AUTHENTICATED
U.S. GOVERNMENT
INFORMATION
GPO

OPERATIONAL EXPERIENCE UNDER THE 2001 RAILROAD RETIREMENT REFORM LAW

(109–71)

HEARING

BEFORE THE

SUBCOMMITTEE ON

RAILROADS

OF THE

COMMITTEE ON
TRANSPORTATION AND
INFRASTRUCTURE
HOUSE OF REPRESENTATIVES

ONE HUNDRED NINTH CONGRESS

SECOND SESSION

MAY 10, 2006

Printed for the use of the
Committee on Transportation and Infrastructure

U.S. GOVERNMENT PRINTING OFFICE

28–286 PDF WASHINGTON : 2006

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2250 Mail: Stop SSOP, Washington, DC 20402–0001

COMMITTEE ON TRANSPORTATION AND INFRASTRUCTURE

DON YOUNG, Alaska, *Chairman*

THOMAS E. PETRI, Wisconsin, *Vice-Chair*
SHERWOOD L. BOEHLERT, New York
HOWARD COBLE, North Carolina
JOHN J. DUNCAN, JR., Tennessee
WAYNE T. GILCHREST, Maryland
JOHN L. MICA, Florida
PETER HOEKSTRA, Michigan
VERNON J. EHLERS, Michigan
SPENCER BACHUS, Alabama
STEVEN C. LATOURETTE, Ohio
SUE W. KELLY, New York
RICHARD H. BAKER, Louisiana
ROBERT W. NEY, Ohio
FRANK A. LOBIONDO, New Jersey
JERRY MORAN, Kansas
GARY G. MILLER, California
ROBIN HAYES, North Carolina
ROB SIMMONS, Connecticut
HENRY E. BROWN, JR., South Carolina
TIMOTHY V. JOHNSON, Illinois
TODD RUSSELL PLATTS, Pennsylvania
SAM GRAVES, Missouri
MARK R. KENNEDY, Minnesota
BILL SHUSTER, Pennsylvania
JOHN BOOZMAN, Arkansas
JIM GERLACH, Pennsylvania
MARIO DIAZ-BALART, Florida
JON C. PORTER, Nevada
TOM OSBORNE, Nebraska
KENNY MARCHANT, Texas
MICHAEL E. SODREL, Indiana
CHARLES W. DENT, Pennsylvania
TED POE, Texas
DAVID G. REICHERT, Washington
CONNIE MACK, Florida
JOHN R. 'RANDY' KUHL, JR., New York
LUIS G. FORTUÑO, Puerto Rico
LYNN A. WESTMORELAND, Georgia
CHARLES W. BOUSTANY, JR., Louisiana
JEAN SCHMIDT, Ohio

JAMES L. OBERSTAR, Minnesota
NICK J. RAHALL, II, West Virginia
PETER A. DEFAZIO, Oregon
JERRY F. COSTELLO, Illinois
ELEANOR HOLMES NORTON, District of Columbia
JERROLD NADLER, New York
CORRINE BROWN, Florida
BOB FILNER, California
EDDIE BERNICE JOHNSON, Texas
GENE TAYLOR, Mississippi
JUANITA MILLENDER-MCDONALD, California
ELIJAH E. CUMMINGS, Maryland
EARL BLUMENAUER, Oregon
ELLEN O. TAUSCHER, California
BILL PASCRELL, JR., New Jersey
LEONARD L. BOSWELL, Iowa
TIM HOLDEN, Pennsylvania
BRIAN BAIRD, Washington
SHELLEY BERKLEY, Nevada
JIM MATHESON, Utah
MICHAEL M. HONDA, California
RICK LARSEN, Washington
MICHAEL E. CAPUANO, Massachusetts
ANTHONY D. WEINER, New York
JULIA CARSON, Indiana
TIMOTHY H. BISHOP, New York
MICHAEL H. MICHAUD, Maine
LINCOLN DAVIS, Tennessee
BEN CHANDLER, Kentucky
BRIAN HIGGINS, New York
RUSS CARNAHAN, Missouri
ALLYSON Y. SCHWARTZ, Pennsylvania
JOHN T. SALAZAR, Colorado
JOHN BARROW, Georgia

SUBCOMMITTEE ON RAILROADS

STEVEN C. LATOURETTE, Ohio, *Chairman*

THOMAS E. PETRI, Wisconsin
SHERWOOD L. BOEHLERT, New York
JOHN L. MICA, Florida
SPENCER BACHUS, Alabama
JERRY MORAN, Kansas
GARY G. MILLER, California
ROB SIMMONS, Connecticut
TODD RUSSELL PLATTS, Pennsylvania
SAM GRAVES, Missouri
JON PORTER, Nevada
TOM OSBORNE, Nebraska
MICHAEL E. SODREL, Indiana
LYNN A. WESTMORELND, Georgia, *Vice-Chair*
DON YOUNG, Alaska
(ex officio)

CORRINE BROWN, Florida
NICK J. RAHALL II, West Virginia
JERROLD NADLER, New York
BOB FILNER, California
ELIJAH E. CUMMINGS, Maryland
EARL BLUMENAUER, Oregon
LEONARD L. BOSWELL, Iowa
JULIA CARSON, Indiana
PETER A. DEFAZIO, Oregon
JERRY F. COSTELLO, Illinois
EDDIE BERNICE JOHNSON, Texas
JAMES L. OBERSTAR, Minnesota
JOHN BARROW, Georgia
(ex officio)

CONTENTS

TESTIMONY

	Page
Hamberger, Edward, President, Association of American Railroads	9
Hixon, James A., Trustee, National Railroad Retirement Investment Trust	9
Parker, Joel, Trustee, National Railroad Retirement Investment Trust	9
Scardelletti, Robert, President, Transportation Communications International Union	9
Schwartz, Hon. Michael S., Chairman, Railroad Retirement Board, accompanied by V.M. Speakman, Labor Member, Railroad Retirement Board, Jerome Kever, Management Member, Railroad Retirement Board, Steven Bartholow, General Counsel, Railroad Retirement Board, Kenneth Boehne, Chief Financial Officer, Railroad Retirement Board, and Frank Buzzi, Chief Actuary, Railroad Retirement Board	3

PREPARED STATEMENTS SUBMITTED BY MEMBERS OF CONGRESS

Brown, Hon. Corrine, of Florida	22
Costello, Hon. Jerry F., of Illinois	25
Cummings, Hon. Elijah E., of Maryland	27
Johnson, Hon. Eddie Bernice, of Texas	45
Oberstar, James L. of Minnesota	49
Young, Hon. Don, of Alaska	66

PREPARED STATEMENTS SUBMITTED BY WITNESSES

Hamberger, Edward	32
Hixon, James A	42
Parker, Joel	52
Scardelletti, Robert	56
Schwartz, Hon. Michael S	58

SUBMISSION FOR THE RECORD

Schwartz, Hon. Michael S., Chairman, Railroad Retirement Board, accompanied by V.M. Speakman, Labor Member, Railroad Retirement Board, Jerome Kever, Management Member, Railroad Retirement Board, letter concerning the Widow(er)s' Intitial Minimum Benefit Amount (WIMA), June 9, 2006	63

OPERATIONAL EXPERIENCE UNDER THE 2001 RAILROAD RETIREMENT REFORM LAW

Wednesday, May 10, 2006,

HOUSE OF REPRESENTATIVES, SUBCOMMITTEE ON RAILROADS, COMMITTEE ON TRANSPORTATION AND INFRASTRUCTURE, WASHINGTON, D.C.

The subcommittee met, pursuant to call, at 2:00 p.m., in room 2167, Rayburn House Office Building, the Hon. Steven C. LaTourette [Chairman of the subcommittee] presiding.

Mr. LATOURETTE. The Subcommittee will come to order. Good afternoon, I want to welcome you all to this afternoon's hearing about the Operational Experience Under the 2001 Railroad Retirement Reform Law.

In 1998, this Subcommittee, under chairman Jack Quinn, held a hearing about the need to reform our Nation's railroad retirement system. At that time, the system was headed for a crisis. Due to the severe downsizing of the industry, fewer and fewer employees were paying into the railroad retirement system. Meanwhile, the number of retirees and surviving spouses continued to increase.

Fortunately, after years of effort by rail labor, management and members on both sides of this Committee, the Railroad Retirement and Survivors' Improvement Act of 2001 was signed into law. Enactment of this legislation was a great victory for railroad workers and their families as well as the railroads themselves. The 2001 legislation reduced the retirement age from 62 to 60, provided enhanced Tier II benefits for retirees and their surviving spouses, and reduced taxes on current railroad employees. This was achieved by allowing the National Railroad Retirement Investment Trust to invest in a diversified portfolio rather than exclusively in low yield Government securities. In what is truly a pleasant surprise, the investment trust has performed far better than anyone expected back in 2001. The portfolio has grown remarkably, and payroll taxes have actually declined.

Today, I am looking forward to hearing more about the success of the National Railroad Retirement Investment Trust as well as any continuing issues faced by the Railroad Retirement Board, rail labor, and management.

