SOCIAL SECURITY

Office of the Chief Actuary

July 12, 2016

The Honorable Kevin Brady
House of Representatives
Washington, D.C. 20515

Dear Chairman Brady:

I am writing in response to your request for our estimate of the financial effects on the Social Security Trust Funds of the amendment in the nature of a substitute that you are planning to offer for H.R. 711, the "Equal Treatment of Public Servants Act of 2015," which you introduced on February 4, 2015 with Representative Neal. This amendment would generally replace the windfall elimination provision (WEP) with a new formula that you have referred to as the "Public Servant Fairness Formula" (PSF). The proposal would also provide for a rebate payment starting in 2018 for individuals affected by the current WEP. We have enjoyed working with Amy Shuart and Lara Rosner of your staff in the development of this proposal. Our analysis and estimates provided for this proposal reflect the efforts of many in the Office of the Chief Actuary, but particularly Jacqueline Walsh, Chris Chaplain, and Karen Glenn.

The proposal reflects your prior bills in concept, replacing the current complex WEP with a more straightforward approach. The PSF provides retired-worker and disabled-worker beneficiaries (and their dependents) with a modified benefit computed reflecting all past earnings (including earnings in employment that was not covered under the OASDI program in our records starting with 1978), then multiplied by the ratio of the average indexed monthly earnings (AIME) computed without non-covered earnings to a modified average indexed monthly earnings (AIME′) that includes both covered and non-covered earnings in our records. As with OASDI covered earnings, potential beneficiaries would be asked to review the non-covered earnings we have in our records so that they would have the opportunity to make corrections. Another way to describe the new PSF approach is that beneficiaries will receive a benefit that reflects the replacement rate applicable for a worker with the same career earnings, where all earnings had been covered. Effectively, the PSF formula would compute the worker's PIA as the ratio of PIA based on all earnings (covered and non-covered) to the average indexed monthly earnings (AIME) computed based on all earnings, multiplied by the AIME based on covered earnings only. These two ways of describing the new approach are mathematically equivalent.

Importantly, for workers becoming eligible for OASDI benefits in 2018 or later, the proposal would eliminate the requirement for receipt of a pension based on earnings not covered by the OASDI program in order to apply the new PSF reduction. However, in the case where a disabled-worker or retired-worker beneficiary is entitled to receive periodic payments based on foreign employment not covered under a totalization agreement, the PSF would not apply and the current

WEP would be utilized with regard to any periodic payments received based on the foreign or any domestic non-covered earnings.

The new PSF would be applied for all retired-worker and disabled-worker beneficiaries (other than those who are in receipt of a periodic payment based on work abroad) who are newly eligible for benefits after December 2017. For retired or disabled workers and their auxiliary beneficiaries who receive a Social Security benefit after December 2017 that is reduced by the current-law WEP, an annual rebate will be paid at the end of each calendar year starting in 2018, reflecting a percentage reduction of the current WEP offset for monthly benefits received for the year. The rebate percentage applicable for benefits paid for months in each year 2018 through 2026 will be promulgated by the Commissioner of Social Security based on a calculation made by the Social Security Administration's Chief Actuary by October 1 of each year. The Chief Actuary will use the best available data at the time to determine the supplement to be as high as possible and limited to assure that the net effect of the Bill on Social Security program cost through 2026 would be neutral or positive. At this time, we estimate that the percentage reduction to the WEP effect would be 14.7 percent, resulting in a roughly neutral effect for the proposal as a whole through calendar year 2026. For each year after 2026, the Commissioner will promulgate based on a calculation made by the Chief Actuary by October 1 of that year a rebate percentage as high as possible but not to exceed 50 percent, limited to assure that the net effect of the Bill on Social Security program cost for the year would be neutral or positive. At this time, we estimate that the percentage reduction would be 50 percent for each year after 2026.

The proposal will result in added program cost for workers newly eligible for an OASDI benefit after 2017 whose benefit amount would be reduced less by the PSF than by the WEP. However, because the PSF does not require receipt of a pension based on non-covered earnings, and eliminates most exemptions from adjustments based on non-covered earnings for workers becoming newly eligible for OASDI benefits after December 2017, our estimate reflects small benefit reductions from the PSF for a relatively large number of workers who would not be reduced by the WEP. The net OASDI program benefit savings are estimated at $7.4 billion total for calendar years 2018 through 2026 for those newly eligible for OASDI benefits after 2017. The cost for the rebate applied for beneficiaries eligible before 2018 is estimated to fully offset the savings through calendar year 2026. For each year after 2026, net program savings from application of the PSF are estimated to exceed the cost of the rebate. Over the long-range period, the net effect of the proposal on the 75-year actuarial balance would be an increase (improvement) of 0.03 percent of payroll. All estimates are based on the intermediate assumptions of the 2015 Trustees Report.

