S.1710		Under H.R. 3249	
	Contributed by Employee	Paid by Agency	Contributed by Employee	Paid by Agency	Contributed by Employee	Paid by Agency
Initial CSRS Employee Contributions	$9,900		$9,900		$9,900	
FERS required make-up contributions						
Agency automatic (1%)		$3,300		$3,300		$3,300
Agency matching		$9,900		$9,900		$12,990
Agency payment in lieu of employee make-up contributions		n/a		n/a		$18,090
Lost earnings		$8,570		$8,570		$21,546
Optional additional make-up contributions						
Employee contributions	$6,600		$6,600		n/a	
Lost earnings with respect to employee optional make-up contributions	n/a	n/a		$4,285	n/a	n/a
Agency matching		$3,300		$3,300		n/a
Lost earnings on agency matching		$2,142		$2,142		n/a
Total	$16,500	$27,212	$16,500	$31,497	$9,900	$55,926
Market earnings on initial contributions		$6,427		$6,427		$6,427
Corrected total account balance		$50,139		$54,424		$72,253

Notes: This example is based on the following assumptions:

a) The participant was erroneously covered by the Civil Service Retirement System for 11 years (1987-1997).
b) The annual salary was $30,000.
c) Contributions (based on the rate indicated above) were level throughout the period. For the purposes of this analysis, it is assumed that the individual made annual investment allocation elections in the same proportions as actual gross contributions received by the TSP in the respective years.
d) Market earnings on initial employee contributions are based on the actual annual investment rates of return in the respective years.
e) For simplicity, lost earnings on employee make-up contributions (under S. 1710) and on agency payments (under current law and under S. 1710) are calculated as though all of these funds were deposited at once. The employee and associated matching contributions are made up over time, however.
f) Agency payments under H.R. 3249 are based on the actual annual average deferral rates of FERS contributors, the same allocations of investments as elected for prior actual employee contributions (see note c), and the actual annual investment rates of return in the respective years as prescribed in that proposed legislation. In this example, the assumed elections of investment allocations are the same as the investment allocations required under H.R. 3249 in the absence of prior actual contributions.

Example 4 - 5% Employee contribution rate before correction, electing to make up additional 5% contribution.

	Under Current Law		Under S.1710		Under H.R. 3249	
	Contributed by Employee	Paid by Agency	Contributed by Employee	Paid by Agency	Contributed by Employee	Paid by Agency
Initial CSRS Employee Contributions	$16,500		$16,500		$16,500	
FERS required make-up contributions						
Agency automatic (1%)		$3,300		$3,300		$3,300
Agency matching		$13,200		$13,200		$12,990
Agency payment in lieu of employee make-up contributions		n/a		n/a		$16,080
Lost earnings		$10,712		$10,712		$20,697
Optional additional make-up contributions						
Employee contributions	$16,500		$16,500		n/a	
Lost earnings with respect to employee optional make-up contributions	n/a	n/a		$10,712	n/a	n/a
Agency matching		$0		$0		n/a
Lost earnings on agency matching		$0		$0		n/a
Total	$33,000	$27,212	$33,000	$37,924	$16,500	$53,067
Market earnings on initial contributions		$10,712		$10,712		$10,712
Corrected total account balance		$70,924		$81,636		$80,279

Notes: This example is based on the following assumptions:

a) The participant was erroneously covered by the Civil Service Retirement System for 11 years (1987-1997).
b) The annual salary was $30,000.
c) Contributions (based on the rate indicated above) were level throughout the period. For the purposes of this analysis, it is assumed that the individual made annual investment allocation elections in the same proportions as actual gross contributions received by the TSP in the respective years.
d) Market earnings on initial employee contributions are based on the actual annual investment rates of return in the respective years.
e) For simplicity, lost earnings on employee make-up contributions (under S. 1710) and on agency payments (under current law and under S. 1710) are calculated as though all of these funds were deposited at once. The employee and associated matching contributions are made up over time, however.
f) Agency payments under H.R. 3249 are based on the actual annual average deferral rates of FERS contributors, the same allocations of investments as elected for prior actual employee contributions (see note c), and the actual annual investment rates of return in the respective years as prescribed in that proposed legislation. In this example, the assumed elections of investment allocations are the same as the investment allocations required under H.R. 3249 in the absence of prior actual contributions. Also in this example, the agency payment in lieu of employee make-up contributions under H.R. 3249 is limited to 5% of pay because the total of employee contributions actually made plus agency payments in lieu of employee make-up contributions may not exceed the maximum (10%) deferral rate for employee contributions under FERSA.

TESTIMONY OF
ROBERT M. TOBIAS
NATIONAL PRESIDENT

Chairman Cochran, Members of the Subcommittee:

I am Robert M. Tobias, National President of the National Treasury Employees Union (NTEU). On behalf of the more than 150,000 employees represented by NTEU, thank you for holding this important hearing today and for inviting our input.

It is our hope that this hearing will finally result in a solution to a problem that has persisted for some time. Employees who, through no fault of their own, have been placed in the wrong retirement system have been significantly disadvantaged in their ability to prepare and plan for their own retirement. In many cases, more than a decade has expired since these errors occurred. Many employees have already had their retirement placements "corrected", however, they are still waiting to be made whole. The legislation before your Subcommittee today seeks to do just that.

NTEU first brought these errors to Congress' attention, as well as to the Executive Branch's attention in early 1994. Many of these errors stem from Congressional passage of legislation that retroactively determined retirement placement for federal employees and left agencies with less than clear guidance on complex issues. While numerous employees represented by this Union have been

determined to be in the wrong retirement program, many more have not yet been found. It is our hope that Congress, in consultation with NTEU and the other federal employee unions and organizations, as well as the Office of Personnel Management, will, as a result of this hearing, be able to enact the appropriate solution and implement it with no further delay.

Mr. John B. Gabrielli, an IRS employee, and member of NTEU Chapter 58 from Buffalo, New York, was placed in the wrong retirement system in September of 1984 when his temporary appointment was converted to a civil service career conditional appointment. Mr. Gabrielli testified before the House Civil Service Subcommittee in July of 1997, asking that body to provide closure to his nightmare. In early 1993, Mr. Gabrielli was first notified by his agency that he had been incorrectly placed in the Civil Service Retirement System (CSRS) and should have been in the Federal Employees Retirement System (FERS) -- after almost ten years had elapsed. Mr. Gabrielli was transferred to the FERS program and in September of 1993, he began making contributions to the Thrift Savings Plan, a key component of the FERS program. Mr. Gabrielli spent almost ten years in the wrong retirement system. To date, Mr. Gabrielli has not been made whole.

As you know, NTEU has been actively seeking relief for Mr. Gabrielli and the many others represented by this Union who are in similar situations. We are anxious to reach a final solution and hope that this Congress will be able to pass legislation that

brings closure to the nightmare experienced by federal employees who, because of these placement errors, fear their retirement is in jeopardy.

Mr. Chairman, it is our understanding that rather than attempting to affix blame for these retirement errors, your proposal seeks only to make the affected employee whole. We appreciate your common sense approach at resolving these dilemmas. As you know, affected employees may have worked at several different agencies over the last decade, making it not only difficult, but cumbersome and unreasonable to attempt to assign blame.

It is our further understanding that your proposal mandates that the costs associated with correcting these retirement coverage errors be paid from the Civil Service Retirement and Disability Fund. This appears to be the best approach. Just as it would be difficult, if not impossible, to reasonably assign blame for the initial retirement placement errors, it would be equally difficult to determine which agencies should be held responsible for absorbing costs associated with correcting these errors. For many federal agencies, discretionary appropriations have already been squeezed to the point where there is no wiggle room. Saddling agencies with additional costs could force some agencies to conduct reductions in force as a result of attempting to fix retirement errors for other employees.

49-133 98 - 3

We further understand that your legislation would allow employees improperly placed in CSRS to either be placed in the FERS retirement program or in the CSRS Offset program, which for many employees offers the best of both programs. Retirement planning is a very individual choice and no two employees are likely to make the same decisions. We strongly support affected employees being given these choices.

Like you, we believe that the final retirement error correction package must make employees whole. For those employees who have already been transferred to FERS and for those who choose to transfer to FERS, several important ingredients must be present. Employees should automatically be provided with the flat 1% of salary Thrift Savings Plan (TSP) contribution that all FERS employees receive. Moreover, employees must have the opportunity to make up lost contributions through future salary withholdings and receive retroactive agency matching contributions. In addition, I understand that your legislative proposal provides for lost earnings on both agency and employee make up contributions. These factors truly will make employees whole and put an end to the uncertainty that has surrounded some federal employees' retirement planning for too many years now.

Again, thank you for holding this hearing today and for your leadership in advancing this legislation to correct retirement coverage errors. NTEU appreciates your commitment to insuring that all federal employees are not only placed in the correct retirement system, but made whole again in the process. We look forward to continuing to work with you and your staff in an effort to see this legislation signed into law this year.

STATEMENT OF THOMAS J. O'ROURKE
SHAW, BRANSFORD, & O'ROURKE
WASHINGTON, D.C.

at a hearing of the

SUBCOMMITTEE ON INTERNATIONAL SECURITY, PROLIFERATION AND FEDERAL SERVICES
COMMITTEE ON GOVERNMENTAL AFFAIRS
UNITED STATES SENATE

ON

LEGISLATION TO CORRECT ERRONEOUS ENROLLMENTS IN FEDERAL RETIREMENT SYSTEMS

MAY 13, 1998

Mr. Chairman and members of the subcommittee:

Thank you for the opportunity to present my views on S1710, a proposal to correct erroneous enrollments in the Federal Retirement Systems.