Before yielding to my distinguished Ranking Member Ms. Brown, I want to ask unanimous consent to allow 30 days for members to revise and extend their remarks and to permit the submission of additional statements and materials by members and also witnesses. Without objection, so ordered.

It is now my pleasure to yield to Corrine Brown of Florida, our distinguished Ranking Member, for any observations she would choose to make.

Ms. BROWN. Thank you, Mr. Chairman, for hosting this meeting. It is nice to have a hearing where all of the witnesses have good news for us. Thank you.

I believe that the Railroad Retirement and Survivors' Improvement Act of 2001 was a resounding success. It improved benefits to men and women who work on our Nation's railroads and the 634,000 retirees and survivors of Retired Railroad Workers. It significantly reduced Tier II taxes for railroad and for railroad workers for the first time in 2005 from 4.9 percent to 4.4 percent.

The Act also created the National Railroad Retirement Investment Trust which has been a tremendous success. The net value of the trust management assets have soared up to $28.9 billion as of March, 2006, representing an increase of over $10 billion, that is with a B, above the net book value of assets transferred to the trust for investment in 2001.

In other words, the 2001 Railroad Retirement Reform Law was a win/win situation for everyone: for the railroad, for the railroad workers, for the railroad retirees and survivors, and for former and current members of this Subcommittee who worked so hard to create this program.

I welcome the witnesses here today and look forward to hearing more about the implementation of the 2001 Reform Act. Thank you, Mr. Chairman.

Mr. LATOURETTE. I thank the gentlelady very much.

Mr. Boswell, any remarks you would like to make?

Mr. BOSWELL. No, thank you, Mr. Chairman.

Mr. LATOURETTE. OK.

With that, it is my pleasure to welcome the first panel today. The first panel, despite its appearance, actually contains one witness and a lot of friends. So we are pleased to have today with us the Honorable Michael Schwartz who is the Chairman of the Railroad Retirement Board. He is accompanied today by Mr. V.M. Speakman who is the Labor Member for the Railroad Retirement Board, Mr. Jerome Kever who is a Management Member of the Railroad Retirement Board, Steven Bartholow who is the General Counsel for the Railroad Retirement Board, Mr. Kenneth Boehne who is the Chief Financial Officer for the Railroad Retirement Board, and Mr. Frank Buzzi who is the Chief Actuary for the Railroad Retirement Board.

Chairman Schwartz, we thank you for coming. We thank you for bringing all your friends with you today. We look very much forward to your testimony.

TESTIMONY OF HON. MICHAEL S. SCHWARTZ, CHAIRMAN, RAILROAD RETIREMENT BOARD, ACCOMPANIED BY: V.M. SPEAKMAN, LABOR MEMBER, RAILROAD RETIREMENT BOARD; JEROME KEVER, MANAGEMENT MEMBER, RAILROAD RETIREMENT BOARD; STEVEN BARTHOLOW, GENERAL COUNSEL, RAILROAD RETIREMENT BOARD; KENNETH BOEHNE, CHIEF FINANCIAL OFFICER, RAILROAD RETIREMENT BOARD; FRANK BUZZI, CHIEF ACTUARY, RAILROAD RETIREMENT BOARD

Mr. SCHWARTZ. Thank you. Good afternoon, Chairman LaTourette, Ranking Member Brown, and distinguished members of the Committee. I am Michael Schwartz, and I am the Chairman of the Railroad Retirement Board. It is indeed a pleasure to appear before you today to testify on behalf of the Railroad Retirement Board concerning our experience under the Railroad Retirement and Survivors' Improvement Act. I request that my statement be inserted in the record.

As you know, the Railroad Retirement and Survivors' Improvement Act of 2001 originated in this Committee, and it made a number of changes in railroad retirement benefits and in the financing of the railroad retirement program. The Railroad Retirement and Survivors' Improvement Act of 2001 was a product of an agreement between rail labor and rail management.

On the benefit side, the 2001 Act reduced the minimum retirement age for full benefits for employees with 30 years of service from age 62 to age 60. Another change was the elimination of the so-called railroad retirement maximum, which had imposed a cap on the combined benefits of an employee and the employee's spouse. The Act added a new minimum initial benefit amount for widow and widowers, so that the amount of the benefit payable when a widow's or widower's annuity is awarded is equal to what the employee received prior to his or her death. Another change on the benefit side was a reduction in the number of years needed to be eligible for Tier II railroad retirement benefits. Tier II benefits are now available to employees who have five years of railroad service after 1995. These changes are all fully operational.

In addition to the benefit changes I just mentioned, the Railroad Retirement and Survivors' Improvement Act made significant and far reaching changes in the financing of railroad retirement benefits. The Act called for the creation of a new entity, the National Railroad Retirement Investment Trust, to handle investment of railroad retirement funds. The Trust is not a Federal Agency or instrumentality; it is separate and apart from the Railroad Retirement Board.

Prior to the 2001 legislation, railroad retirement funds were invested only in Government securities or certain Government-backed securities. The 2001 law changed this by authorizing the Trust to invest railroad retirement funds in a wide array of investments including stocks and bonds as well as Government securities.

In addition to the investment changes, the Railroad Retirement and Survivors' Improvement Act of 2001 substituted for the flat tax rates in prior law, a new tax ratchet mechanism for setting the Tier II tax rate for employees and employers. Under the tax ratch-

et, Tier II tax rates for employers and employees can increase or decrease depending on the account benefits ratio. The account benefits ratio is determined by comparing the market value of railroad retirement assets to benefit payments. Thus, the tax rate is adjustable to meet financing needs of the railroad retirement system.

Almost immediately after President Bush signed the Railroad Retirement and Survivors' Improvement Act into law, steps were initiated to form the National Railroad Retirement Investment Trust. The Trust is comprised of seven trustees. Three trustees represent the interest of rail management; three represent the interest of rail employees; the seventh is an independent member of the Board of Trustees and is selected by a majority of the other six trustees. Trustees representing railroad employees and railroad management were appointed and first met on February 1st, 2002. The original trustees, as well as the trustees who have been appointed after the Trust was formed, all have had strong backgrounds in investment and pension plan management as required by the statute.

The first transfer for the investment occurred in September, 2002. For several months thereafter, additional transfers of significant amounts were made until a total of $21.3 billion had been transferred to the Trust. Initially, the Trust limited its investments to index funds, but as the Trust's staff has grown, the Trust has moved funds into a combination of index funds and actively managed investments handled by an increasing number of investment managers. Today the Board of Trustees and the Trust's professional staff are responsible for the investment of $28.9 billion.

Although the Railroad Retirement and Survivors' Improvement Act makes it clear the Railroad Retirement Board and the National Railroad Retirement Investment Trust are separate entities, the responsibilities of the two organizations are such that the Board and the Trust must work together in order to serve the needs of the plan participants and stakeholders. Today, I am pleased to report that the Board and the Trust have worked closely from the inception of the Trust and that we are accomplishing our respective responsibilities under the Act.

The three members of the Railroad Retirement Board meet at least twice a year with the Trust, and the Railroad Retirement Board's General Counsel meets on a frequent basis with the Counsel to the Trust and the Trust Chief Investment Officer to discuss issues of mutual concern.

The Railroad Retirement Board, the Trust, the Office of Management and Budget, and the Department of the Treasury are all parties to a Memorandum of Understanding under which the Board receives monthly reports from the Trust showing the market valuation of the Trust portfolio. Moreover, the Trust provides the Board with copies of its annual management report to Congress showing details of the Trust's operations for the previous fiscal year. The Railroad Retirement Board receives quarterly updates of the annual report from the Trust. Information about the Trust, including an annual management report and quarterly updates, is posted to the Railroad Retirement Board's web site and is available for public review.

Since the inception of the Trust, the market value of the Trust's portfolio has increased significantly. As I noted earlier, the Railroad Retirement Tax Act was amended by the 2001 law to provide a tax ratchet mechanism for setting Tier II tax rates for employers and employees. Before the tax ratchet became effective in 2004, the 2001 Act had already reduced the Tier II tax rate on employers from 16.1 percent in 2001 to 15.6 percent and 14.2 percent in 2002 and 2003, respectively.

When the tax ratchet took effect in 2004, the employer tax rate was further reduced to 13.1 percent, and in 2005, both the employer and the employee Tier II tax rates were reduced. In 2005, the employer tax rate declined to 12.6 percent and the employee tax rate declined from 4.9 to 4.4 percent. Tax rates for 2006 are the same as 2005. These reductions in the Tier II tax rates for both employers and employees were almost entirely the result of good investment performance over the past few years.

In closing, I am pleased to say that, in view of the Railroad Retirement Board, the Railroad Retirement and Survivors' Improvement Act has been very successful and that the goals sought by the legislation are being achieved. We would be happy to answer any questions at this time.

Mr. LATOURETTE. Well, Chairman Schwartz, thank you very much. As Ms. Brown said, it is rare that we have a hearing where it is all good news all the time. Certainly, your testimony and your report today is good news.