Over the long-range period, the implications of the proposal would change 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 principally to the roughly 25 percent of all state and local government employees who are not covered by OASDI.

Our estimates for the proposal reflect extensive innovative analysis of data for individuals born in 1950 with experience through June of 2013, including SSA records of earnings not covered by OASDI back to 1978, with adjustments for over-recording of non-covered earnings for years 1978 through 1981. This analysis has allowed us to model the potential effect of the proposal for 2013 as if it were fully in effect for all retired and disabled workers at that time. Based on these results, we are able to model the expected effects of the proposal for benefit payments starting in 2018. For the purpose of illustrating some of the distributional effects of the proposal (the PSF and the rebate), the following sections provide dollar estimates of the effects relative to benefit levels in 2016.

Effects of the Proposal on Beneficiaries Becoming Newly Eligible after 2017

In order to meaningfully illustrate the effects of the new PSF on workers who will become eligible starting in 2018 under this proposal, we provide here estimates of the effects of the PSF for all current beneficiaries in 2016, assuming the new approach were fully phased in and had applied for them since their initial benefit eligibility. The average monthly WEP reduction for workers in 2016 with the current approach is about $270.

For the roughly 1.5 million retired-worker and disabled-worker beneficiaries in 2016 whose primary benefit is reduced under the current WEP, the new PSF, if applicable for them, would result in an increased primary benefit for about 1.25 million beneficiaries (about 84 percent of all currently-affected beneficiaries). The average reduction would be about $78 less on average, from $284 per month under the current WEP to about $206 per month under the new PSF. The remaining 0.25 million beneficiaries (about 16 percent of all currently-affected beneficiaries) would see a further small reduction in their primary benefit, if the new PSF were applicable for them. Their average reduction would be about $13 more on average, from $198 per month under the current WEP to about $211 per month under the PSF.

For 2016, we estimate that there are roughly 13 million retired-worker and disabled-worker beneficiaries with some non-covered earnings after 1977 who are not reduced under the current WEP (assuming adjustments for erroneous recording of non-covered earnings for some workers in years 1978 through 1981). Again, we illustrate how this group would be affected if the new PSF had been in effect for them since their initial benefit eligibility. We estimate that for about 1 million (about 8 percent) of these beneficiaries in 2016, the new PSF would not change their primary benefit. For the other 12 million beneficiaries, the average reduction in benefit would be about $25 per month if the PSF were applicable for 2016. For the half of this 13 million that would be least affected by the PSF, the average primary benefit reduction would be just $2 per month. For the half that would be most affected, the reduction would average $42 per month. About 55 percent of the 13 million, or roughly 7 million beneficiaries, qualify now for exemption from the current WEP because they have 30 or more years of substantial OASDI covered earnings. Because these 7 million retired-worker or disabled-worker beneficiaries have relatively few years of non-covered earnings, their reduction under the new approach would be relatively small if the PSF were applicable for them. In addition, more than 75 percent of these 13 million workers have fewer than 5 years with any non-covered earnings.

Effects of the Proposal on Beneficiaries Becoming Newly Eligible before 2018

For individuals becoming newly eligible for retired-worker or disabled-worker benefits before 2018 (and for those in receipt of a foreign pension thereafter), the amount of any WEP reduction for years 2018 through 2026 will be partially offset by a rebate at the end of each year equal to an estimated 14.7 percent of WEP reductions for the year, and by a rebate equal to an estimated 50 percent of WEP reductions for 2027 and later years. Expressed in dollar amounts relative to 2016 benefit levels, where the average WEP reduction is about $270 per month, the average WEP rebate would be an estimated $40 per month through 2026, and an estimated $135 per month after 2026. Because this rebate will be provided for all months in a calendar year in a single payment at the end of the year, the annual rebate payment for those reduced by the WEP throughout a year (expressed in dollars relative to 2016 benefit levels) will on average be about $476 through 2026, and $1,620 for later years.

Sincerely,

Stephen C. Goss

Stephen C. Goss, ASA, MAAA
Chief Actuary