I am an attorney affiliated with the Washington, D.C. law firm of Shaw, Bransford, & O'Rourke. In my law practice, I regularly represent both private sector businesses and individuals and employees of the federal government in tax, pension, and estate issues. I am currently representing a number of federal employees who were improperly placed in the Civil Service Retirement System ("CSRS") and later involuntarily transferred to the Federal Employees Retirement System ("FERS").

I first learned of this problem in the late summer or early autumn of 1996. Since that time, I have been contacted by approximately 50 federal employees who were erroneously placed in the wrong federal retirement system. All of the persons who have contacted me were incorrectly placed in the CSRS and have subsequently been transferred into the FERS.

The losses described to me relate to the fact that a FERS participant will receive a significantly smaller annuity than a person who participates in CSRS. Thus, it is more important for a FERS participant to contribute to the Thrift Savings Plan ("TSP") to assure an adequate retirement income. Employees who have been placed in the wrong retirement system have been deprived of the opportunity to intelligently plan for retirement.

I have had extensive discussions with the federal employees who have contacted me and with officials in a number of federal agencies. The affected employees describe a feeling of anguish and frustration. They want to fix the problem created by the erroneous classification, but they can't seem to find anybody who knows how to help them. The emotional toll on them has been significant. Two clients have suffered heart attacks. One client had a nervous breakdown that the Department of Labor determined was caused by the stress induced by this problem. Several clients have described problems in their marriages.

Agency personnel have for the most part been sympathetic, but they also have expressed frustration. They have studied the problem, but have come to the conclusion that existing laws do not permit them to grant a true, make whole remedy.

In an effort to seek compensation for the losses sustained by several of our clients, we filed administrative claims with their employing agencies and we also filed a lawsuit in the U. S. District Court for the District of Columbia, Garcia, et al. v. United States., Docket No. 97-1698(JR) . The agencies have denied the claims and the court dismissed the lawsuit because present law does not provide an adequate mechanism for compensating an individual for the losses he or she has sustained.

The only way to effectively resolve the problems created by an erroneous retirement classification is through legislation that clearly specifies what actions agencies may or must take to compensate employees who have suffered harm through no fault of their own. Any remedy that is enacted should also refrain from causing further harm.

I have been given the opportunity to review both the Senate (S1710) and the House (HR3249) proposals designed to correct the erroneous retirement classification problem. Both proposals take positive steps to address the problems caused by an erroneous retirement classification. In my view, HR3249 is preferable to the S1710 because it creates a mechanism for compensating an injured employee.

A common feature of both proposals is to allow affected individuals to elect coverage under the CSRS Offset program. I believe this feature should be included in any legislation that is ultimately enacted. It allows individuals who were erroneously placed in the CSRS (the situation with all of the individuals who have contacted me) to select retirement coverage that provides essentially the same retirement benefits they thought they would earn before they learned of the classification error.

S1710

S1710 is a commendable effort and will resolve many problems. If an employee has been improperly placed in the CSRS and has not been notified of the error, S1710 allows the individual to remain in essentially the same system as the employee had chosen.

S1710 is not fair to an individual who has been notified of the retirement classification error, removed from CSRS, and taken steps to mitigate the loss caused by the erroneous retirement classification. This proposal does not make such an employee whole, and it creates the possibility that the individual will be punished further.

When an individual received notice that he or she was improperly placed in the CSRS and was to be transferred to FERS, it would have been prudent for the employee

to make the maximum possible contributions to the TSP. Most of the individuals I represent have made make-up contributions to the extent their individual financial circumstances and the applicable statutory limits permit. S1710 will punish these individuals who acted in good faith to minimize the loss resulting from their agency's error.

Under S1710, an employee who has been improperly placed in the CSRS will be given the option of switching into the CSRS Offset or remaining in FERS. Regardless of which option the employee elects, he/she will suffer significant financial harm.

An employee who elects to remain in FERS, will forever lose the earnings on contributions that could have been made during the period of improper classification. If the employee elects to be covered by CSRS Offset, he or she must withdraw any contributions made to the TSP in excess of 5% per year and must also return any agency matching contributions. When the employee withdraws these excess contributions from the TSP, he or she will incur liability for income tax, and may also become liable for certain tax penalties. Thus, under the S1710, no matter which option the individual elects, he or she will be penalized and will incur an additional financial loss.

HR3249

HR3249 also offers affected individuals the opportunity to elect to be covered by CSRS Offset or to switch to FERS. As stated earlier, the option to elect CSRS Offset coverage is a desirable option because it allows an affected individual to receive benefits substantially equivalent to the benefits they thought they earned prior to being notified of the classification error.

Unlike S1710, HR3249 requires the agency who made the classification error in the first instance to bear the financial burden for correcting it. It requires Federal agencies to do precisely what any private sector employer would be required to do — compensate an innocent employee for the harm caused by the employer's error.

HR3249 attempts to make an affected individual whole and does not impose any additional financial burden. If an individual did make make-up contributions to the TSP after being notified of the classification error, he or she may simply leave these contributions (and all accrued earnings) in his or her TSP account. While the individual will forfeit any agency contributions, these contributions will be returned directly to the agency. No taxable distribution will be made to the individual and no tax or penalty will be payable.

This provision represents a reasonable compromise. It does not allow a person who elects to be covered by CSRS Offset to retain the benefit of agency contributions.

It also does not expose them to a tax penalty by forcing them to withdraw contributions they made to the TSP when they were notified that they had been placed in the wrong retirement system. We believe that S1710 should be modified to incorporate a similar mechanism. This will allow employees who made a good faith effort to minimize the losses caused by their agency's error to avoid further financial loss.

HR3249 also includes a reasonable and objective mechanism to make an affected employee whole for any contributions that could have been made to the TSP during the period of improper classification. The make whole mechanism in section 102(c) of the HR3249 bill prevents an affected individual from using hindsight to make TSP investment decisions. It also removes the financial burden of paying for the costs of correcting the classification error from the innocent employee to the agency that created the problem.

Suggested Modifications to S1710

While S1710 does take a number of positive steps, we believe that it should be modified to insure that affected employees do not suffer further economic harm because of their employer's error. As indicated above, we believe that, at a minimum, an employee who has been notified of the error and made make-up contributions to the TSP, should be allowed to leave all contributions and earnings on deposit in the TSP.

We also disagree with any provision that requires an employee to make any contributions to the OASDI portion of the Social Security Trust Fund. The Tax Code clearly specifies that an employer who fails to withhold and pay taxes into the Social Security Trust Fund bears the burden of correcting this error. The federal government should bear the same burden that it imposes on any other employer.

S1710 does not include a provision designed to compensate affected employees for all of the harm they have sustained as a result of an erroneous classification. Such losses include not only emotional stress, but economic losses sustained by employees who followed their agency's advice in trying to correct the classification problem (e.g., the cost incurred in selling a home in an effort to raise funds to make-up contributions to the TSP).

I recognize that the present proposals can not practically resolve every problem caused by retirement classification errors. The proposed bill should, however, clearly specify that affected individuals do have the right to pursue any individual damage claims they may have under such existing procedures as the Federal Tort Claims Act or the Back Pay Act. If they are successful in proving a claim, they should be allowed to recover all costs of pursuing the claim, including attorneys' fees, court and other costs, and expert witness fees in accordance with existing standards. Procedures for resolving such claims have been in existence for many years. These statutes include

administrative claims procedures, and judicial precedent is available to guide agencies in resolving any claim that may be made. If an affected individual does successfully pursue a claim, S1710 properly includes a mechanism for preventing an employee from being unjustly enriched.

This Subcommittee has heard or will hear testimony about the cost of correcting the erroneous retirement classification problem. While the cost of any legislation is a significant consideration, any cost incurred in correcting the problem should not be borne by the innocent employee who is the victim of the mistake.

Thank you for permitting me to present this written testimony to your Subcommittee on this matter of great importance to many federal employees.

EMBARGOED UNTIL 2 P.M. EDT
STATEMENT FOR THE RECORD
Text as Prepared for Delivery
May 13, 1998

TREASURY AGENCY RETIREMENT COUNSELOR LINDA OAKEY-HEMPHILL
SENATE GOVERNMENTAL AFFAIRS SUBCOMMITTEE ON INTERNATIONAL SECURITY, PROLIFERATION AND FEDERAL SERVICES

Mr. Chairman and Members of the Committee:

I am pleased to submit testimony concerning S.1710, a bill that provides for the correction of retirement coverage errors under Chapters 83 and 84 of Title 5 of the United States Code.

The Departmental Office of Personnel Policy, in which I work, is responsible for providing technical and policy guidance in the various personnel specialities, and serves as liaison with other agencies (such as the Office of Personnel Management) for the Department's 13 constituent bureaus. Our primary internal contacts are the bureau headquarters human resources staffs. I am the agency's designated Retirement Counselor and, as specified under Chapter 83, am responsible for the establishment of the retirement counseling program for the Department's 150,000 or so employees.

Erroneous retirement coverages have been a matter of growing concern during the past 14 years, since the implementation of the Social Security Act amendments that provided coverage for Federal employees. During that time, Treasury staff has attempted to act both responsibly as a Federal Executive Agency and with compassion for the affected employees. In light of Treasury's tax collection and financial management roles, our interest in resolving coverage issues has been particularly keen, and we have maintained a proactive posture commensurate with our interests when dealing with the issues associated with coverage errors.

Retirement coverage is based on each employee's unique service history and can be affected by any number of factors. Errors occur as the result of a combination of conditions, but largely because determining correct coverage is a complex process that has been further complicated by changes in statute and case law with which operating personnel offices have difficulty keeping up.