Just a housekeeping matter, we have a Majority Leader here. His name is Boehner. I think, Mr. Boehne, I said your name was Boehne, and I have been told that it is Boehne. And so, I apologize for that. I just took the R off of Boehner and made you Mr. Boehne. But, just so the record is clear, welcome.

Again, Chairman Schwartz, thank you for your testimony and bringing everybody with you today.

I want to begin where you ended, I guess, and that is the tax rate and commend you and the Board for continuing to reduce the tax rate on both the employer and the employee. As you sort of pull out your crystal ball, do you see that as being a trend that you can continue, thanks to the good management skills that you are exercising over this Trust?

Mr. SCHWARTZ. Yes, and that is the way the ratchet system was set up. As long as the investments continue to be strong, we will be able to lower the rate.

Mr. LATOURETTE. Great. There was a big discussion and a little dust up here last year and the year before over social security, and everybody becomes concerned about the impact of the pending retirement of the baby boomers on our middle class entitlement programs.

Mr. SCHWARTZ. Sure.

Mr. LATOURETTE. I am just wondering if, after the 2001 legislation, have you and your actuaries have taken a look at what the retirement of the baby boomer generation does to what you are currently doing?

Mr. SCHWARTZ. Yes, we have a 75 year projection. That is all we get, just 75 years out. We see no cash flow problems in the next

75 years because of these good investments and because of the employment.

Mr. LATOURETTE. That is unbelievable.

Earlier this year, this Committee, I think with the support of the Board or at least the Board was supportive, reported H.R. 5074 which was legislation that went back and took a look at the 2001 Act and put the Treasury back in charge of the payment of Tier II benefits. That was, at the time, I think it was one of those that everybody thought it would be a good idea and was going to save money, I think. I don't have my notes in front of me from that hearing, but it seemed to me that it was costing $13 million more than we anticipated it costing.

I assume that the Board continues to be supportive of the legislation, one; and two, at this moment in time, are there any other items like that, that you think the Board needs to bring before this Committee for fine tuning the 2001 legislation?

Mr. SCHWARTZ. First of all, we would like to thank the Committee for doing that and thank you for your help. There is nothing at this time, other than that, that we need.

Mr. LATOURETTE. That is excellent. That makes our work a lot easier.

[Laughter.]

Mr. LATOURETTE. I think my last question to you is, in your latest management report to Congress, could you outline sort of the major issues that you brought up in that report? Again, I heard you just say that you look out over 75 years. Is your prognosis for this year to be a good year, and if not, do you have any significant issues or concerns that you think are on the horizon in the short term?

Mr. SCHWARTZ. Well, it is kind of interesting that in March of 2002, the employment in the railroad industry was 229,000 people. The actives are now 237,000 people. There has been hiring. We think we do anticipate through the years for there to be somewhat of a decline, but I can tell you that our actuary is telling me that he is looking at those numbers, and he may be even adjusting those hiring numbers a little bit to maybe show a little less of a decline in hiring than there has been projected in the future.

So I would say that, as long as the hiring stays around where it is or drops just a little bit each year, as long as our investments continue to bring in a good return like they are, we don't see any problem with the fund for the next 75 years.

Mr. LATOURETTE. Again, I apologize; I should know this, the mix. When you took the 2001 Act and went away from solely low yield Federal securities, what is the current mix of your portfolio?

Mr. SCHWARTZ. I think we would need the Trust to testify on that exactly at this point. When the Trust first went into it, of course, they had U.S. equities, non-U.S. equities, fixed, private, and I think the current mix, I would prefer them to testify on that.

Mr. LATOURETTE. OK, well, I thank you very much. Again, I thank you and the Board and everybody associated with the Board for this good news. I think if all of the pieces of legislation that we have passed around here bore the same good fruits that you have put into effect, it would be a much happier place.

Mr. SCHWARTZ. Great, thank you.

Mr. LATOURETTE. Thank you very much.

Ms. Brown?

Ms. BROWN. Thank you.

Many members on this Subcommittee have heard from widows in their Congressional District about a serious problem with how their railroad retirement pensions interact with their social security benefits. From what I understand, these widows are not getting cost of living increases in their railroad retirement pensions, even though the cost of living continues to escalate each year. Why is this and what can be done to resolve this situation?

Mr. SCHWARTZ. Frank, do you want to talk on that?

Ms. BROWN. Anyone else can feel like they can participate.

Mr. BUZZI. The minimum widow's benefit establishes an initial benefit level, and that level is fixed and does not have cost of living increases. However, the benefit under the old law is still calculated as it was previously. Then the widow receives the larger of those two. So, in effect, for several years, the widow will receive no cost of living increase, and thereafter, as the benefit under the old law exceeds the guarantee, she will, he or she will.

Ms. BROWN. OK, now do that again because I didn't quite get it.

Mr. BUZZI. The widow's benefit is comprised of a Tier I and Tier II portion. The Tier I portion is equal to 100 percent of the employee's Tier I. The Tier II portion is 50 percent of the employee's Tier II. However, the guaranteed amount is 100 percent of the employee's Tier II. The 100 percent of Tier I plus 100 percent of Tier II is the guarantee amount that the widow is guaranteed to receive.

The old law benefit was 100 percent of Tier I plus 50 percent of Tier II. The old law amounts received cost of living increases. The guarantee amount does not. So the widow receives the larger of the two, the initially calculated guaranteed amount based on 100 percent of Tier II or the old law amount, whichever is greater. So, in effect, the widow will receive no cost of living increases for several years under total annuity. But thereafter, as the old law amount exceeds the guarantee amount, the widow will receive cost of living increases.

Ms. BROWN. OK, but the widow is getting more under this.

Mr. SCHWARTZ. Yes.

Mr. BUZZI. Yes, absolutely.

Ms. BROWN. Just one other follow-up: What recourse does a retiree have if the Railroad Retirement Board staff misinforms him or her about the qualification requirement to obtain full pension and survivor benefits, and it is a mistake on the part of the staffer? I hope that was in writing because, basically, if it is not you have just one person's word over another.

Mr. BARTHOLOW. Unfortunately, mistakes are made but not all that often by our people. We have a very, very good work force. As you can see, most of us have been around a while, and we know the program. There are mistakes occasionally made, however. We do, obviously, look into situations, but if there is a mistake that is made and bad information is given, unfortunately, we can't change the law. The law does, in fact, control the amount of the benefit, and that is the amount payable.

As I said, it is unfortunate, but those things do happen, and they happen not only in our program but they happen in other pro-

grams. That is the law that is applicable under all Government pension programs.

Ms. BROWN. OK, well, thank you, Mr. Chairman.

Mr. LATOURETTE. I thank the gentlelady very much. I just have one more question, and then if the gentlelady has another question, I will yield back to her.

Something I forgot to ask earlier, as members of Congress, as Federal employees, we have something called the thrift savings plan that we can participate in. Given the great record that you have accumulated since the passage of the 2001 Act, is it possible for an employee to take advantage of this great performance by contributing more than the minimum amount at this moment in time to receive additional benefits at the end?

Mr. SCHWARTZ. They are set. It is set in statute that is what it would be. It would be the Tier II would be 4.4 percent for an employee.

Mr. LATOURETTE. So they don't. If an employee said, you know what, boy, I would really like to put in some more dough, he does not at this moment in time have the opportunity to do that.

Mr. SCHWARTZ. Right, that is correct.

Mr. LATOURETTE. Let me ask you this. Do you think that it is a good idea if we looked at that since you are doing such a bang-up job, if we made that an option for railroad employees in the future?

Mr. SCHWARTZ. Well, the way I look at it is if this Committee wants to look at something, we certainly would take a look at that as well.

Mr. LATOURETTE. Good, thank you. Do you have any more questions?

Well, Chairman Schwartz, I want to thank you and your fellow Board members and everyone else associated from the Board for not only coming and sharing your story and testimony today but also letting us share in your success. Thank you very much.

Mr. SCHWARTZ. Thank you.

Mr. LATOURETTE. Thank you.

It is now our pleasure to welcome our second panel this afternoon. We are going to be joined by Mr. James Hixon who is a trustee with the National Retirement Investment Trust, Mr. Joel Parker, another trustee with the National Railroad Retirement Investment Trust, Mr. Robert Scardelletti who is the President of the Transportation Communications International Union, and for a return engagement, Mr. Edward Hamberger who is the President of the Association of American Railroads.

I want to thank all of you for coming today, and we look forward to hearing from you.

Mr. Hixon, you are first.

TESTIMONY OF JAMES A. HIXON, TRUSTEE, NATIONAL RAILROAD RETIREMENT INVESTMENT TRUST; JOEL PARKER, TRUSTEE, NATIONAL RAILROAD RETIREMENT INVESTMENT TRUST; ROBERT SCARDELLETTI, PRESIDENT, TRANSPORTATION COMMUNICATIONS INTERNATIONAL UNION; EDWARD HAMBERGER, PRESIDENT, ASSOCIATION OF AMERICAN RAILROADS

Mr. HIXON. Mr. Chairman and members of the Subcommittee, my name is Jim Hixon. I am the Executive Vice President Law and Corporate Relations of the Norfolk Southern Corporation as well as a member of the Board of Trustees of the National Railroad Retirement Investment Trust. I am pleased to be here today and would like to thank the Subcommittee for giving me this opportunity to testify about the Trust's operational experience since its inception a few years ago.

