CalPERS

Pension & Health Benefits Committee

California Public Employees' Retirement System

Agenda Item 5a

May 19, 2015

ITEM NAME: House Resolution 711 (Brady-TX) – The Equal Treatment of Public Servants Act of 2015

As Introduced February 4, 2015

PROGRAM: Legislation

ITEM TYPE: Action

RECOMMENDATION
Approve a **Support** position for House Resolution (HR) 711.

EXECUTIVE SUMMARY
HR 711 proposes to reform the Windfall Elimination Provision (WEP), which reduces Social Security benefits for many retired public employees who have earned retirement benefits through employment that is not covered by Social Security. The bill would replace the existing WEP formula, which uses an arbitrary reduction percentage, with a formula that takes into account the actual wage history for the public employee. Nearly all CalPERS safety members and about half of non-safety contracting agency members are employed in positions that are not covered by Social Security. The legislation is intended as a pragmatic compromise to a law that has been criticized since its enactment, and is designed to be cost neutral to the Social Security trust fund.

The **Support** recommendation is consistent with the federal priorities approved by the Board in April 2015, and with the California Public Employees' Retirement System (CalPERS) Board's Legislative and Policy Engagement Guidelines supporting the opportunity for all employees to pursue retirement security.

STRATEGIC PLAN
This item supports Strategic Plan Goal C to engage in state and national policy development to enhance the long-term sustainability and effectiveness of our programs.

BACKGROUND
1. <u>Background for the Windfall Elimination Provision</u>
   The Windfall Elimination Provision (WEP) is a reduction of Social Security benefits that is applied to retirees of state or local governments whose public sector employment was not covered by Social Security. The WEP may only be applied to individuals with a pension earned in employment that is not covered by Social

Security and who separately worked enough in a Social Security-covered job to earn Social Security benefits.

The benefit calculation for Social Security provides a higher earnings replacement amount for low-wage workers than for higher-wage workers. Social Security benefits are based on average earnings in employment covered by Social Security over a working lifetime (35 years). A worker who has spent part of his or her career in employment not covered by Social Security appears to have lower average lifetime earnings, because years with no covered earnings are counted as years of zero earnings for purposes of determining average earnings for Social Security benefit purposes. Therefore, government retirees with a pension and significant periods of non-covered employment would be treated as a low lifetime earner for Social Security benefit purposes and receive the advantage of the weighted benefit formula, while also receiving their public employment pension.

The WEP was enacted in 1983 as part of a large reform package designed to shore up the financing of the Social Security system. The WEP was recommended by the National Commission on Social Security Reform otherwise known as the "Greenspan Commission." Prior to 1983, individuals who worked in jobs which were not covered by Social Security and also had other covered Social Security employment, received Social Security benefits calculated as if they were long-term, low-wage earners. This group received the advantage of a higher percentage of Social Security benefits in addition to their governmental pension from work not covered by Social Security.

WEP eliminates this "windfall" by reducing the multiplier for the individual's Social Security benefits. However, the WEP includes a guarantee designed to help protect workers with relatively low pensions based on non-covered employment. This guarantee provides that the reduction in Social Security benefits can never exceed one-half the amount of the pension based on non-covered work.

In addition, the WEP does not apply in any of the following situations:

- Workers who have 30 or more years of substantial earnings, as defined in federal law, under Social Security. The reduction under the WEP is phased out gradually for workers who have 21-29 years of substantial covered earnings under Social Security.
- Workers who have paid Social Security tax on public employment work.
- Workers who were age 62 or disabled prior to 1986.
- Workers qualified to begin receiving a monthly public retirement benefit before 1986, but continued to work after 1986.
- Individuals who receive spousal benefits.
- Workers whose employment began on December 31, 1983, by a nonprofit organization that did not withhold Social Security taxes from pay, initially, then began withholding.

- Workers who received a pension based on railroad employment.
- Workers who performed work prior to 1957 and paid no Social Security taxes.

A summary of the WEP may also be found in Attachment 3.