Presently, there is no completely reliable method that we can use to scan for coverage errors in our automated systems. Consequently, often neither the employee nor the agency is aware of the error until the employee retires, a pay change occurs, or some other triggering event

happens. It can be years before an error is detected, and it is not uncommon for an employee to transfer from agency to agency carrying an earlier error along.

We have long recognized erroneous retirement coverage to be a significant problem. In order to prevent coverage errors, we have tried a number of approaches within Treasury, including various types of training, personnel file reviews, and the use of centrally developed processing procedures. To minimize the negative impact on affected employees we have concentrated on improving the quality of our retirement counseling, and on keeping abreast of emerging legal issues related to correct coverage and correction of errors. Over the years, we also have worked cooperatively with other agencies and the Internal Revenue Service Office of the Chief Counsel to identify administrative solutions for affected employees, and to obtain guidance to ensure that coverage determinations based on new or unusual circumstances are performed correctly.

Unfortunately, we have found that despite this substantial effort and a high degree of good will and cooperation among the key agencies, the available administrative remedies for preventing and correcting coverage errors are not sufficient to stop them from occurring, or to make all affected employees whole with respect to their retirement and other financial planning. Accordingly, we have concluded that only legislation can help to repair the damage that we have been unable so far to prevent.

Above all, such legislation should provide equitable relief to the employees who have suffered the distress and inconvenience generally associated with an error in retirement coverage. It should give a choice between correcting the coverage, or having the opportunity to retain the benefits which the employee had expected to receive. However, it should not give a windfall or an unfair advantage to an employee who has had an error in coverage over an employee whose coverage has been correct throughout Federal employment.

The provisions of the law should not be complicated, difficult to understand, or to administer. The complexities involved in determining retirement coverage have not been understood well or in all cases implemented correctly by our personnel offices and, therefore, have resulted in errors. Consequently, every effort should be made to make the correction procedures as simple and as streamlined as possible so as to avoid compounding this serious problem.

We applaud all efforts to address this egregious situation. We believe that S.1710 conforms with our previously stated requirements, and could provide relief needed by both employees and their agencies. S.1710 has the additional advantage of close similarity to the Administration's error correction proposal which was circulated extensively throughout the Executive Branch. Agencies had the opportunity to provide input based on their consideration of the proposal in the context of real-life error correction situations and their capability for performing the corrective actions it would require.

There is only one brief remark that we wish to make concerning the bill's provisions for

Thrift Savings Plan (TSP) lost earnings on employee make up contributions. Currently, an employee may make up TSP contributions as part of the process for correcting retirement coverage and certain other agency administrative errors, such as a delay in participation. Under the present rules, lost earnings are paid on agency contributions, but not on the employee make up. S.1710 would pay lost earnings on employee make up contributions stemming from retirement coverage errors, but not those resulting from other types of administrative mistakes. It would be fairer to the employees and easier for agencies to administer if both groups were treated the same.

In closing, we hope that Congress will act quickly. Many employees and the personnel community are aware of Congressional interest in this area. Recently, because of the uncertainty about the shape that legislation will take, some personnel offices have expressed reluctance to correct an error when it is detected for fear that by doing so they will further disadvantage the employee. Moreover, there is a concern that the very labor intensive corrective action will have to be undone at a later date in response to new legislation. Employees, on the other hand, are anxious for a resolution to their dilemmas. They want to know what their options for the future will be and, until we have the tools to assist them that can be provided only by legislation, we are unable to advise them.

Thank you for the opportunity to participate in this important effort. Please be assured that regardless of the outcome of the legislative process we will continue to strive to prevent coverage errors, and to do our best to assist employees in understanding their retirement programs. I hope that these remarks are helpful to you. I will gladly provide any follow-up information that I can.

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STATEMENT OF
WILLIAM E. FLYNN, III, ASSOCIATE DIRECTOR
FOR RETIREMENT AND INSURANCE
OFFICE OF PERSONNEL MANAGEMENT

at a hearing of the

SUBCOMMITTEE ON INTERNATIONAL SECURITY, PROLIFERATION AND
FEDERAL SERVICES
COMMITTEE ON GOVERNMENTAL AFFAIRS
UNITED STATES SENATE

ON

THE RETIREMENT COVERAGE ERROR CORRECTION ACT OF 1998

MAY 13, 1998

MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE:

I AM PLEASED TO APPEAR TODAY TO DISCUSS THE SUBJECT OF ERRONEOUS ENROLLMENTS IN THE FEDERAL RETIREMENT SYSTEMS. AT TODAY'S HEARING, I WOULD LIKE TO SHARE WITH THE SUBCOMMITTEE OUR PERSPECTIVE ON THIS PROBLEM, AS WELL AS THE OBJECTIVES WE BELIEVE SHOULD BE ACHIEVED BY THE REMEDY TO THIS PROBLEM.

RETIREMENT COVERAGE ERRORS ARE GENERALLY THE RESULT OF THE DIFFICULTIES GOVERNMENT AGENCIES HAVE EXPERIENCED IN THE STILL-ONGOING TRANSITION THAT BEGAN IN 1984 FROM THE CIVIL

SERVICE RETIREMENT SYSTEM (CSRS) TO THE FEDERAL EMPLOYEES RETIREMENT SYSTEM (FERS). TWO SETS OF STATUTORY TRANSITION RULES MUST BE APPLIED IN THESE CASES. FIRST, EFFECTIVE IN 1984, CAME THE EXCEPTIONS TO THE UNIVERSAL SOCIAL SECURITY COVERAGE LEGISLATION INTENDED TO COVER FEDERAL EMPLOYEES UNDER SOCIAL SECURITY. THIS SET OF RULES WAS RETROACTIVELY AMENDED IN MID-1984 TO COVER SOME EMPLOYEES PREVIOUSLY EXCLUDED FROM SOCIAL SECURITY TAXES. THE GRANDFATHERING PROVISIONS OF THE FERS ACT OF 1986 COMPRISE THE SECOND SET OF TRANSITION RULES. FERS WAS DESIGNED TO COVER ALL EMPLOYEES HIRED AFTER 1983. THE EXCEPTIONS TO THESE RULES INVOLVED EMPLOYEES WHO WERE EXCLUDED FROM SOCIAL SECURITY OR MET ONE OF TWO VERSIONS OF A 5-YEAR SERVICE TEST IN THE LAW. ANOTHER IMPORTANT ASPECT OF THIS HISTORY IS THE CREATION OF A HYBRID SYSTEM KNOWN AS CSRS OFFSET, WHICH COMBINES CSRS AND SOCIAL SECURITY BENEFITS, AND WILL CONTINUE FOR THE DURATION OF THE TRANSITION.

FEDERAL AGENCIES MUST APPLY THE CURRENT RULES TO SELECT FOR EACH EMPLOYEE THE CORRECT RETIREMENT SYSTEM COVERAGE FROM AMONG FOUR POSSIBILITIES: CSRS, CSRS OFFSET, FERS, AND SOCIAL

SECURITY ONLY. WITH FOUR POSSIBLE COVERAGES, THERE ARE 12 POSSIBLE ERRONEOUS COVERAGE SITUATIONS, ALL OF WHICH HAVE ACTUALLY OCCURRED: FERS MISCLASSIFIED AS CSRS, FERS MISCLASSIFIED AS CSRS OFFSET, FERS MISCLASSIFIED AS SOCIAL SECURITY ONLY, CSRS MISCLASSIFIED AS CSRS OFFSET, AND SO ON. WHILE THE OVERWHELMING MAJORITY OF DETERMINATIONS MADE UNDER THESE LAWS HAVE BEEN DONE CORRECTLY, WE KNOW THAT ERRORS HAVE OCCURRED OVER THE YEARS.

THE LAW REQUIRES AGENCIES THAT FIND A MISTAKE IN AN EMPLOYEE'S RETIREMENT COVERAGE TO CORRECT IT. AN EMPLOYEE ERRONEOUSLY PLACED IN FERS, AT A TIME WHEN THE EMPLOYEE'S PROPER COVERAGE WOULD HAVE PROVIDED THE STATUTORY OPPORTUNITY TO ELECT FERS, MUST BE RETROACTIVELY PLACED IN THE CORRECTED COVERAGE, UNLESS THE EMPLOYEE EXERCISES THE FERS DEEMED ELECTION OPTION. WHERE THE LAW MANDATES FERS COVERAGE, BUT THE EMPLOYEE WAS ERRONEOUSLY PLACED IN CSRS OR CSRS OFFSET, THE ERROR MUST BE CORRECTED RETROACTIVELY BECAUSE EMPLOYEES DO NOT HAVE A RIGHT TO ELECT CSRS OR CSRS OFFSET.

THE LAW REQUIRES THAT, AFTER DISCOVERY OF A COVERAGE ERROR, AN EMPLOYEE'S DEFINED BENEFIT COVERAGE, INCLUDING SOCIAL SECURITY, BE FULLY CORRECTED WITH RETROACTIVE AMENDMENTS TO RETIREMENT RECORDS AND REALLOCATION OF EMPLOYEE AND AGENCY CONTRIBUTIONS. OF THE VARIOUS COVERAGE ERROR SITUATIONS, THEREFORE, THOSE THAT NEGATIVELY AFFECT THE EMPLOYEE'S DEFINED CONTRIBUTION PLAN PARTICIPATION ARE THOSE THAT MAY DISADVANTAGE THE EMPLOYEE. AN EMPLOYEE'S PARTICIPATION IN THE THRIFT SAVINGS PLAN (TSP) IS A MATTER OF PERSONAL CHOICE, AFFECTED BY THE EMPLOYEE'S AVAILABLE INCOME AND PERSONAL RETIREMENT PLANNING, WHICH IN TURN RELIES ON A CORRECT COVERAGE DETERMINATION.