In December of 2001, years of collaboration between rail management, rail labor, and Congress resulted in the enactment of legislation forming the National Railroad Retirement Investment Trust, and on the day it was officially established, the $20 billion Trust fund became one of the largest pension investment trusts in the United States.

This very successful collaboration has continued as we have worked to build this statutory concept into an actual institution, and the need for collaborative effort has been magnified because of the Trust's very unique status as a public-private partnership. As a result, transforming the Trust into an entity that could effectively and efficiently manage and invest railroad retirement assets for the benefit of beneficiaries has presented many challenges in the Trust's formative years.

In the 41 days between enactment and the Trust's establishment date of February 1st, 2002, a labor-management implementation task force worked almost around the clock to create this new entity. The group included representatives of all major railroads and several railway labor unions and called on the expertise of a variety of senior executives from industry to provide advice on legal, investment, treasury functions, insurance, and human resources issues.

The task force also met and coordinated closely with representatives of the Railroad Retirement Board on various start-up issues and ultimately provided recommendations regarding the outline of a basic organizational structure to be considered by the new Board of Trustees when it first convened.

The National Railroad Retirement Investment Trust Board of Trustees met for the first time on February 1st, 2002, with participation of three appointees selected by rail management and three appointees selected by rail labor. Many of the initial challenges were organizational, including acceptance by the trustees of their positions and notification to the Railroad Retirement Board, selection of a chair, adoption of bylaws, retention of counsel, and the acquisition of insurance and bonding coverages.

During the initial months, the Board approved and adopted internal policies on administrative issues including a conflicts of interest policy and a disclosure of investment information policy. The Board also was successful, after conducting two nationwide

searches, in selecting a statutorily mandated independent trustee and hiring its first full time employee, the Chief Investment Officer.

With these key individuals in place and the broad outline of an entity beginning to take shape, the Board began the process of developing an investment structure to enable the receipt and management of railroad retirement assets for investment. In doing so, the Board turned its attention to fundamental investment issues including the development of investment guidelines. As part of this process, the trustees and industry experts met with senior investment professionals from some of the country's largest corporate pension plans and Taft Hartley plans to explore a variety of investment and organizational issues.

Among the advice received from these plans was the importance of hiring a dedicated staff, including specialized directors and advisors in various asset classes that would have the primary responsibility for making investment recommendations to the Board of Trustees rather than having the Board rely on outside investment advisors for such recommendations. My fellow trustee, Joel Parker will discuss these and other investment related issues in greater detail.

Early on, the Board of Trustees evaluated proposals from all of the major accounting firms and selected Deloitte and Touche as its independent auditor.

We also formed an Audit Committee to aid in the development of internal accounting procedures and administrative controls. The committee has continually reviewed key aspects of the Trust's auditing, financial reporting, internal accounting, and internal controls processes as it has grown, and through its relationship with the Trust staff and the Trust custodial bank and independent auditor, the committee has developed effective controls and reporting processes. As part of its ongoing review of new statutory and regulatory developments in the areas of internal accounting and controls contained in the Sarbanes Oxley Act and pronouncements by various regulatory agencies, the Audit Committee has also implemented various best practices recommendations appropriate for application to the Trust.

Development of the Trust has also required a great deal of coordination with Federal Government Agencies, and the Trust has maintained regular communications with the Railroad Retirement Board and the Department of the Treasury. As a result of discussions with these agencies, the Trust became a party to a four way Memorandum of Understanding which outlines the budgetary, transfer, accounting, and financial reporting responsibilities with respect to assets held by the Trust and assets held within the Treasury for the Trust.

Monthly Trust information reports submitted pursuant to the MOU, together with quarterly reports transmitted to the Congressional committees of jurisdiction and the annual management report that the Trust is required to submit to Congress and the Executive Branch have provided the means to communicate the status of Trust activities to interested parties.

We have worked closely with the Railroad Retirement Board to develop a strong partnership while maintaining the investment

independence mandated by Congress. We recognize that the Congressional rationale for this separation was rooted in the fact that, although the Trust is responsible for the management and investment of Federal Government assets, there was a concern about the implications of the Federal Government itself investing in and thereby influencing the financial markets. Thus, while the Trust was established by Federal statute and the reporting requirements and fiduciary standards applicable to it are set forth in the statute, Congress made clear that the Trust is not a department, agency or instrumentality of the Government of the United States.

This unique status, as a non-Governmental entity that is responsible for the management and investment of Government assets, has presented some challenges in the Trust's first four plus years. Among those challenges has been coordinating the audit of the Trust's year-end financial statement with that of the Railroad Retirement Board so the Trust's audited statement can be included in the RRB's own financial statement and Statement of Social Insurance for eventual inclusion in the Financial Report of the United States Government.

The Trust's unique status has also been recognized by the Internal Revenue Service, which has modified our IRS reporting requirements in light of the statutorily mandated annual management report. On a related matter, the Trust is preparing to submit a ruling request to the Service to clarify the application of other tax rules to the Trust.

In addition, we have worked with Congress to secure various technical corrections to address issues not anticipated in the original legislation.

Challenges like these are inevitable, given the quasi-governmental nature of the Trust. However, they have been and will continue to be successfully resolved because of the continued cooperative relationship that exists between the Trust, the RRB, and other Government Agencies.

Mr. Chairman, there are a number of ways to measure success, and in my opinion, the National Railroad Retirement Investment Trust has been a categorical success by any of these. A little over four years ago, six trustees were seeking a seventh trustee and the Trust's first employee. Just last month, the Trust's newly hired Chief Accounting Officer brought to 12 the number of full time professionals employed by the Trust. Trustees have transitioned on and off of the Board, but the spirit of cooperation that brought about railroad retirement reform is just as strong today as it was four years ago.

On behalf of my fellow trustees, I again thank you for the opportunity to appear before you today and would be happy to respond to any questions you may have.

Mr. LATOURETTE. Mr. Hixon, thank you very much.

Mr. Parker, welcome, we look forward to hearing from you.

Mr. PARKER. Thank you. Good afternoon, Mr. Chairman and members of the Subcommittee. My name is Joel Parker. I am Special Assistant to the President and International Vice President of the Transportation Communications International Union, as well as an original member of the Board of Trustees of the National Railroad Retirement Investment Trust.

I appreciate the opportunity to discuss with you the progress of the Trust. I will focus on the Trust's investment strategy and performance—good news.

The Railroad Retirement and Survivors' Improvement Act of 2001 has provided for the transfer of approximately $21 billion in railroad retirement system funds to the Trust for investment in a diversified portfolio similar to other large U.S. pension plans.

As a first priority, the Trust conducted a detailed asset-liability study of the railroad retirement system to assess the Trust's projected funding obligations and alternative approaches to asset allocation. Based on the asset-liability study, the Trust developed, and in August of 2002, adopted a set of investment guidelines. We recognized that it would not be possible to immediately diversify the Trust's assets into the full array of asset classes set forth in the guidelines. As a result, we adopted an initial strategy of placing the assets in indexed accounts in three broad classes: domestic equities, international equities, and fixed income.

To answer the Chairman's question to the previous panel, the asset allocation, which we adopted then and still have today, was 45 percent in domestic equities of which 5 percent could go to private equity, 20 percent in international equities, and 35 percent in fixed income.

Indexation allowed us to diversify the Trust's investment exposure quickly and cost effectively as we received railroad retirement system funds. With these arrangements in place at the end of Fiscal Year 2002, our first fiscal year, the process of moving railroad retirement system assets to the Trust and investing them could begin. Working with the Railroad Retirement Board and the Treasury Department, we developed a schedule for transferring railroad retirement system assets held by the Treasury over a period of approximately six months beginning late in Fiscal Year 2002. When the final scheduled transfer took place in mid-March of 2003, the Trust had received a total of $19.3 billion of railroad retirement system assets.

During 2003, the Trust undertook a major planning process to develop a plan to move the investment portfolio beyond indexed only investments. In the course of this process, the Trust reviewed a variety of investment strategies and methodologies to determine how active management could add value to expected returns at reasonable levels of risk, and I emphasize the latter, the reasonable levels of risk.

The product of this effort was an investment plan. The investment plan includes a target for the level of the Trust's diversification within each asset class between indexed and actively managed assets based on an assessment of the potential for active management to add value to expected returns at reasonable levels of risk.

Investment performance for the Trust's major asset classes was positive for Fiscal Year 2003, our first full year of investment activity. The Trust achieved overall performance returns of 19.9 percent compared to the target index return of 18.8 percent. In Fiscal Year 2003, the full year performance return resulted in an increase of $2.7 billion in the Trust-managed portfolio.