2. The Government Pension Offset
The WEP impacts retirees that have earned both Social Security benefits and a pension in employment not covered by Social Security. The Government Pension Offset (GPO) impacts individuals that have a pension earned outside Social Security and have no Social Security benefits. Unlike the WEP, which reduces an individual's Social Security benefits, the GPO reduces the Social Security benefit provided to a beneficiary. For an impacted beneficiary, the GPO reduces the Social Security beneficiary benefits by two-thirds of the amount of the individual's pension from non-covered employment, which could eliminate the entire beneficiary benefit.

For a beneficiary who separately receives his or her own Social Security retirement benefit, a beneficiary benefit has always been reduced one dollar for each dollar of the retirement benefit. The GPO is intended to reduce beneficiary benefits in a similar manner for beneficiaries that have pensions earned through non-covered employment and did not earn a Social Security retirement benefit. A summary of the GPO may be found in Attachment 3.

HR 711 does not propose to revise the GPO.

3. Administration of the WEP
The Social Security Administration (SSA) is responsible for implementing the WEP, and uses information reported by individuals for enforcement. When a person applies for Social Security benefits, he or she is required to tell SSA if they are receiving a pension based upon non-covered employment. SSA then obtains verification of the pension and applies the WEP accordingly. SSA largely relies on the applicant to correctly inform the SSA that he or she is entitled to a non-covered pension.

The General Accounting Office (GAO) has issued studies of SSA's administration of the WEP provisions and determined that there are many beneficiaries who are not subjected to the WEP because SSA does not know they are receiving pensions based on non-covered employment. In the near future, the SSA expects to improve compliance with the WEP because it will have 30 years of payroll Medicare data. This payroll data will provide the SSA with information on individuals that are employed in jobs that are not covered by Social Security, which will provide for better WEP compliance without relying on the existing self-reporting structure.

4. <u>Number of Impacted CalPERS Members</u>
Among active CalPERS members, approximately 232,000 members are in positions that are not covered by Social Security, according to information from fiscal year ending 2011 (FYE 2011). As shown on the table below, over 96 percent of CalPERS safety members and over half of all non-safety contracting agency members do not participate in Social Security. The extent to which these members might be subject to the WEP is dependent on the specifics of their work history, such as the number of years in Social Security-covered employment, if any.

FYE 2011 Social Security Coverage						
	Non-Safety		Safety		Overall Totals	
State	**Count**	**Percent**	**Count**	**Percent**	**Count**	**Percent**
Covered	172,647	99.89%	25	0.03%	172,672	69.80%
Non-covered	183	0.11%	74,518	99.97%	74,701	30.20%
Total State Active	172,830	100.00%	74,543	100.00%	247,373	100.00%
School						
Covered	288,247	96.57%	0	0.00%	288,247	96.37%
Non-covered	10,251	3.43%	608	100.00%	10,859	3.63%
Total School Active	298,498	100.00%	608	100.00%	299,106	100.00%
Public Agency (PA)						
Covered	93,615	47.47%	4,108	8.65%	97,723	39.93%
Non-covered	103,610	52.53%	43,408	91.35%	147,018	60.07%
Total PA Active	197,225	100.00%	47,516	100.00%	244,741	100.00%
Total						
Covered	554,509	82.94%	4,133	3.37%	558,642	**70.61%**
Non-covered	114,044	17.06%	118,534	96.63%	232,578	**29.39%**
Total Active	668,553	100.00%	122,667	100.00%	791,220	**100.00%**

ANALYSIS

<u>Proposed Changes</u>
Specifically, HR 711 does the following:

For current retirees:

- Provides a rebate amount equal to a percentage of the benefit reduction imposed by the WEP.
- Requires SSA to determine the amount of the rebate for existing retirees, based on the amount of savings generated by this bill.
- Requires SSA to recover money from existing retirees that have not been in compliance of notifying the Administration of pension benefits earned from non-covered employment.

For future retirees, first eligible for Social Security benefits on and after January 1, 2017:

- Repeals the WEP and establishes a new formula that takes into account wages earned in employment not covered by Social Security.
- Specifies this new formula as taking what would be an individual's Social Security benefit using both covered and non-covered employment and multiplying that benefit amount by a fraction equaling the average indexed monthly earning including only covered employment divided by the average indexed monthly earnings, including non-covered employment.
- Defines, for the purposes of this bill, several key terms, including average indexed monthly earnings, recorded non-covered earnings, and adjusted total covered earnings.
- Requires SSA to establish regulations for methods to determine earnings for non-covered employment.