IN 1989, THE COMPTROLLER GENERAL CONCLUDED THAT IN THE ABSENCE OF A STATUTORY AUTHORITY, AGENCIES WERE NOT ALLOWED TO PAY INTO EMPLOYEE TSP ACCOUNTS EARNINGS LOST DUE TO THE AGENCY'S DELAY IN MAKING TSP CONTRIBUTIONS. IN 1990, CONGRESS ADDRESSED THIS SITUATION. PUBLIC LAW 101-335 PROVIDED A REMEDY THAT, IN GENERAL TERMS, REQUIRES THE EMPLOYER TO DEPOSIT INTO THE TSP THE AMOUNTS AN EMPLOYEE WOULD HAVE RECEIVED IN THE WAY OF A GOVERNMENT

CONTRIBUTION AND EARNINGS ON THAT CONTRIBUTION, BUT FOR THE AGENCY'S ERROR. APART FROM THE 1 PERCENT GOVERNMENT CONTRIBUTION AND EARNINGS ON THAT AMOUNT WHICH MUST BE DEPOSITED FOR ALL FERS EMPLOYEES REGARDLESS OF WHETHER THE EMPLOYEE CONTRIBUTES, THE TOTAL AMOUNT OF THE AGENCY'S MAKE-UP CONTRIBUTION DEPENDS ON THE EMPLOYEE'S PAST CONTRIBUTIONS TO THE TSP AND HIS OR HER FUTURE SALARY WITHHOLDINGS TO MAKE-UP FOR THE PERIOD OF THE ERRONEOUS COVERAGE.

THIS APPROACH TO MAKING AN EMPLOYEE WHOLE FOLLOWING IDENTIFICATION OF A RETIREMENT COVERAGE ERROR HAS SIGNIFICANT GAPS. FOR EXAMPLE, BECAUSE THIS APPROACH RELIES ON FUTURE SALARY WITHHOLDINGS, AN EMPLOYEE WHOSE COVERAGE ERROR IS DISCOVERED UPON SEPARATION FROM SERVICE DOES NOT HAVE AN OPPORTUNITY TO MAKE UP LOST CONTRIBUTIONS. A SIMILAR PROBLEMS OCCURS FOR AN EMPLOYEE WHO DOES NOT HAVE INCOME AVAILABLE FOR THIS PURPOSE DURING THE PERIOD WHEN THE MAKE-UP CONTRIBUTIONS WOULD BE ALLOWED.

THE ADMINISTRATION BELIEVES THAT A COMPREHENSIVE SOLUTION IS ESSENTIAL, ONE THAT ADDRESSES SITUATIONS IN WHICH A LONG-TERM COVERAGE ERROR HAS BEEN CORRECTED IN THE PAST AS WELL AS THOSE IN WHICH THE ERROR HAS NOT YET BEEN DISCOVERED AND CORRECTED. WE STRONGLY BELIEVE THAT THE REMEDY SHOULD BE COMPLETE, AND THAT IT SHOULD EXPLICITLY DEAL WITH ALL SIGNIFICANT ISSUES, INCLUDING THE CASES OF EMPLOYEES WHO HAVE RETIRED OR DIED.

WE REALIZED FROM THE OUTSET THAT IT WOULD REQUIRE THE COOPERATION AND COORDINATION OF A NUMBER OF AGENCIES TO CRAFT A PROPOSAL THAT WOULD ACHIEVE THE DESIRED RESULT. IT WAS NECESSARY TO RESOLVE MANY COMPLEX AND DIFFICULT ISSUES. TO DO SO, WE WORKED CLOSELY WITH THE FEDERAL RETIREMENT THRIFT INVESTMENT BOARD, THE SOCIAL SECURITY ADMINISTRATION, AND THE TREASURY DEPARTMENT. THE ADMINISTRATION'S PROPOSAL REPRESENTS THE CONSENSUS POSITION THAT IS THE BEST WAY TO RESOLVE THE MYRIAD OF INTRICATE AND INTERTWINED ASPECTS OF THIS SITUATION.

AS NOTED IN OUR REPORT OF SEPTEMBER 9, 1997, ON RETIREMENT COVERAGE ERRORS, WE BELIEVE THAT, TO SUCCEED, THERE ARE FOUR SPECIFIC OBJECTIVES THAT ANY REMEDY MUST MEET.

- THE REMEDY SHOULD DEMONSTRATE THAT THE GOVERNMENT CARES ABOUT FEDERAL EMPLOYEES WHO HAVE BEEN DISADVANTAGED BY AN ERROR IN THEIR RETIREMENT COVERAGE, AND IS COMMITTED TO AN EQUITABLE SOLUTION FOR THESE EMPLOYEES AND THEIR FAMILIES.

- EMPLOYEES SHOULD HAVE A CHOICE BETWEEN CORRECTED COVERAGE AND THE BENEFIT THE EMPLOYEE EXPECTED TO RECEIVE, WITHOUT DISTURBING SOCIAL SECURITY COVERAGE LAWS.

- THE OPTIONS PROVIDED TO THE EMPLOYEE SHOULD BE EASY TO UNDERSTAND.

- FINALLY, WE WANT TO MINIMIZE ADMINISTRATIVE ASPECTS OF THE REMEDY IN ORDER TO KEEP THE SOLUTIONS SIMPLE AND TIMELY.

MR. CHAIRMAN, WE BELIEVE THE ADMINISTRATION PROPOSAL MEETS THESE OBJECTIVES. DURING OUR STUDY OF THIS MATTER, WE CONSIDERED THE OPTION OF PLACING INDIVIDUALS UNDER FERS AND MAKING A PAYMENT TO THE TSP, BUT REALIZED THERE WERE INTRACTABLE BASIC PROBLEMS THAT LIMIT THE FEASIBILITY OF THAT APPROACH. MORE IMPORTANTLY, WE CONCLUDED THAT THE APPROACH OF OFFERING CSRS OFFSET COVERAGE WOULD PROVIDE A MAKE-WHOLE SOLUTION TO AFFECTED INDIVIDUALS. UNDER THIS APPROACH, NO ONE WOULD GET LESS THAN THEY BELIEVED THEY WERE GOING TO RECEIVE.

MR. CHAIRMAN, THE BILL INTRODUCED BY YOU [SEN. COCHRAN] AND OTHERS -S. 1710-- IS LARGELY BASED ON THE ADMINISTRATION'S PROPOSAL. MOST IMPORTANTLY, BOTH IT AND THE ADMINISTRATION'S PROPOSAL WOULD PROVIDE A SOLUTION FOR ALL AFFECTED GROUPS, INCLUDING THOSE WHO HAVE ALREADY RETIRED, AND SURVIVORS OF EMPLOYEES WHO HAVE DIED. WHILE THERE ARE DIFFERENCES BETWEEN THE TWO PROPOSALS, I AM CONFIDENT THAT WE CAN WORK TOGETHER TO ACHIEVE AN ACCEPTABLE SOLUTION.

WE WORKED DILIGENTLY TO PRODUCE AN EQUITABLE REMEDY TO THIS DIFFICULT PROBLEM. HOWEVER, WE CANNOT MOVE FORWARD TO MAKE THAT REMEDY A REALITY UNTIL LEGISLATION IS ENACTED. OUR HOPE IS THAT WE CAN NOW MOVE FORWARD QUICKLY, SO WE CAN BEGIN THE REAL WORK OF ACTUALLY DELIVERING RELIEF TO ALL OF THOSE PEOPLE WHO HAVE BEEN ADVERSELY AFFECTED.

I HOPE THIS INFORMATION HAS BEEN HELPFUL AND I WILL BE GLAD TO ANSWER ANY QUESTIONS YOU MAY HAVE.

FOR RELEASE ON DELIVERY
Expected at 2:00 p.m.
May 13, 1998

STATEMENT OF THE HONORABLE ROGER W. MEHLE
EXECUTIVE DIRECTOR
FEDERAL RETIREMENT THRIFT INVESTMENT BOARD
BEFORE THE SENATE SUBCOMMITTEE ON INTERNATIONAL SECURITY,
PROLIFERATION, AND FEDERAL SERVICES
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Good afternoon, Mr. Chairman and members of the Subcommittee. My name is Roger Mehle, and I am the Executive Director of the Federal Retirement Thrift Investment Board. As such, I am the managing fiduciary of the Thrift Savings Plan (TSP) for Federal employees. I have been invited to present the Board's views on S. 1710, the Retirement Coverage Error Correction Act of 1998.

Background

The proposed legislation addresses the longstanding problem of retirement system coverage errors of what the Board understands may be thousands of Federal employees. Unfortunately, upon discovery of these coverage errors, the only legal avenue for agencies at present is to reclassify the affected individuals into the correct system, often entailing serious financial consequences and special problems for those about to separate from Federal service.

Early Board Action on Retirement System Coverage Errors

The Board first addressed the issue of coverage errors in April 1989 when it proposed legislation to authorize Federal agency payment to employees for earnings lost from agency failure to permit timely TSP employee contributions. At that time, the Board observed that allowing Federal Employees' Retirement System (FERS) employees misclassified to the Civil Service Retirement System (CSRS) for several years to remain covered by CSRS might be an equitable and practical solution to their predicament, although a policy choice not within the Board's role to advocate.