In U.S. equity, the Trust's goals are a portfolio that combines indexation and active management in order to achieve performance

in excess of the market at reasonable levels of risk. Execution of the U.S. equity portion of our investment plan focused primarily on large cap enhanced indexation strategies whose performance tracks relatively closely with that of their benchmark index while adding modest value. In Fiscal Year 2004, the Trust hired active managers both in domestic large cap strategies and in large cap value strategies.

For fixed income assets, the Trust hired three enhanced index bond managers. As in equity, these managers take small and carefully calculated deviations from the index portfolios, aiming to add modest performance over the index without incurring significant risk.

In addition, under the investment guidelines and our investment plan, 5 percent of the overall Trust portfolio, which is funded from the 45 percent U.S. equity allocation, was designated for private equity investments. In Fiscal Year 2004, the first private equity commitments were made.

Also during Fiscal year 2004, we performed another multiphased asset allocation study to reexamine assumptions about return and risk in different asset classes in order to see whether the Trust asset allocation policy should be updated to improve returns and portfolio diversification. As a result of this study, the trustees authorized the investment staff to examine strategies in three new asset classes: real estate, commodities, and hedge funds. Work continues in these areas, but no funds have yet been allocated to these asset classes.

For the 12 months of Fiscal Year 2004, the investment return on all Trust-managed assets was 13.3 percent. This compared favorably with the Trust's composite benchmark which returned 12.7 percent. At the end of Fiscal Year 2004, assets overseen by NRRIT totaled $25 billion, and the total value of railroad retirement system assets, including those held in the RRB accounts at the Treasury, was $26.4 billion.

During Fiscal Year 2005, continued diversification away from indexation in most major asset classes resulted in retaining 21 new managers during the fiscal year. At year end, and that is the last fiscal year, at the end of the last fiscal year, 34 percent of the Trust investments were actively managed by more than 40 investment managers.

With respect to U.S. equities, the Trust focused primarily on active large cap strategies, adding managers in several segments of that asset class. During that year, we continued to manage our non-U.S. equity investments through investments in index funds, but during this period, we adopted the non-U.S. equity portion of our investment plan and we took steps to begin adding enhanced index strategy. We also continued moving beyond indexation in fixed income assets during Fiscal Year 2005, and in private equity, the trustees approved investments in nine additional private equity limited partnerships.

For Fiscal Year 2005, the investment return on Trust-managed assets was 14.0 percent. This compared favorably with the composite benchmark which returned 13 percent. At fiscal year end, the net asset value of assets overseen by the Trust totaled $27.7 bil-

lion, and the total value of railroad retirement system assets, including those held at the Treasury, totaled $29 billion.

In conclusion, from its inception in February, 2002, to September 30th, 2005, the Trust received $21.3 billion from the Treasury, and we have transferred $2.7 billion back to the Treasury. The net book value of funds received from the Treasury since inception, therefore, is $18.6 billion. Those assets were invested in a diversified multi-asset class portfolio in accordance with our investment policy. This diversification of assets has allowed the Trust's assets to grow significantly beyond their original book value. As of September 30th, 2005, the net asset value of the Trust-managed assets totaled $27.7 billion, representing an increase of $9.1 billion above the net book value of assets transferred to the Trust for investment.

At the end of the most recent quarter, March 31st, 2006, the net asset value of assets overseen by the Trust totaled $28.9 billion. The total value of railroad retirement system assets stood at $30.3 billion, about $10 billion more than the total value of assets held by the system at the time the Trust began. This $10 billion increase is net of an additional $3.2 billion transferred from the Trust to the Treasury for benefit payments during this period.

Mr. Chairman, we believe the Trust has provided the kind of value to the railroad retirement system and its beneficiaries that was envisioned by the authors of the legislation that created this new and unique structure. We appreciate that the early years have been good ones for the financial markets and the Trust. We also recognize that markets have their cycles. Our goal has been to establish a solid professional organization, to develop a prudent investment plan that provides for a broad diversification of assets, and to take steps to judicially implement this plan. We believe this three-pronged approach will serve us well in strong markets and also help to maintain stability in more challenging times.

Thank you very much.

Mr. LATOURETTE. I thank you, Mr. Parker, very much.

Mr. Scardelletti, welcome to you, and we look forward to hearing from you.

Mr. SCARDELLETTI. Thank you, Mr. Chairman.

Mr. Chairman and Ranking Member, my name is Robert Scardelletti. I am the International President of the Transportation Communications International Union. I deeply appreciate the opportunity to appear before you today to discuss the National Railroad Retirement Investment Trust on behalf of rail labor.

Mr. Chairman, I was part of the rail labor team that worked with rail management to develop the initial outlines of the proposal for improving the railroad retirement system that ultimately became the Railroad Retirement and Survivors' Improvement Act of 2001. While the measure was under consideration by Congress, I had the privilege of working with members of this Committee as you improved and perfected the proposal that rail labor and management brought to you. The record shows that these collaborations between labor and management and between the combined forces of labor, management, and forward-looking members of this Committee have borne fruit.

First, the Act provided better railroad retirement benefits for rail workers, their dependents, and survivors. Surviving spouses of de-

ceased retirees now inherit the full Tier II annuity of the retiree rather than no more than 50 percent of the annuity which was previously allowed under law. The age at which a worker with 30 years of service may retire was reduced from 62 to 60. And the vesting period for Tier I and Tier II benefits was cut in half from 10 to 5 years.

Second, the financial security of the railroad retirement system has been strengthened. The total assets of the system now stand at $30.3 billion, about $10 billion more than when the Trust first began its investment activities in the Fall of 2002, which is a 50 percent increase.

Third, the cost of the system to employers and employees has declined. For calendar year 2006, the Tier II rate on employees is 4.4 percent, down from 4.9 percent prior to the Act, and the employer tax has dropped from 16.1 percent to 12.6.

The structure of the Trust has worked well. The balance of three labor and three management members of the Board of Trustees along with one independent trustee, has produced a cooperative team-oriented approach to meeting a common goal: protecting and growing the assets held by the Trust for the benefit of current and future railroad retirees and their dependents, spouses, and survivors. I am not aware of a single instance to date in which Trust decisions have been discussed or decided based on a labor or a management affiliation.

The success to date of the Trust is testimony not only to the trustees and staff who are directly responsible for its operation but also to the leadership of this Committee and the Congress in passing the legislation in 2001. In addition, the cooperation and assistance of the Railroad Retirement Board has been vital to the start-up and smooth functioning of the Trust. Likewise, the Treasury Department has played a key role in developing new policies and procedures to facilitate the work of this unique organization and its special mission.

One issue of concern to active workers and retirees, especially in light of the favorable position of the Trust Fund, is that future appropriations for the Railroad Retirement Board may not be adequate to maintain the level of service the railroad community expects and deserves. We would ask for your assistance in monitoring this situation.

Mr. Chairman, we in the rail labor movement keep a close eye on the activities of the Trust. After all, our members have much to gain or lose from its success or failure. And so far, we are very satisfied with what we see.

I appreciate the opportunity to speak to you on this important subject and would be pleased to answer any questions. Thank you.

Mr. LATOURETTE. Thank you, Mr. Scardelletti.

Mr. Hamberger, thank you for coming. We look forward to hearing from you.

Mr. HAMBERGER. Mr. Chairman, thank you, Congresswoman, Brown, thank you for the opportunity to be here. I am last in the line here, so I will make five quick points.

Point number one, thank you for your wisdom and leadership on this Committee, this Subcommittee, and Congress in general for enacting the Railroad Retirement and Survivors' Improvement Act

of 2001. Now, you probably expected me to say that, but those are not empty words. I have a personal memory of a hearing scheduled September 17th, 1998, a mere two months after I got this job and the first time I was testifying before this Subcommittee. You can imagine how pleased I was that the first hearing was on the interaction of Tier I and Tier II, and widows' and survivors' benefits, and the supplemental annuity tax and how it interacted with the social security tax.

Notwithstanding my apprehension, the hearing was a major success, and my counterpart at that time, Clarence Monin, I believe with the BLE, and I, under the urging of this Subcommittee, agreed that management and labor should sit down and see whether they could come up with an agreed upon approach.

Just to give it further proof, a contemporaneous written statement, we put out a press release dated September 28th, in which the AAR thanked and applauded the Subcommittee for providing the catalyst for talks on railroad retirement reform. We hope to schedule meetings with rail labor in the very near future. We did schedule those meetings, and because of that hearing in September, 1998, we are able to hold this today, almost eight years later. If this could be submitted for the record, I would appreciate it.

Second point, it shows how well management and labor can work together and when we do, how successful we can be. The personal respect I have for Mr. Scardelletti, Mr. Parker, and others in rail labor that was developed over this long fight still survives today, and I look at them as partners in many ways.

Number three, clearly, the legislation has worked. You have heard about how well it has worked.