1. <u>Author's Intent</u>
In 2014, Congressman Kevin Brady of Texas stated, "It (the WEP) penalizes public servants who've earned Social Security and have also earned pension from their work like so many Americans. Since 1983, it has treated these workers, I believe, unfairly. It is costly, it is wrong and it is time that it be changed." Mr. Brady further stated, "It is assumed that everyone who was receiving both pension payment and Social Security benefits was wealthy. Well, if you talk to our firefighters and teachers and police, 'wealthy' would not be the phrase that comes to mind. I think no matter where you are in America, no matter how you paid into Social Security, you just want to be treated fairly at the end of the day, and that's what this is."

2. <u>Obstacles to Eliminating the WEP</u>
In response to dissatisfaction to the WEP, efforts to reform and repeal these benefit reduction laws have been discussed for decades. However, a significant obstacle to eliminating the WEP is the scored cost to the federal budget, because Social Security benefits would increase for retirees that are currently subject to these benefit reductions. Without an offset of some kind, such an increase in benefits reduces the long-term funding status of the Social Security trust fund.

   In order to offset an increase in Social Security benefits, there would need to be a general benefit reduction or an increase in contributions to the system. A decrease in benefits, in order to eliminate the reductions imposed by the WEP, does not seem a politically realistic trade. However, increasing contributions to bolster the entire system and offset the elimination of the WEP has been discussed in the past. In particular, mandatory Social Security participation for all state and local government employees has been raised as a mechanism to eliminate the need for WEP, while also increasing contributions into the system.

Mandatory participation for all state and local government employees would face significant challenges. Such an effort would face immediate political opposition from groups aligned with state and local government employees, especially law enforcement and firefighters. As recently as 2011, the Coalition to Preserve Retirement Security released a report arguing against mandatory Social Security participation. This report claimed that state and local governments would have $53.5 billion in additional costs within the first five years of mandatory participation. Among its arguments, this report states that mandatory coverage "ignores the diverse work-force requirements of the public sector."

Separate from these political challenges, mandatory participation would also require difficult implementation decisions by the Congress, including whether to include only new hires or phase-in existing employees and whether to continue enforcement of the WEP on non-covered retirees. Additionally, a significant program change like mandatory coverage would likely be bundled with larger programmatic changes that could include changes to the payroll tax rate, benefit level changes, and benefit eligibility changes.

In addition to federal policy decisions, mandatory Social Security participation would trigger policy and fiscal decisions for state and local governments that do not currently participate in Social Security. These government employers already provide a qualified retirement benefit plan to their employees, as required by federal law, so mandatory participation would immediately increase employer costs, unless there is a corresponding reduction in the state or local retirement benefit plan. If these costs are not offset by benefit reductions, government employer costs would be increased, which would create budgetary competition at the state or local level, including pressure for increased taxes.

The Board's Legislative and Policy Engagement Guidelines explicitly support the continued ability of local governments to choose whether to participate in the Social Security system, and opposes mandatory participation in Social Security.

3. <u>Social Security Impact Estimate</u>
In a letter dated November 13, 2014, the Social Security Administration Chief Actuary Stephen Goss estimated the fiscal impacts of the Equal Treatment of Public Servants Act of 2014, which is substantively the same as HR 711. The letter states that the bill replaces "the current complex WEP with a more straightforward approach…."

Chief Goss notes that the savings from the bill would come from expanding the number of individuals that would be subject to some Social Security benefit reduction by including workers with more than 30 years of covered employment and by removing the requirement that individuals have a pension from non-covered employment. In addition, the letter notes the expected program savings resulting from improved compliance through the use of payroll data collected since 1978, which would include data from non-covered employment. The Chief Actuary makes a preliminary estimate of 32 percent for the rebate percentage that would be added to the Social Security benefits for existing Social Security retirees that have been subject to the WEP prior to 2017.