Present Proposals in General

In that regard, Mr. Chairman, both S. 1710 and H.R. 3249 -- comparable legislation pending in the House of Representatives -- wisely provide complete relief for such errors by allowing the affected employees to elect coverage under a retirement system virtually equivalent to CSRS, that is, CSRS-Offset. Since all such employees had much earlier, by law, already been offered and had rejected FERS coverage, absent any newly legislated inducements to do otherwise, practically all should opt for the retirement coverage which they always thought they had. It is difficult to conceive a more equitable and principled result, both for the employee and for the Government.

Both proposals, however, also permit employees misclassified as CSRS to select FERS coverage, thereby triggering makeup contributions and lost earnings procedures. To implement this choice, S. 1710 adopts the well understood makeup processes now used when TSP contributions are missed, either as a result of employing agency error or hiatus from civilian employment to perform military service. In contrast, H.R. 3249 would create special new error correction provisions, requiring complex new Board regulations and procedures to implement.

At this point, I should briefly describe existing error correction law and its rationale.

Existing Error Correction Law and Its Rationale

There are two statutory requirements upon which TSP correction procedures, including the calculation of lost earnings, are now based:

- First, while employee makeup contributions to the TSP are permitted, employing agencies make no payment of lost earnings on these contributions, provided they were not withheld from the employee's pay. The reasoning is that, because the agency failed to deduct the contributions, he or she had the use of the money for any purpose desired, and the agency therefore should not be required to reimburse the employee for putative "opportunity losses."
- Second, if an employee had not made a previous investment choice, lost earnings are to be calculated at the G Fund rate. Otherwise, the employee's investment choices of record are to be used to calculate lost earnings. The reasoning is that the G Fund will always provide a positive return; moreover, permitting an employee to hypothesize choices among the funds with the benefit of hindsight would give him or her an unwarranted benefit relative to other TSP contributors.

To aid in understanding these requirements and how they would change under S. 1710 and H.R. 3249, we have developed some examples and have provided them separately to Subcommittee staff.

S. 1710 and H.R. 3249 Error Correction Approaches

In permitting employees misclassified as CSRS to select FERS coverage and to make up "missed" contributions, S. 1710 retains the same lost earnings calculations currently embedded in TSP mainframe computer programs. Thus, error correction under S. 1710 could be accomplished immediately.

S. 1710 does authorize agency-paid lost earnings on makeup employee contributions, a benefit not in current law. However, lost earnings on employee contributions are now paid by agencies if, having withheld these contributions, they fail to forward them timely for investment. The computer programs that calculate such lost earnings can easily be applied to makeup contributions by misclassified employees who select FERS coverage.

In contrast, the legislation pending in the House would mandate an option radically different from existing law. Most notably, misclassified employees would no longer make up their own missed contributions. Instead, agencies would be required to pay an amount equal to a kind of proxy for missed employee contributions, as well as missed agency contributions, together with much differently calculated lost earnings on the whole.

Limited Board Purview

As a matter of longstanding practice, the Board takes no position on the appropriateness of benefit levels available under the various Federal retirement programs, including the benefit levels of the TSP. These are matters for the Congress and the Administration to debate and conclude. In my testimony before the House Subcommittee on Civil Service, however, I pointed out some significant and unsustainable administrative burdens for the Board created by H.R. 3249. (Collaterally, I mentioned what I then thought were other unintended consequences of the bill; I have since learned that they were intentional.)

TSP Administrative Burdens from the House Bill

There are practical limitations on the Board's ability to implement the error correction procedures of H.R. 3249, both in the manner and within the time it contemplates.

First, the Board is currently halfway through a complete redesign of its entire computer software system. The existing system is to be replaced by a state-of-the-art design to permit daily valuation of participant accounts, investment in two additional funds, and greatly improved service to participants. The resources of the Board and its record keeper, the National Finance Center of the U.S. Department of Agriculture, not devoted to new system design and current system maintenance are committed to the exigency of making the current system Year 2000 compliant.

The Board therefore would not be able to program or run the calculation of lost earnings called for by the House proposal, which is completely different from the calculations that would be used under S. 1710 or current law, on the mainframe computers at the National Finance Center. To do so would jeopardize both our current system integrity and our timetable for year-2000 compliance and new system implementation.

The Board, moreover, is not in a position, as contemplated by the House bill, to perform the new lost earnings calculations in some other way, nor is its record keeper. The potentially thousands of payroll and personnel records needed to do so, to say nothing of the myriad individual circumstances of misclassified employees, dictate that such calculations be accomplished by the employing agencies, with personal computer software and guidance furnished by the Board. This accords with current agency statutory responsibility for the calculation and correctness of TSP contributions submitted by the agencies for their employees.

Finally, one full year would be required to develop the new approach contemplated in the House bill, rather than the six months it would allow.

Chairman Mica invited the Board to submit legislative language that would resolve these concerns. We did so, but unfortunately the changes were not incorporated into H.R. 3249. Thus, the Board continues strongly to oppose the House bill.

Administrative Workability of the Senate Bill

The legislation being considered by this Subcommittee creates no administrative problems for the Board, nor, for that matter, should it do so for agencies as they correct retirement misclassification errors under it. Thus, we would be able to implement the TSP provisions of S. 1710 soon after its enactment.

We have appreciated the opportunity to work with your staff on this legislation. We look forward to working with the staff and members of the Subcommittee in the future.

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Thank you, Mr. Chairman. That concludes my remarks. I would be pleased to answer any questions.

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Senate Committee on Governmental Affairs

Subcommittee on International Security, Proliferation, and Federal Services

Hearing on Proposals to Correct Federal Retirement Coverage Errors

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Summary

I was asked to provide information today on private-sector practices in the pension area, as it relates to the proposals before the Committee in S.1710.

- The first set of questions upon which I was asked to comment dealt with a private plan sponsor's ability to simultaneously (1) pay employer catch-up contributions, (2) pay employee catch-up contributions and (3) assume that these contributions had been invested in a diversified portfolio, including, equities, to account for "lost" investment earnings. Although certain participant-specific and planwide constraints may limit the extent to which a private sponsor can engage in this behavior, it does not appear that the sponsor is prohibited from making such contributions. We have not been able to identify data, however, on when it has occurred, as it is not a common practice.

- The second set of questions dealt with the issue that some federal employees were given a chance to switch plans in the past and did not. There is now discussion that the government may reopen the opportunity since the markets have done so well. I am not personally aware of private plan sponsors that provide this type of flexibility and given the various regulatory constraints detailed in my full submission, qualification of such an approach may prove to be problematic. Given the ability this would present for employees to in essence exercise a financial option against their employers, I believe it is fair to characterize this as a plan design that would be considered quite "extreme" by private employers.

- The first element that needs to be considered is what happens to the benefit accrued under the defined benefit plan employees were thought to have been participating in. If it is decided that they have a legal claim to such a benefit, then the increased value of this benefit vis-à-vis the smaller value under the defined benefit plan for new hires should be deducted from the gross claim that is determined under the defined contribution plans. If it is decided that the claim does not exist since they were never participants, then no further action is needed to net out this value.

- Determining the employer's retroactive obligation to the misclassified employee under the defined contribution plan requires several assumptions. In each case, the "correct" assumption will likely depend on the interpretation of equity.

- The nonelective contribution to the employees is probably the easiest element to agree on. Since this amount would have been accumulated in the employee's account but for the misclassification (regardless of his or her own contribution behavior), it is difficult to construct an argument under which it would not be equitable for this to be a requirement for the employer.

- The matching rate for the employer is also fairly easy to agree on; however, should it be assumed that the employee would necessarily have contributed a sufficient amount of his or her compensation to receive the maximum match?

- Perhaps the most complicated assumption in this determination would be the participant's asset allocation. If one were to assume the employee should be rewarded for risk that was not actually taken (since investments were not actually made), presumably the employer can rely on the actual historical fund performances to determine the rate of return for each component; however, the total investment income would be based to a large extent on how aggressively the participant would have invested his or her defined contribution balances. To attribute an average asset allocation to participants would create both winners and losers. Based upon data that EBRI has developed, the range of actual allocations is very broad.

- Once the decision for the correct asset allocation assumption is made, there will likely be little disagreement on its application to assets that would have been generated from nonelective contributions and matching contributions. However, the equitable treatment of investment income for employee contributions is likely to be more problematic.

Mr. Chairman and members of the Committee. I am Dallas L. Salisbury, President and CEO of the Employee Benefit Research Institute (EBRI), a nonprofit research and education organization located in Washington, DC. EBRI does not lobby, advocate policy positions, and in the past two years has not had any contracts with the government. Thank you for the opportunity to testify today. EBRI had the pleasure of sponsoring a series of forums with this Committee in the early 1980s as it did its initial work that led to creation of the Federal Employees' Retirement System (FERS). In addition to my testimony today, I ask that the two *EBRI Issue Briefs* submitted to the Subcommittee be entered into the record.

I was asked to provide information today on private-sector practices in the pension area, as it relates to the proposals before the Committee in S.1710.

The fact that we are not permitted to take a position on pending legislation constrains, to a certain degree, the type of testimony I am able to provide in this matter. However, I hope to be of assistance to the committee by framing some of the issues in terms of their private-sector analogy. Although we need to be mindful of the different environments and constraints under which these plans operate, the various ways in which employers may respond to competing objectives may be of use in future deliberations with respect to this legislation.