Let me focus point number four on how well it has worked for the railroads. Over the course of the last four years, rail taxes on management have gone down by a total of $1.5 billion. We talked about this at the last hearing two weeks ago. What happened to that money? Well, we increased our spending on capital and maintenance over those same four years by $5.8 billion; we hired 10,000 new employees since 2003; and we have dealt with a fuel situation where in 2001, the average price of diesel fuel was 85 cents a gallon, and as of March 31, 2006, it has more than doubled to $1.89. So we have taken that money and turned it back into the industry, and we continue to do that.

As I testified two weeks ago, $8.3 billion is going to be spent on capital expenditures in 2006 alone, and just this week, two of our members, Burlington Northern Santa Fe and Union Pacific announced an additional $100 million to be spent over the next several years to triple track more than 40 miles of right of way into the Southern Powder River Basin. When we have the opportunity to invest, we take that opportunity.

Number five, I will end as I began, thanking you for your leadership, this time for reporting out H.R. 5074 which would continue to have the Treasury be the dispersing agent for the railroad retirement checks. As you know, that is important for at least two reasons. One, it is much cheaper; I believe it is about $2 a check versus 18 cents a check, the cheaper coming out of the Department of the Treasury. And second, it means that we do not have to turn

over massive amounts of personal information to an outside private vendor.

So thank you for your work on railroad retirement reform and thank you for your work on H.R. 5074.

Mr. LATOURETTE. Mr. Hamberger, thank you. I notice a theme between your testimony last time and this time. You always seem to have five points, and that makes it easier for those of us up here to follow.

Thank you all for testifying today. I appreciate it very much.

Mr. Hixon, just by way of education, I would be interested in knowing how the fund works and who selects the products in the portfolio? Whether it is the Board, or it is the fund managers, and I assume it is not the individual employee, but who makes the selection as to what stocks are in the portfolio of the Trust?

Mr. HIXON. The selection of what is in the portfolio is made by the investment manager that the Trust has retained to make those decisions. We have a very stringent process where the employees of the Trust review various candidates for an investment opportunity they have. It is a very qualitative and quantitative process, a lot of due diligence. It takes about six months to make a choice. But once the staff recommends the investment manager to the Board, the Board must approve the investment manager, then that investment manager is the one that actually makes the investment decisions within the portfolio.

Mr. LATOURETTE. How is that reviewed by the trustees? Does the fund manager then come and say, here is what we have done, and what do you all think, or no?

Mr. HIXON. The trust staff actually has several visits a year with the investment managers, onsite visits, to review their performance. They have monthly reviews on their performance as well. They have investment guidelines they have to comply with. Then each year, the trustees actually get an in-depth annual review on their performance. Like the U.S. equity side, we get an annual review on what has happened with the investment managers on the U.S. equity side, a detailed review, and each month we get a review of the performance of each of our investment managers.

Mr. LATOURETTE. Can you describe for us what safeguards are in place to prevent things like conflicts of interest, insider trading, things like that on behalf of the fund managers?

Mr. HIXON. We have our custodian bank. Northern Trust has our investment guidelines, and they monitor the investments made by the investment managers. For example, we have set up a rule that the investment managers could not invest in railroad stocks, and after the way stocks of our industry have performed over the last couple years, several of them have bemoaned the fact that we restrict them from investing in railroads.

But nevertheless, the custodian then reviews each of their investments to make sure they meet the criteria that we have set for that investment manager. In the event they have invested in any railroad or invested outside of what they were allowed to invest in, then we make them give up that investment.

Mr. LATOURETTE. Also in your testimony, you mentioned that, given I guess we can call it the quasi-governmental nature of the Trust, some issues have been created with the IRS and other Agen-

cies. Have those issues been resolved, or do you think that you are going to be coming to the Committee in the future for additional technical corrections?

Mr. HIXON. I think a lot of those issues have been resolved. I think it was the nature of the start-up, where a lot of people didn't know what we were doing or how we were set up. I think over the last couple of years, we have been able to get that settled, and I think at this point we don't anticipate coming to the Committee with any other corrections, but as always if we see a need, we will come to you.

Mr. LATOURETTE. Thank you.

Mr. Parker, I just want to elaborate on part of your testimony. You mentioned in 2004 that three enhanced index bond managers were hired as well as managers for large cap strategies and domestic capitalization strategies. You also indicated that you are expanding the use of the fund manager for major asset classes. At this point, are most of the Trust assets managed primarily by outside managers, or do you still have a real strong in-house management as well?

Mr. PARKER. We don't have any in-house management. The staff selects managers. All the assets are externally managed. Maybe the confusion was that we indexed at first wholly, and we are gradually moving toward an active strategy depending on asset class. The amount of active management will vary across different asset classes based on the asset allocation plan.

Mr. LATOURETTE. When the Trust makes or retains a new outside manager, who makes that selection, and can you just briefly describe for us how the selection process works?

Mr. PARKER. I think Jim, Mr. Hixon, went through it fairly well. We have a very rigorous review process conducted by our in-house staff. We don't have any external staff. We have external managers, but our staff is totally in-house. We have an open door policy that any manager can approach the staff. You don't have to jump through hoops.

They will have a meeting, and then they will conduct a review that generally takes up to six months. That includes a winnowing process where the manager has to fit within our overall asset allocation strategy. So, if a manager approached us who was in a sector that we were not ready or prepared to go into, let us say large cap growth to just use an example, we wouldn't pursue that manager at that time, but we would put them on the shelf and look at them when we were ready because a diversification plan is very methodical. Our goal is to diversify, diversify, diversify, but very carefully, very prudently, very conservatively.

The ultimate recommendation of the manager, to get back to your question, is made by the staff. They have to come to us, to the trustees, with their final recommendation. They present to us a very in-depth recommendation, a relative analysis of the manager versus all the other managers they looked at, a due diligence book that generally is a volume this thick, very thick, with all the interviews and analyses they have made of that particular manager.

As Mr. Hixon said, that doesn't end it. There is a continual monitoring process of all the managers by the in-house staff.

Mr. LATOURETTE. Then in my last question for you, Mr. Parker, I just want to focus on the 5 percent private equity. Does that mean that the Trust is investing in IPOs?

Mr. PARKER. We are investing in limited partnerships, I want to say exclusively at this point. Well, with private equity, some of the private equities, the investment manager with a general partner who is doing the investments may be investing in IPOS and buyouts and things like that.

Mr.HIXON. What we do is we look at the performance of their funds, and they take our contribution to those funds. Then they allocate them as they see fit, and we monitor their performance. Some of them may be doing it, but it is not something we get involved in. We are not involved in those decisions.

Mr. LATOURETTE. So, just to be clear, you make the investments with the limited partnership. The limited partnership, as part of their work, may invest in an IPO, but you don't say we are going to invest in an IPO.

Mr. PARKER. That is correct.

Mr. LATOURETTE. OK, so there is a step in between.

Mr. Hamberger, I just want to ask you one question. There was some talk recently about Amtrak perhaps suggesting that they wanted to remove their employees from the railroad retirement system and place them into social security. I would just like to solicit your thoughts on whether that is a good idea or a bad idea.

Mr. HAMBERGER. Bad idea.

Mr. LATOURETTE. Right. Am I correct, to Mr. Parker and Mr. Hixon, it has been a while since I have seen the figures, but that Amtrak employee contributions and Amtrak contributions to the Trust are about 10 percent of receipts? Is that fair?

Mr. HIXON. I think that is fair. It may be slightly less now but about that.

Mr. LATOURETTE. About 10 percent, OK.

Mr. Scardelletti, I asked Chairman Schwartz this question. We had sort of crunch, a financial crunch in 1983, I think after the passage of the bill, and in 2001 we saw additional retirements. Can you, from your standpoint, sort of give us the forecast based upon where you think employment is going and whether or not we are going to see an additional strain on the railroad retirement system as a result of the retirement of the baby boomers?

Mr. SCARDELLETTI. Well, I think, as the Board testified, the actuaries have gone through those numbers quite extensively, and all indications are the fund can handle all the people that are intending to retire without any problem. As far as the railroads hiring, of course, that is under their control, but as Mr. Hamberger just said, they have hired 10,000 and they are talking about hiring a number of other people. So I think the fund is in excellent shape to handle the situation.

Mr. LATOURETTE. We had a hearing a couple of weeks ago that Mr. Hamberger alluded to on rail capacity. Clearly, what came out of that hearing, at least in my mind, is that there are choke points and part of the choke points, some of it is infrastructure and some of it is train crews, quite frankly. Just for my own edification, if a railroad employee is retired, does he or she have the ability to come back and help alleviate some of that difficulty if all parties

are willing, or does that screw up their ability to continue to receive retirement benefits?

Mr. SCARDELLETTI. No. Once you retire, you have to resign from the railroad when you retire, and once you get your pension, you are not allowed to work for your former employer.

Mr. LATOURETTE. OK, thank you very much.

Ms. Brown?

Ms. BROWN. Mr. Hamberger, you stated that the Act partially encouraged the retirement of a number of railroad workers, so that the industry had a significant increase in its hiring requirements. How many workers has the railroad industry hired since enactment of the Act, and how many would you say are the results of the Act directly?

