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SSDI Solvency and Pension De-Risking in the Spotlight

A congressional panel heard testimony this week on the finances of the trust fund for Social Security's disability insurance program, which is expected to be depleted in the fourth quarter of 2016. Also, the Government Accountability Office released a report on pension de-risking.

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Social Security Disability Insurance

The trust fund for Social Security Disability Insurance (SSDI) is financed by FICA and SECA payroll taxes. The combined 12.4% of wages that employees and employers pay under FICA — and the 12.4% of net earnings from self-employment under SECA — is split 10.6% for the Old Age and Survivor Insurance (OASI) trust fund, and the remaining 1.8% for the SSDI trust fund. The trustees for the SSDI trust fund and the Congressional Budget Office estimate that the trust fund will be exhausted during FY 2017 — which runs from October 1, 2016 through September 30, 2017. Once that occurs, unless Congress acts, the Social Security Administration will be required to reduce SSDI benefit payments because the agency is not permitted to pay benefits in excess of the amounts held in the trust fund.

Why does the solvency of the SSDI trust fund matter to employers?

Long-term disability plans maintained by employers often link plan benefits to SSDI benefits — for example, by paying a fixed benefit that is offset by SSDI benefits received by the plan participant. Occasionally, pension benefit plans will link benefits or provide supplements to SSDI as well. In the event of trust fund depletion, SSDI benefits would be reduced, with the result that such a plan's benefit payment liability would increase, depending on the exact nature of the linkage in the plan. Congress is highly likely to address the trust fund's finances prior to its depletion.

The Social Security Subcommittee of the Ways and Means Committee in the House of Representatives (House) held a hearing on the solvency of the SSDI trust fund on Wednesday. One of the fund trustees testified that the SSDI trust fund is expected to become insolvent in the first quarter of FY 2017, with incoming FICA and SECA receipts only able to pay approximately 81% of SSDI benefits. Eleven million individuals currently receive SSDI benefits. The other two witnesses — from policy organizations that focus on federal budgetary issues — testified on possible solutions for the trust fund's expected shortfall. One witness advocated for a reallocation of FICA and SECA tax receipts among the OASI and SSDI trust funds to make up for the SSDI shortfall — noting that Congress has done so a number of times

in the past. The president's proposed budget for FY 2016 includes a reallocation provision. The other witness advocated for a *temporary* reallocation — as a means of giving Congress more time to reform Social Security comprehensively, but within limits. The witness observed that Congress failed to enact reforms, as had been hoped, when sometimes using the reallocation solution in the past.

Congress is highly likely to address the SSDI trust fund's finances prior to its depletion. How and when it will do so remains to be seen. Possible solutions include reallocating existing FICA and SECA receipts, increasing payroll taxes or finding alternative sources of revenue for the trust fund, reducing program benefits, or a combination of these approaches.

Reallocation-only solution barred by House procedural rules?

A procedural rule change (Section 3(q) on page 30 of **H.Res. 5**) adopted by the House at the beginning of this year addresses "reallocation-only" solutions to the SSDI trust fund. Under the rule, a bill that provides for reallocation only is "not in order" on the House floor and may not be considered if any member objects. An exception permits a reallocation provision if it is accompanied by other provisions that improve the combined finances of the OASI and SSDI trust funds.

While the procedural rule they've adopted signals the policy preference of House Republicans for addressing the SSDI trust fund, the rule change does not foreclose reallocation-only legislation. The House's procedural rules could be changed, or this type of procedural rule could be waived by the Rules Committee when it establishes the terms of debate for specific legislation on the House floor dealing with the SSDI trust fund. For example, **H.Res. 70** set the terms of debate for HR 596 (legislation that would repeal the Affordable Care Act — see our **February 6, 2015** *Legislate* for more information on the repeal bill), and the second sentence of the resolution waives all points of order against the bill.

Retirement

The Government Accountability Office (GAO) released a report yesterday on pension plan de-risking, titled "Participants need better information when offered lump sums that replace their lifetime benefits." The report was requested by Ways and Means Committee ranking member Rep. Sandy Levin (D-MI) and retired Rep. George Miller (D-CA) (former ranking member of the Education and Workforce Committee). The report focuses on pension de-risking by offering participants a window to elect a lump-sum cashout of their accrued benefits. GAO found there is little public data on the extent to which lump-sum windows are offered to participants, and recommended that DOL ask pension plan sponsors for this information. In its response to GAO, DOL agreed that this information would be helpful, but noted that ERISA does not clearly provide for this information collection, so the agency would have to examine whether this type of reporting could be required.

GAO also reviewed participant communication materials on lump-sum cashout offers from 11 plan sponsors — representing offers made to approximately 250,000 participants. The agency did not evaluate whether the notices were legally compliant with ERISA and the tax code, but the report notes that the communication materials appear to be compliant. GAO identified the following eight information areas as necessary for participants to evaluate a lump-sum offer:

- Benefit options available to the participant — such as the monthly annuity benefit that is available immediately or on a deferred basis, the existence of early retirement subsidies, and the amount of the lump sum
- Calculation of the lump sum — e.g., what interest rates and mortality assumptions were used, and what benefits were included or excluded from the lump sum
- Relative value of the lump sum and annuity benefits — such as whether the plan's annuity benefit could be replicated by purchasing a retail annuity with the lump sum
- Pros and cons of accepting a lump sum — e.g., investment, inflation, leakage, and longevity risks
- Tax implications of a lump sum — including rollover options and early distribution penalties
- Loss of PBGC protection — including the level of protection that would be provided under each benefit option
- Procedures for electing the lump-sum offer
- Contacts for follow-up questions

GAO found that eight of the communications packets it reviewed covered at least five of the eight areas described above. All 11 packets omitted information in at least one key area.

GAO made the following recommendations to executive branch agencies:

- DOL, IRS, and PBGC should issue guidance on the information that plan sponsors must give participants when offering a lump-sum window — specific areas GAO identified that could be improved are the relative value disclosure, information on protections offered by the PBGC, and the pros and cons of accepting a lump sum
- The Department of Treasury should update its relative value guidance to ensure a meaningful comparison of benefits is provided, review the ability of plan sponsors to select a lookback interest rate when calculating lump-sum offers, and establish a procedure for periodically updating mortality tables.

Treasury, IRS, and PBGC did not provide policy comments to GAO on the report, while DOL generally agreed with the report.

What did participants think of the communication materials and the lump-sum offer?

GAO also interviewed 33 plan participants who received the communications packets. Among the complaints voiced by participants were:

• The relative values table is confusing, and more information is needed for participants to understand it (all 11 packets included the relative value notice required by IRS)

• Details about the calculation of the lump sum and identification of the assumptions used (eight of the 11 packets did not disclose the interest rates used for the calculation)

• The monthly benefit that would be provided from a retail annuity that is purchased using the offered lump sum (none of the packets provided this information)

The top three reasons that participants identified in accepting a lump-sum offer were:

• Fear of plan sponsor default

• Desire to manage the investment of the lump sum

• Distrust of the plan sponsor's management of the pension plan

The top three reasons for rejecting a lump-sum offer were:

• Longevity concerns

• Concern that the lump-sum calculation is not fair

• A preference for annuity payments

Most of the 33 participants took steps to assess the lump-sum offer, with the most common steps being internet research and trying to estimate the lump sum's value. A third of the participants received a tool from their plan sponsor (a calculator or spreadsheet) for evaluating the lump sum, and almost 70% found the tool helpful.

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