The first set of questions on which I was asked to comment dealt with a private plan sponsor's ability to simultaneously (1) pay employer catch-up contributions; (2) pay employee catch-up contributions; and (3) assume that the contributions had been invested in a diversified portfolio, including, equities, which included all "lost" investment earnings. Although certain participant-specific[1] and planwide[2] constraints may limit the extent to which a private sponsor can engage in this behavior, it does not appear that the sponsor is prohibited from making such contributions. In fact, the Reish & Luftman law firm[3] specifically provides the following commentary for a hypothetical situation in which the sponsor of a profit-sharing plan under which employer contributions are geared to participant compensation provides incorrect contributions due to data entry errors:

> One alternative would be for the plan to be "readministered" in accordance with its terms. That is, the contribution, plus the amount which had been earned on those contributions, would be reallocated among the participant accounts to reflect the correct compensation.
>
> The other approach would be for the employer to make an additional contribution to the plan so that, based on the correct compensation data, each participant would have a contribution equal to the same percentage of pay. In this case, the employer would also need to add earnings to the contribution.

They point out that Revenue Procedure 98-22 contains a number of principles applicable to the correction of a misallocation for private plan sponsors. With respect to question 3 above, they specifically make the following two points:

> Corrective allocations should be based on the terms of the plan at the time of the error and should be adjusted for earnings and forfeitures that would have been allocated if the failure had not occurred. The Revenue Procedure states that "corrective allocations *need not* be adjusted for losses."
>
> Where a plan permits participant-directed investments, rather than calculating the actual earnings for each participant based on his or her actual investment mix, **it is permissible to use the investment**

option with the highest earnings rate for a particular year (emphasis added), so long as most of the participants receiving a corrective allocation are non-HCEs.

Although we have no way of identifying cases in which a sponsor of a private plan has voluntarily performed the three actions above, there have been other documented cases in which some sponsors have used corporate assets to provide additional contributions to participants who have been potentially impacted by the misfortunes of insurance companies that had issued guaranteed investment contracts (GICs) to the sponsors' defined contribution plan. Although these were voluntary events, it should be noted that class-action suits had already been filed against at least one other plan sponsor holding an Executive Life GIC in 1991. Therefore, these events may not appear "extreme" to other private employers.

The second set of questions dealt with the issue that some federal employees were given a chance to switch plans in the past and did not, and there is now discussion that the government may reopen the opportunity since the markets have done so well. I am not personally aware of private plan sponsors that provide this type of flexibility[4] and given the various regulatory constraints alluded to above, qualification of such an approach may prove to be problematic. Given the ability this would present for employees to, in essence, exercise a financial option against their employers, I believe it is fair to characterize this as a plan design that would be considered quite "extreme" by private employers.

The question as to what the employer's equitable response should be in such a situation still remains unanswered. I would like to abstract from the constraints imposed on private sponsors for a few minutes and consider how competing objectives might be satisfied.

For simplicity, let me assume that we have an employer that was once sponsoring only a contributory defined benefit plan and that the participants were not included in Social Security. Further, assume that the generosity of the defined benefit plan has been significantly reduced for participants hired after some threshold date, but that their combined contribution to Social Security and the new defined benefit plan is exactly the same as it was under the previous arrangement. As a quid pro quo, the sponsor has decided to set up a participant-directed defined contribution plan with two components: a first part consisting of a nonelective employer contribution that will be contributed for all newly hired employees and a second part that matches the employee's contribution up to some specified percentage of compensation. Finally, as a result of some type of clerical error, assume that some employees hired after the threshold date had mistakenly been told they were in the defined benefit plan (and thus did not make any contributions to the defined contribution plan, whether or not they would have made them if they had been assigned to the correct plan).

The first element that needs to be considered is what happens to the benefit accrued under the defined benefit plan the employees were thought to have been participating in. If it is decided that they have a legal claim to such a benefit, then the increased value of this benefit vis-à-vis the smaller value under the defined benefit plan for new hires should be deducted from the gross claim that is determined under the defined contribution plans.[5] If it is decided that the claim does not exist since they were never participants then no further action is needed to net out this value.

Determining the employer's retroactive obligation to the misclassified employee under the defined contribution plan requires several assumptions. In each case, the "correct" assumption will likely depend on the interpretation of equity.

The nonelective contribution to the employee is probably the easiest element to agree on. Since this amount would have been accumulated in the employee's account but for the misclassification (regardless of his or her own contribution behavior), it is difficult to construct an argument under which it would not be equitable for this to be a requirement for the employer.

The matching rate for the employer is also fairly easy to agree on; however, should it be assumed that the employee would necessarily have contributed a sufficient amount of his or her compensation to receive the maximum match? EBRI studies of the 401(k) market[6] suggest that while many employees contribute just enough to maximize the employer's match, a significant percentage of eligible employees contribute less than that amount (if anything at all). Unfortunately, this leaves policymakers with the Solomonesque decision of either (1) ensuring that no employee receives less of a match than they would have received had they contributed a sufficient amount to ensure the maximum match (in which case the employer pays more than it would have expected to contribute)[7] or (2) having the employer provide matching contributions based on some average contribution rate (presumably determined from those employees that were correctly classified) with the result that some employees would likely end up with a smaller match than they otherwise would have had.[8]

Perhaps the most complicated assumption in this determination would be the participant's asset allocation. If one were to assume[9] the employee should be rewarded for risk that was not actually taken (since investments were not actually made), presumably the employer can rely on the actual historical fund performances to determine the rate of return for each component; however, the total investment income would be based to a large extent on how aggressively the participant would have invested his or her defined contribution balances. To attribute an average asset allocation to participants would create both winners and losers. Based on data that EBRI has developed, the range of actual allocations is very broad.[10] Depending on the sponsor studied, between 20 percent and 37 percent of participants put no money into equities, between 10 percent and 21 percent put all of the 401(k) money into equities, and the remaining participants are spread across a range, as shown by tables 1–3. It is important to note, however, that these aggregate percentages mask significant age, gender, wage and tenure effects. They also mask important investment menu impacts as well as strong influences from the participant direction (or lack thereof) of matching employer contributions.[11]

Once the decision for the correct asset allocation assumption is made, there will likely be little disagreement on its application to assets that would have been generated from nonelective contributions and matching contributions. However, the equitable treatment of investment income for employee contributions is likely to be more problematic. On one hand, employees can argue that they would have earned investment income on the contributions they made (if any) but, at the same time, the employer can correctly make the case that, since the employees did not actually have to contribute these funds to the plan in the intervening years, they had the opportunity to earn investment income outside of the plan. Mitigating this argument to some extent is the fact that the participants have been denied the ability to benefit from the tax-advantaged treatment of the plan's trust during this time.

One of the assumptions made above was that employees who did not actually subject themselves to market risk (since the hypothetical employer did not allow them into the defined contribution plan) would actually be rewarded with some type of market-related rate of return that included at least a portion of the rate of return available through equities. There are those who might take exception to rewarding employees for what in essence was a risk-free investment (ex post). In fact, in a recent case involving the purchase of a series of Executive Life GICs by Unisys[12] for its 401(k) plans, the finance professor used as the damages expert for the plaintiffs testified that he adopted the triple-A Solomon Brothers bond index to determine the damages owed to participants after the expiration of the contracts, without having made actual inquiry into the participants' investment strategies and propensities. Even though some class representatives put the money return from Executive Life into equity investments, the alleged damages were computed based on assumptions much closer to a risk-free rate of return. In other words, if there appears—to at least some professionals—to be a basis for adopting a 100 percent bond rate of return in a situation where the participant's actual asset allocation decisions are available, then certainly some may feel that in those cases where there are no observed investment choices for employees that were misclassified, the rationale for an all-bond rate of return would be even stronger.

In conclusion, let me restate that we have attempted to respond to the request for analysis, albeit in a philosophical as opposed to an empirical mode. We do not take positions on any of it or make legislative action recommendations. However, the database mentioned above would put us in the unique position to assist the Committee if they choose to provide a more refined analysis of the participants' likely asset allocation during this time had they been given the opportunity to invest their own contributions and those of the employer. Thank you for allowing me the opportunity to testify today.

Endnotes

[1] Annual limits on additions to defined contribution plans in general and elective contributions specifically are set forth in Internal Revenue Code (IRC) Sections 415(c) and 402(g), respectively

[2] IRC Section 401(a)(4) makes it problematic to have a contribution scheme that provides a higher percentage of compensation for "highly compensated employees." In general, these are employees earning in excess of $80,000, although specific guidance may be found in IRC Section 414(q). It should be noted that certain types of private defined contribution plans may provide for a limited amount of disparity between the contribution rates of highly compensated employees and their lower paid counterparts as long as it does not exceed the limitations specified in IRC Section 401(l).

[3] Fred Reish, Bruce Ashton, and Nick White, "Misallocations Resulting From Calculation Errors" Q&A: Plan Defects. URL:http://www.benefitslink.com/benefits-bin/qa.cgi?mode=list&database=qa_plandefects (23 March 1998)

[4] Note, however, that university plans may provide some type of initial choice for the participants. For example, Robert L. Clark, Loretta Harper, and M. Melinda Pitts recently authored an article in TIAA-CREF's *Research Dialogues* (Issue Number 50, March 1997) titled "Faculty Pension Choices in a Public Institution: Defined Benefit and Defined Contribution Plans" in which they found, for the most part, academic institutions can be divided into three groups with respect to the primary retirement plans offered employees: (1) private institutions that require newly hired faculty to enroll in a defined contribution pension plan; (2) public institutions that require faculty to enroll in a defined benefit pension plan sponsored by a state or local government; and (3) public institutions that give newly hired faculty a choice of enrolling in a public retirement plan or one of several defined contribution plans approved by the institution.

[5] This assumes that the claim under the defined contribution plan is larger than that under the defined benefit plan (a high probability event under some of the scenarios below given the recent performance in the financial markets). If this is not the case, the employee may simply be given the opportunity to take whichever benefit is greater: that already earned under the defined benefit plan or that which would have been accumulated under the defined contribution plan.