The Chief Actuary's letter concludes, "Initially, the proposal would affect substantial numbers of Federal, state, and local government employees and former employees. Over the long-range period, the implications of the proposal would progress because the closed group of Federal government employees who are not covered by OASDI were all hired before 1984. Eventually, the group affected by the proposal will be limited solely to the roughly 25 percent of all state and local government employees who are not covered by OASDI."

4. <u>Potential Impacts on CalPERS Members</u>
   As noted above, nearly all CalPERS active safety members and approximately half of contracting agency non-safety members are employed in positions that are not covered by Social Security. While all of these individuals could potentially be impacted by the WEP or HR 711, the application of the WEP or HR 711 is dependent on the individual work history of each retiree. If the individual did not work enough years in Social Security-covered employment, he or she would not qualify for Social Security benefits, so would not have a benefit to be reduced. For example, a firefighter could have worked less than 10 years as a young person in Social Security covered employment, not enough years to be eligible for retirement benefits. This individual could then work his or her entire safety career and retire with a CalPERS pension, without assuming further employment. Because this individual would not qualify for a Social Security benefit, there would be no benefit to reduce through the WEP or HR 711.

   In order to qualify for Social Security benefits, thus potentially be subject to the WEP or HR 711, the possible work histories for public employees is as diverse as the population of CalPERS members. An individual could work in covered employment at the beginning of his or her career, then move into public service, or start in public service, then move into the private sector. Some may work in non-covered public employment while concurrently working in a part-time private sector job. An individual may retire from public service, then work in the private sector for enough years to be eligible for Social Security benefits. And particularly for non-safety members, an individual could move between public sector employers, some of which participate in Social Security and some that do not participate. The possible combinations of covered and non-covered employment are almost endless.

   However, the different impacts of the WEP and HR 711 can be described in broad terms. The WEP reduces Social Security benefits based solely on the number of covered years of earnings. For instance, the WEP reduction is the same for a person who works 10 years of relatively low-wage jobs as a young person and for a person who works 10 years of relatively high-wage jobs as a middle-aged person. In addition, a person could work 30 years and be exempt from any WEP reduction, regardless of whether the work was low-wage part-time employment or high-earnings consulting employment.

For future retirees, HR 711 proposes to use the actual earnings history of individuals to apply a Social Security benefits reduction. For some individuals, HR 711 will apply a reduction greater than the WEP, and for others, HR 711 will apply a smaller reduction. Because of the large number of possible work history combinations, it is only possible to generalize about how the HR 711 benefit reduction compares to the WEP as illustrated in attachment 1. In general, HR 711 will provide a smaller reduction for lower-wage workers and a greater reduction for higher-wage workers. In addition, those that would have been exempt from the WEP due to 30 or more years of covered employment would not be exempt from the HR 711 reduction. The WEP also only applies to individuals that receive a pension from non-covered employment, while HR 711 applies to any person with at least one year of non-covered earnings. The impacts of HR 711 on any individual are dependent on the particulars of that person's earnings history.

For current Social Security retirees, HR 711 proposes to reduce the WEP impact on their benefits. The bill requires SSA to determine a rebate amount based on the amount of savings it determines HR 711 generates by replacing the WEP with the new formula for future retirees and improved compliance for current retirees. According to SSA, the rebate amount would be 32 percent of the WEP reduction for each retiree.

BUDGET AND FISCAL IMPACTS

1. <u>Benefit Costs</u>
   No impact to CalPERS administered benefits.

2. <u>Administrative Costs</u>
   No administrative costs for CalPERS or its contracting agencies.

BENEFITS/RISKS

1. <u>Benefits of HR 711 Becoming Law</u>
   - Replace an arbitrary benefit reduction with a more commonsense formula that accounts for each member's full salary and wage history.
   - Implements a policy compromise without imposing mandatory Social Security participation on public employers and employees.

2. <u>Risks of HR 711 Becoming Law</u>
   - Because the bill is designed to be cost neutral to the Social Security trust fund, some members will experience a benefit reduction compared to the WEP in current law.

ATTACHMENTS

Attachment 1 – Potential Effects of HR 711 on Social Security Benefits
Attachment 2 – Legislative History
Attachment 3 – WEP and GPO 1-Page Summaries
Attachment 4 – List of Support and Opposition

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