Mr. HAMBERGER. I really can't say how many are a result of the Act directly, but in my written testimony, we do have a chart that shows the number, if I can just refer you to that. I believe it was at 163,000 it looks like in 2001. We are now up to about 165,000. It fell from 2001 to 2003, hitting about 153,000. So about 10,000 retirees over that two year period, and then between 2003 and 2005, rehiring those 10,000 plus about another 2,000.

Ms. BROWN. Mr. Scardelletti, I know that you are concerned for ensuring future appropriations for the Railroad Retirement Board, and I will be happy to send a letter with the Chairman to the Committee. Have you heard of any problems your members are experiencing with the retirement program, or is everything going real well, as you said, from the beginning?

Mr. SCARDELLETTI. Right now, I think it is going well, but the Railroad Retirement Board is considering cutting the number of field offices which then will be a problem. That is what we are talking about, and we think money should be allocated for that, to keep those offices there, so people have ready access like they have had forever. We would be very happy to provide the Committee with details on this. Rail labor would be happy to do that. I am sure our people have already discussed it, though, individually, but we will provide something in writing that goes right to the crux of what we are saying.

Ms. BROWN. That is pretty much it. You know everything is going very well, it seems, excellent performance and relationships with other pension plans. I guess just keep up the good work.

Any other comments that you want to make to the Committee, Mr. Hixon?

Mr. HIXON. No, but thank you for all your assistance.

Ms. BROWN. We don't usually have a Committee meeting this pleasant.

Mr. LATOURETTE. Well, I thank the gentlelady very much, and I hope this is the first of many such happy meetings.

I want to thank all of you for your testimony today. I think that, as we said with the first panel, a growth of 50 percent, taking assets and increasing it by $10 billion in a short period of time is remarkable. Our counsel, Mr. Scammel, in commenting on your report at the close of 2005, said that if everything was as clear as that, the Federal Government would be running a lot better. So you certainly deserve congratulations on the good work that you are doing. I think maybe after the hearing, Ms. Brown and I would

like to talk to you about managing our retirement portfolios as well.

Again, thank you all for this excellent report. Thank you for coming today, and you go with our thanks.

[Whereupon, at 3:15 p.m., the subcommittee was adjourned.]

STATEMENT OF
THE HONORABLE CORRINE BROWN
SUBCOMMITTEE ON RAILROADS
HEARING ON
"OPERATIONAL EXPERIENCE UN IDER THE 2001 RAILROAD RETIREMENT REFORM LAW"
MAY 10, 2006

Thank you, Mr. Chairman, for holding this important hearing. It's nice to have a hearing where all the witnesses have good news for us.

I believe the Railroad Retirement and Survivors' Improvement Act of 2001 was a resounding success.

It substantially improved benefits to the men and women who work on our nation's railroads and the 634,000 retirees and survivors of retired railroad workers.

It significantly reduced Tier II taxes for railroads and for railroad workers (for the first time in 2005) from 4.9 percent to 4.4 percent.

The Act also created the National Railroad Retirement Investment Trust, which has been a tremendous success: the net value of Trust-managed assets has soared to $28.9 billion as of March 2006, representing an increase of more than $10 billion above the net book value of assets transferred to the Trust for investment in 2001.

In other words, the 2001 railroad retirement reform law was a win-win situation for everyone: for railroads, for railroad workers, for railroad retirees and survivors, and for the many former and current members of this Subcommittee who worked so hard to create the program.

I want to welcome the witnesses here today. I look forward to hearing from them about their experience with implementation of the 2001 reform law.

Statement by Congressman Jerry F. Costello
Committee on Transportation and Infrastructure
Subcommittee on Railroads
Hearing on Operational Experience under the 2001 Railroad Retirement Reform Law
May 10, 2006

Mr. Chairman, thank you for calling today's hearing on the operational experience under the 2001 Railroad Retirement Reform Law. I'd like to welcome today's witnesses.

The new legislation mandated by the Railroad Retirement and Survivors' Improvement Act of 2001 was based on the recommendations of a joint labor-management negotiating committee. The provisions agreed upon took into account cost factors and the solvency of the trust funds as well as the wish to increase benefits.

However, many widows in my congressional district have brought to my attention a serious problem with their railroad retirement pension and how it interacts with Social Security. Widows' annuities increased to the "initial minimum amount" provided by the new law are not further increased by the annual cost-of-living adjustments until the regular formula amount payable under prior law, plus interim cost-of-living adjustments, exceeds the amount payable under the new law.

A widow's benefits are actually decreasing when her Social Security benefit increases, because railroad retirement tier I benefits are reduced for Social Security entitlements. My constituents are not getting their much needed cost-of-living increases, even though the cost-of-living continues to escalate each year.

These offsets are, in principle, very similar to the Government Pension Offset (GPO) and the Windfall Elimination Provision (WEP). Just as I believe the GPO and the WEP should be completely repealed, I also think our railroad retirement widows should not be penalized and should receive, in full, the Social Security benefits that they have rightfully earned throughout the course of their careers.

It is my hope to work with this Subcommittee to make the necessary changes to this system so that more of our seniors do not have to suffer.

I look forward to today's hearing and the testimony of today's witnesses.

COMMITTEE ON TRANSPORTATION & INFRASTRUCTURE
Subcommittee on Railroads

"Operational Experience Under the 2001 Railroad Retirement Reform Law"

May 10, 2006
2:00 p.m.
Room 2167, Rayburn House Office Building

Opening Statement of Congressman Elijah E. Cummings

Mr. Chairman:

I thank you for calling today's hearing to enable us to examine how the Railroad Retirement System is performing under the reform laws adopted in 2001.

The Railroad Retirement System is a two-tiered system that provides retirement benefits for all railroad workers in the United States. The first tier closely resembles the Social Security System – and in fact the benefits provided under Tier I are calculated using the Social Security benefit formula. The benefits paid under Tier II resemble a

pension plan. Both tiers are funded largely with payroll taxes.

The System is supervised by the three-member Railroad Retirement Board, which also administers survivor and disability benefits for railroad workers.

The Railroad Retirement System is currently configured and managed under the provisions of the Railroad Retirement and Survivors' Improvement Act of 2001, which adjusted the rates of some payroll taxes that support the Railroad Retirement System and which created a new National Railroad Retirement Investment Trust to invest the Railroad Retirement System's assets in a diversified portfolio of asset holdings.

According to the Congressional Research Service, in fiscal year 2005, more than $9 billion was paid by the Railroad Retirement System in all benefit forms – including retirement, survivor, and disability benefits – to more than 660,000 beneficiaries.

CRS reports that the average retirement benefit paid to a railroad worker at the end of fiscal year 2005 was $1,750 per month.

The National Railroad Retirement Investment Trust reported that as of September 30, 2005, the entire Railroad Retirement System had assets in all accounts totaling some $29 billion.

In its 2005 Annual Report, the U.S. Railroad Retirement Board, which oversees the Railroad Retirement system, reported that it will likely experience no cash-flow problems over the next quarter century. However, the Board reports that the long-term stability of the systems is still "questionable."

This finding is troubling to me – particularly as railroad workers seem to be blessed with considerable longevity after their retirement. Thus, a study completed in 2000 by the Chief Actuary of the Railroad Retirement Board found that a male railroad worker retiring at the age of 65 can be expected to live more than 16 years after retirement.

Today's hearing will give us the opportunity to examine the current condition of the Railroad Retirement System,

including the extent to which assets are keeping pace with obligations, and the adequacy of the service being provided to railroad retirees.

I look forward to hearing from today's witnesses and I yield back.

STATEMENT OF

EDWARD R. HAMBERGER

PRESIDENT & CHIEF EXECUTIVE OFFICER

ASSOCIATION OF AMERICAN RAILROADS

BEFORE THE

U.S. HOUSE OF REPRESENTATIVES

COMMITTEE ON TRANSPORTATION AND INFRASTRUCTURE

SUBCOMMITTEE ON RAILROADS

HEARING ON

THE RAILROAD RETIREMENT AND SURVIVORS'

IMPROVEMENT ACT OF 2001

MAY 10, 2006

On behalf of the members of the Association of American Railroads (AAR), thank you for the opportunity to discuss the effects of the Railroad Retirement and Survivors' Improvement Act of 2001. AAR members account for the vast majority of freight railroad mileage, employees, and revenue in Canada, Mexico, and the United States.

Overview of Railroad Retirement

As members of this committee know, the approximately 180,000 employees of U.S. freight railroads — as well as employees of Amtrak, commuter railroads, and rail-related organizations such as rail labor unions and the AAR — are the only significant group of private sector workers in the United States not covered by Social Security. Railroad Retirement provides retirement, disability, and survivor benefits to railroad workers and their families, just as Social Security does for the rest of the work force.