[6] Paul J. Yakoboski and Jack L. VanDerhei, "Contribution Rates and Plan Features: An Analysis of Large 401(k)

Plan Data" EBRI Issue Brief #174, June 1996.

7 In a recent court case (*Garcia v. U.S.*, DC DC, No. 97-1698, 3/9/98) workers alleged they suffered additional losses in that they were deprived of the "right to plan intelligently for retirement." Had they been correctly placed in FERS when they should have been, they said, they would have made greater contributions to the Thrift Savings Plan (TSP).

8 Of course, this is offset by the fact that other employees receive more than they otherwise would have received if they had been given the choice of how much (if any) of their compensation they would contribute.

9 The potential impact of not making this assumption is explored below.

10 Paul J. Yakoboski and Jack L. VanDerhei, "Worker Investment Decisions: An Analysis of Large 401(k) Plan Data" *EBRI Issue Brief* no.176, Employee Benefit Research Institute, August 1996.

11 EBRI has undertaken a collaborative effort with the Investment Company Institute to attempt to scientifically analyze the asset allocation, contribution, participation, and loan and withdrawal decisions of 401(k) participants. A forthcoming joint publication will focus on participant level data from more than 30,000 401(k) plans.

12 *In re Unisys Savings Plan Litigation*, DC E.Pa, No. 91-3067, 11/24/97.

Table 1

Allocation Distributions of Participant Account Balances, Company A Retirement Savings Plan, 1994

	Nonequity Investments				Equity Investments				Company A Stock			
	Zero	<20%	20%–80%	80%+	Zero	<20%	20%–80%	80%+	Zero	<20%	20%–80%	80%+
Total	15.4%	12.8%	42.5%	29.3%	20.9%	13.5%	44.6%	21.1%	77.4%	11.8%	8.6%	2.1%
Age												
20–29	19.6	16.3	44.4	19.7	16.9	7.4	48.7	27.0	71.7	16.3	10.1	1.9
30–39	15.2	14.0	45.0	25.8	18.3	12.1	47.8	21.7	76.4	12.9	8.7	2.0
40–49	14.7	11.7	41.2	32.5	23.2	14.6	42.6	19.5	78.8	10.8	8.2	2.3
50–59	16.3	11.3	38.9	33.6	22.7	16.6	40.0	20.7	79.0	10.1	8.6	2.3
60 and over	14.2	9.1	32.3	44.4	33.1	16.0	32.0	18.9	86.2	5.7	6.2	1.9
Salary												
$10,000–$19,999	10.6	6.0	34.3	49.1	40.8	13.6	34.3	11.3	78.1	12.8	6.5	2.5
$20,000–$29,999	9.2	7.4	33.9	49.5	41.2	13.1	33.8	11.8	82.3	9.4	6.5	1.8
$30,000–$39,999	12.2	10.6	38.9	38.3	28.7	14.4	40.2	16.6	79.1	11.4	7.4	2.1
$40,000–$49,999	15.5	13.0	43.5	28.0	19.4	13.7	45.7	21.1	76.6	12.7	8.6	2.2
$50,000–$59,999	17.1	14.1	44.7	24.1	16.5	12.7	47.3	23.6	76.6	12.4	8.7	2.2
$60,000–$74,999	17.3	14.6	45.3	22.8	14.8	13.0	48.1	24.1	76.3	12.0	9.6	2.1
$75,000–$99,999	18.4	14.7	44.4	22.4	14.0	13.8	47.3	24.9	76.3	11.9	9.7	2.1
$100,000 or more	19.9	14.2	44.2	21.6	14.2	13.3	47.2	25.3	76.0	11.2	10.3	2.5
Tenure												
2 years or less	24.0	10.4	28.0	37.6	39.0	4.1	33.9	23.1	73.3	11.1	13.2	2.5
2+ years–5 years	23.2	16.4	40.6	19.8	19.4	6.7	45.7	28.3	68.6	15.8	12.2	3.4
5+ years–10 years	18.2	15.0	46.1	20.7	16.2	9.3	49.7	24.9	74.3	14.3	9.3	2.1
10+ years–15 years	13.4	13.0	44.2	29.3	20.1	13.8	46.2	19.9	78.9	11.6	7.5	2.0
15+ years–25 years	13.5	11.8	41.7	33.0	22.5	15.6	43.1	18.9	79.2	10.9	8.0	1.9
Over 25 years	16.3	11.5	40.3	31.9	20.9	16.9	41.4	20.8	78.1	10.7	9.0	2.3
Gender												
Male	16.5	13.4	42.2	27.8	20.0	13.6	44.7	21.6	75.6	12.1	9.8	2.6
Female	12.7	11.2	43.1	32.9	22.9	13.1	44.3	19.6	82.1	11.2	5.6	1.1
Marital Status												
Single	15.3	12.7	42.3	29.7	22.1	12.1	44.6	21.3	77.9	12.3	7.9	2.0
Married	15.5	12.9	42.6	29.1	20.5	13.9	44.7	21.0	77.3	11.8	8.8	2.2
Unknown	12.4	9.4	36.6	41.6	30.6	15.4	36.6	17.5	82.1	9.7	6.7	1.6
Race												
White	15.7	12.9	42.6	28.8	20.2	13.5	44.8	21.4	77.9	11.6	8.5	2.1
Nonwhite	14.4	12.2	41.8	31.6	24.0	13.2	43.5	19.2	75.4	13.3	9.0	2.3

Source: Employee Benefit Research Institute.

Table2

Allocation Distributions of Participant Contributions, Company B Retirement Savings Plan, 1994

	Nonequity Investments				Equity Investments			
	Zero	<20%	20%–80%	80%+	Zero	<20%	20%–80%	80%+
Total	12.3%	8.6%	47.4%	31.7%	25.4%	7.1%	47.8%	19.7%
Age								
20–29	15.2	11.2	47.9	25.7	19.8	7.4	48.5	24.3
30–39	13.0	10.6	50.7	25.6	20.0	6.5	51.5	22.0
40–49	12.3	9.0	47.1	31.6	24.9	7.5	47.5	20.2
50–59	11.6	5.0	45.5	38.0	31.7	6.7	45.5	16.1
60 and over	4.8	0.5	31.4	63.3	55.2	8.1	31.4	5.2
Salary								
$10,000–$19,999	18.1	8.1	40.0	33.7	30.4	4.1	39.6	25.9
$20,000–$29,999	10.9	5.6	46.4	37.2	32.2	6.1	46.5	15.2
$30,000–$39,999	11.1	8.1	46.5	34.3	27.7	7.8	46.1	18.4
$40,000–$49,999	13.5	9.9	46.7	29.9	22.9	7.8	47.6	21.7
$50,000–$59,999	11.7	8.0	51.0	29.3	22.0	7.6	51.5	18.8
$60,000–$74,999	15.4	9.7	51.5	23.4	17.5	6.4	52.8	23.2
$75,000–$99,999	15.1	15.4	44.5	25.0	18.0	7.4	46.0	28.7
$100,000 or more	7.8	10.8	50.0	31.5	23.4	8.1	51.1	17.5
Tenure								
2 years or less	27.4	12.8	40.9	18.9	16.1	3.0	41.5	39.3
2+ years–5 years	16.8	10.6	46.2	26.4	21.1	6.3	47.1	25.5
5+ years–10 years	11.0	9.0	50.2	29.8	23.9	6.8	50.6	18.6
10+ years–15 years	9.2	8.5	50.0	32.3	24.8	8.4	50.4	16.4
15+ years–25 years	7.8	6.4	49.2	36.6	28.4	8.7	49.4	13.4
Over 25 years	7.2	4.8	41.1	46.9	40.5	7.2	40.9	11.4
Gender								
Male	15.9	11.3	45.6	27.2	21.7	6.0	46.9	25.4
Female	9.9	6.7	48.6	34.8	28.1	7.8	48.4	15.7
Marital Status								
Single	11.5	8.8	47.6	32.2	25.5	7.8	47.6	19.2
Married	13.0	8.9	47.4	30.7	24.9	6.5	48.1	20.5
Unknown	10.3	3.8	45.1	40.8	32.4	9.4	44.6	13.6
Race								
White	13.9	9.2	47.7	29.2	23.7	6.3	48.3	21.7
Nonwhite	7.2	6.6	46.2	40.0	31.1	9.7	46.0	13.2

Source: Employee Benefit Research Institute.

Table3

Allocation Distributions of Participant Account Balances, Company C Retirement Savings Plan, 1994

	Equities				Nonequities				Employer Stock			
	Zero	<20%	20%–80%	80%+	Zero	<20%	20%–80%	80%+	Zero	<20%	20%–80%	80%+
Total	37.0%	11.3%	41.6%	10.1%	45.0%	11.4%	31.9%	11.6%	19.9%	10.4%	49.8%	19.9%
Age												
20–29	28.1	6.8	51.2	13.8	57.2	10.7	25.9	6.2	17.2	9.2	57.2	16.4
30–39	34.0	10.7	44.7	10.7	44.8	12.4	32.5	10.3	18.7	10.8	53.2	17.3
40–49	40.2	11.7	38.7	9.4	44.4	11.6	31.4	12.5	20.2	9.8	48.0	22.0
50–59	39.4	13.6	38.0	9.0	41.8	9.8	34.1	14.2	22.6	11.0	44.6	21.8
60 and over	41.6	15.3	34.5	8.6	32.1	8.2	40.4	19.2	28.8	13.8	40.7	16.7
Salary												
$10,000–$19,999	29.3	6.5	39.9	24.3	61.6	10.5	22.3	5.6	23.6	11.4	48.4	16.6
$20,000–$29,999	39.1	5.2	39.8	15.9	56.5	7.7	25.0	10.9	23.2	9.7	47.2	19.9
$30,000–$39,999	47.3	8.7	34.0	9.9	45.0	8.6	30.3	16.1	23.2	8.6	46.9	21.3
$40,000–$49,999	44.4	9.8	36.8	9.0	45.7	9.6	31.2	13.5	20.4	8.4	49.3	21.9
$50,000–$59,999	41.6	11.5	37.9	9.8	46.0	11.0	31.0	11.9	18.4	9.3	49.6	22.7
$60,000–$74,999	34.1	12.5	43.6	9.8	45.2	12.4	31.7	10.6	18.3	10.9	51.1	19.7
$75,000–$99,999	28.1	12.3	48.4	11.2	42.6	13.3	34.0	10.0	20.3	12.4	51.4	15.9
$100,000 or more	21.0	11.7	54.3	13.0	37.3	13.4	38.8	10.4	27.9	14.9	46.2	11.0
Tenure												
2 years or less	21.3	2.6	54.2	21.9	71.7	6.3	18.8	3.2	22.1	8.8	53.2	15.9
2+ years–5 years	26.4	6.6	53.1	13.9	59.1	10.4	25.2	5.3	18.1	7.8	56.5	17.6
5+ years–10 years	33.2	10.2	45.6	10.9	43.7	12.7	33.3	10.3	19.3	10.9	53.8	16.0
10+ years–15 years	36.2	12.7	41.9	9.2	40.1	12.2	35.3	12.3	19.2	11.5	52.0	17.3
15+ years–25 years	42.2	12.3	37.1	8.4	43.2	11.9	31.6	13.3	19.5	10.2	47.4	22.9
Over 25 years	41.7	13.0	36.3	8.9	43.7	10.0	32.3	14.0	22.4	10.1	43.3	24.2
Gender												
Male	37.3	11.3	41.2	10.2	47.1	11.1	30.5	11.3	20.2	10.1	47.9	21.8
Female	36.5	11.2	42.3	10.0	41.5	11.9	34.3	12.1	19.5	10.8	53.2	16.5
Race												
White	36.4	11.4	41.7	10.6	45.5	11.4	31.5	11.6	20.4	10.5	49.1	20.0
Nonwhite	39.7	10.8	41.3	8.2	42.8	11.8	33.7	11.6	17.7	9.6	53.1	19.6

Source: Employee Benefit Research Institute.

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Statement of Mr. Daniel F. Geisler, President
The American Foreign Service Association
Before the Senate Subcommittee on International Security, Proliferation and Federal Services

May 13, 1998

Mr. Chairman and Members of the Subcommittee:

My name is Dan Geisler, and I am the President of the American Foreign Service Association (AFSA). AFSA is the professional organization representing about 23,000 active duty and retired foreign service officers and specialists. We also serve a labor function. AFSA is the recognized bargaining agent for active duty foreign service personnel in five government agencies: the State Department, the Agency for International Development, the United States Information Agency, the Foreign Commercial Service of the Department of Commerce, and the United States Department of Agriculture's Foreign Agricultural Service.

We thank you for this opportunity to testify before the Subcommittee and wish to express our appreciation for your efforts in trying to correct problems resulting from federal employees, through no fault of their own, being placed in the wrong retirement system. As you know, Mr. Chairman, the House Civil Service Subcommittee, through hearings last year, had the opportunity to hear what happens when a career Civil Service employee is placed in the wrong retirement system. Those cases are well known, and I need not repeat them here. Our Foreign Service men and women suffer

the same consequences. Our numbers are much smaller, but the human consequences are the same. We have alerted our members to the problem, asking them to tell us if they think they have been miscategorized, while warning them that if their agency discovers the error, it must take corrective action immediately using existing statutory authority. So far, the numbers are modest, so we do not anticipate a large-scale corrective effort will be needed in the Foreign Service agencies. But for the individuals who have contacted us, the effects can be dramatic.

I personally experienced just the sort of mistake your bill and Congressman Mica's bill are designed to correct. I began my government career in 1984 as a young engineer in the Civil Service. I was 29 years old, and for me retirement was infinitely far off. I was told that the federal retirement system was undergoing change, and that I was being placed in an interim program. Three years later I was a Foreign Service Officer serving abroad. We were sent information about the new retirement program, the Foreign Service Pension System (FSPS), and I was told that I would automatically be transferred into it.

In November of 1987 I received my first bi-annual statement from the Thrift Savings Plan (TSP) and saw that I hadn't received any government matching funds. I went to the embassy's administrative office and was told that I was still under the interim system, the FSRDS Offset plan. Fortunately for me and my family, we were able to correct the mistake before I suffered any further loss. But others have not been so lucky.

The mistake is easy to understand when you consider the nature of the Foreign

Service. Retirement issues are handled by a unit in Washington staffed by professionals who works with the details daily. Embassies abroad usually don't have a similar level of expertise. For those of us in the field, most retirement questions are referred back to Washington for an answer. Getting authoritative information on individual questions is difficult. Back in 1987 when the big changes were taking place, it was even harder -- this was before we had fax machines or e-mail. International phone calls were extremely expensive, and in many of our posts the connections were erratic.

Today, it may be a bit easier to get information needed to rectify a misclassification. But reclassifying by itself doesn't repair the damage and thus we meet to discuss the problems that give rise to your bill and that of Mr. Mica's.

Mr. Chairman, AFSA believes that corrective legislation should contain three features.

First, it should include the Foreign Service. Congressman Mica has graciously included the Foreign Service in his bill, H.R. 3249. As you markup your bill, Mr. Chairman, we ask similar consideration.

Second, employees who are victims of administrative error should have real options. Some will find that their retirement needs cannot be met by the new system (FSPS), and they should be allowed to remain in the FSRDS or FSRDS-Offset plan. Others will find their needs better met by FSPS. They should be allowed to choose which system is best for them. AFSA has noted that both your bill, Mr. Chairman, and Mr. Mica's bill provides options and we appreciate this.

Third, the options should be financially viable. In particular, this means providing corrective measures for employees who opt for the new system. It seems that it is at this point that your bill and Mr. Mica's bill diverge. AFSA believes, as I am sure you and Mr. Mica believe, that the U.S. Government should not deny a financially viable retirement to employees who have been the victim of administrative error. Clearly, retiring under the FSPS without a healthy balance in the TSP is not financially viable, and could limit the realistic options available to a victim of this administrative error.

Let me give you a real-life example. A few months ago, AFSA received an e-mail from a Foreign Service Officer in a developing country. His agency told him that he had been in the wrong retirement system since January 1, 1987, and they were obliged to switch him from the old interim system (FSRDS-Offset) to the new system (FSPS). He was also informed of available corrective measures -- an automatic 1% agency contribution, and the option to make retroactive payments and receive matching contributions to the Thrift Savings Plan (TSP). He wrote:

> "... provisions are needed that are applicable specifically to ... provide some relief on both the size and timing of the retroactive employee contributions. Clearly, in order to obtain the benefits that would have accrued to me, it is not fair to ask me to make full contributions of between $65,000 to $75,000 today (or even in the course of the next several years) that would have been made gradually and in a fashion planned to mesh with other family expenses over the past ten year period. ... these contributions would be additional to those non-retroactive contributions that I would want to make over the course of the upcoming years to the TSP and, hence, would be particularly burdensome from a cash flow perspective for me and my family."

The effect on this Foreign Service Officer is clear. People involuntarily switched

from the old to the new system late in their careers can't accumulate a sufficient TSP balance to ensure a stable retirement unless they can quickly make up a decade's worth of employee contributions. Even then, the employee loses out on the TSP growth that would have been experienced had the agency got it right the first time.

Further Mr. Chairman, those who don't have as much discretionary income, those in support positions for instance, could find it difficult, if not impossible, to contribute years of foregone employee contributions are left with inadequate retirement coverage. In testimony before the Civil Service Subcommittee of the House, the mistake of placing the employee in the wrong retirement system has been estimated as costing the employee tens of thousands of dollars over the rest of their lives. In the Foreign Service's "Up-or-out" personnel system, many of our employees retire when they are in their fifties, and still have children in college. They should not be asked to choose between their retirement and their children's education because the rules were changed on them at the end of their careers.

We believe the changes you are proposing to current law in S.1710 do much to correct the current situation. Certainly making a payment to the employee, equal to the earnings payable on the TSP make-up contributions, will help bring the TSP to a healthy balance faster than current law. Mr. Chairman, Congressman Mica's bill is more generous by requiring the government to provide to the TSP both an average of employee contributions and an average growth of the investment that could have accrued. Some have suggested that this route is too expensive and could result in serious consequences for those currently employed in the government. After hearings

and the markup of H.R. 3249, the House Committee on Government Reform and Oversight disagreed with this conclusion and stated those who disagree with H.R. 3249 overestimate its costs.

AFSA is not in a position to provide an independent estimate of the cost. We leave that to the experts. We trust that our elected representatives in the Senate and the House sincerely recognized the concerns of thousands of federal employees who are victims of this administrative error, and will arrive at a solution that is equitable and provides for a sound retirement for them.

Mr. Chairman, once again I wish to express our appreciation for your efforts to resolve this problem. A responsible government meets its obligations to its employees especially as they approach retirement. And, again, AFSA requests that as the Congress resolves this situation, the Foreign Service be included. Thank you for the opportunity to testify before the Subcommittee.

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