The railroad retirement system has two-tiers. Tier I of Railroad Retirement provides benefits that are largely equivalent to Social Security benefits. Railroad employers and employees pay Tier I taxes that are identical to Social Security payroll taxes. As with Social Security taxes, half of the Tier I tax is paid by the railroad employer and half is paid by the employee.

Tier II of Railroad Retirement provides benefits similar to those of a defined-benefit pension plan. Both employers and employees pay into Tier II, though employers pay a much higher payroll tax rate than employees.

Railroad Retirement also provides benefits to spouses, widows, widowers, and dependent children, and provides disability benefits.[1]

[1] In addition to Railroad Retirement, railroads often offer 401(k) or other retirement plans to their employees.

The Railroad Retirement and Survivors' Improvement Act of 2001

Thanks to the wisdom and foresight that members of this committee and others in Congress showed in passing the Railroad Retirement and Survivors' Improvement Act of 2001 ("RRSIA"), hundreds of thousands of railroad employees and retirees can look forward to a better, more secure future. The RRSIA is also a superb example of how rail management and labor can work cooperatively to build a stronger industry.

The RRSIA has several major components:

- *60/30 retirement.* The RRSIA allows 30-year rail employees to retire with full benefits at age 60, rather than age 62 as under previous law. The spouses of such employees are also eligible for full annuities at age 60.
- *Basic service requirement.* The RRSIA lowered the length of creditable service required prior to "vesting" in Railroad Retirement from ten years to five years for post-1995 service.
- *Maximum provision.* The RRSIA eliminated a ceiling on combined monthly employee and spouse benefits that had led to reduced benefits for thousands of employees and spouse annuitants.
- *Widow(er)s' benefits.* The RRSIA established an "initial minimum amount" for widows/widowers equal to 100 percent of an employee's tier II amount, up from 50 percent under prior law. The Railroad Retirement Board estimated that 20 to 25 percent of the widow(er)s on its rolls in 2001 would see an increase in their annuity because of this provision.
- *Investment changes.* Prior to the RRSIA, Railroad Retirement Account assets could be invested only in U.S. government securities — an outdated investment strategy established by the federal government during the Depression, when railroads were failing. The RRSIA modernized the railroad retirement system by allowing Tier II assets to be invested in equities and debt, as well as in government securities. This key change brought the railroad

retirement system in line with nearly every modern pension fund, which can choose between investment options to find the highest return.

Under the RRSIA, railroad retirement assets and authority over investments options were transferred to the National Railroad Retirement Investment Trust (NRRIT), whose Board of Trustees are comprised of three members selected by rail management, three selected by rail labor, and one member selected by a majority of the other six members. All Trustees must have experience and expertise in the management of financial investments and pension plans. The NRRIT is responsible for setting overall investment strategy, and for hiring and/or engaging investment advisors necessary to fulfill the NRRIT's mission.

- *Supplemental annuities.* The RRSIA eliminated the separate Supplemental Annuity tax under the Railroad Retirement Act, while retaining the supplemental annuity benefit for eligible workers.

The Goals of the RRSIA Are Being Achieved

A major rationale for investing railroad retirement funds in diversified investments, including equities, was to increase the rate of return of those investments — enhancing the long-term viability of the railroad retirement system even as benefits were increased and tax rates were reduced. This is exactly what has happened.

The RRSIA statutorily reduced the Tier II tax rates on rail employers from the then-existing 16.1 percent in 2001 to 15.6 percent in 2002 to 14.2 percent in 2003 and 13.1 percent in 2004. Since 2004, Tier II tax rates for both employees and employers have been adjusted automatically based on the "average account benefits ratio" (AABR), which is the ratio of asset balances to the sum of benefits and administrative expenses. For

Railroad Retirement Payroll Tax Rates

	Tier I*		Tier II	
	Non-Medicare	Medicare	Employee	Employer
2001	6 20%	1 45%	4.90%	16 10%
2002	6.20%	1.45%	4.90%	15.60%
2003	6.20%	1.45%	4.90%	14 20%
2004	6.20%	1.45%	4.90%	13 10%
2005	6 20%	1.45%	4 40%	12.60%
2006	6 20%	1 45%	4 40%	12.60%

*rate for both employers and employees

any given level of benefits (which are known with a fair degree of certainty from one year to the next), a higher level of assets will yield a higher AABR, and only when the AABR reaches a certain minimum level can Tier II payroll tax rates be further reduced. This way, the retirement funds are fully protected in relation to the payout demand on them.

And, in fact, the diversification of investment options has allowed the value of railroad retirement assets to grow well beyond the value they had when they were transferred to the National Railroad Retirement Investment Trust — just as was intended. At the inception of the NRRIT in February 2002, the value of the trust-managed assets was $20.7 billion. As of December 31, 2005, the value had risen to $29.2 billion, an $8.5 billion increase.[2] This increase allowed the Tier II tax rate to be further reduced. Its current level is 4.40 percent for employees and 12.60 percent for employers.[3]

To be sure, the railroad retirement system remains extremely costly for railroads — far more costly, in fact, than the Social Security system that other private industries, including rail competitors, participate in. Still, the costs of railroad retirement today to rail employers are certainly lower than they would be in the absence of the RRSIA.

These reductions in the payroll tax rate mean more money in the pockets of rail employees and financially stronger railroads. Because of the payroll tax reductions associated with the RRSIA and the elimination of the supplemental annuity assessment, from 2002 through 2005 rail employers in aggregate saved approximately $1.5 billion.

---

[2] The transfer of funds was implemented over an extended period of time, and the diversification of investments is still underway.

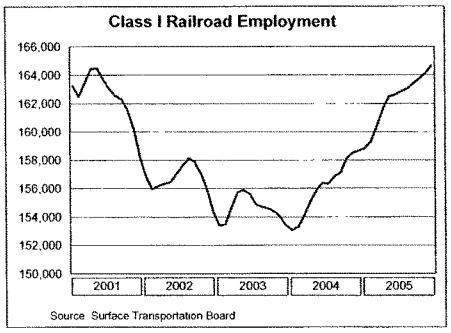
[3] The same mechanisms that allow the Tier II payroll tax rates to be reduced if the AABR reaches a certain threshold also mandate that the payroll tax rate be increased if the AABR falls to a certain level. The tax rate on employees can never rise above 4.9 percent (the rate it was when the RRSIA was passed), though the tax rate for employers can rise to 22.1 percent, if necessary. This way, should the investments in the NRRIT lose money or the trust funds fail to keep pace with benefit distributions, railroads — not taxpayers — will be responsible for ensuring the solvency of the system.

For freight railroads, these savings come at an opportune time. Looking ahead, the United States cannot prosper in an increasingly competitive global marketplace if our freight railroads are unable to meet our growing transportation needs, and having adequate railroad capacity is critical in meeting these needs. Railroads must be able to both maintain their extensive existing infrastructure and equipment *and* build the substantial new capacity that will be required to transport the significant additional traffic our economy will generate. This is especially important given the extreme capital intensity of railroading. From 1995 to 2004, the average U.S. manufacturer spent 3.5 percent of revenue on capital expenditures. The comparable figure for U.S. freight railroads was 17.8 percent, or more than five times higher.

If they are to be able to afford the capacity needed to handle this traffic, though, railroads must earn adequate profits. Thanks in part to reduced Tier II payroll tax rates, rail earnings over the past couple of years, while below average within the universe of all industries, have been higher than they have been historically. This welcome development has meant that railroads can more easily justify and afford the massive investments and capacity enhancements that are needed if railroads are to continue to play their proper role in meeting our freight transportation needs.

Indeed, freight rail spending on infrastructure and equipment, which was already substantial, has risen during the four years (2002-2005) RRSIA has been in place, totaling $5.8 billion more than if the industry's investments had remained at 2001 levels over that period. Moreover, rail spending is expected to rise sharply in future periods. Class I capital expenditures on infrastructure and equipment are expected to exceed $8 billion in 2006, a level sharply higher than in any prior year.

The efficiencies that have flowed from the RRSIA have been an important enabling factor in allowing the railroads to invest more in capacity enhancements, thereby allowing increased traffic volumes. These greater volumes translate into more trains, and more trains require additional crews. Indeed, rail industry employment has increased in recent years for the first time in some 60 years.



In addition to helping to induce higher employment levels by reducing railroad operating costs, the benefits of the RRSIA to rail employees have also been substantial. For example, the feature of the RRSIA that allows 30-year rail employees to retire with full benefits at age 60, rather than age 62 as under previous law, allowed thousands of railroad workers to retire earlier than they would have. In fact, so many workers retired that it increased the rail industry's hiring requirements significantly.

H.R. 5074 — Payments of Railroad Retirement Benefits by the U.S. Treasury

The rail industry appreciates the Committee on Transportation & Infrastructure's recent efforts in reporting out H.R. 5074, which provides for the continued use of the U.S. Department of the Treasury (Treasury) as the disbursing agent for railroad retirement benefits. As this subcommittee knows, Section 107(e) of the RRSIA calls for a nongovernmental financial institution to replace the Treasury as the disbursing agent. This provision was not part of the original rail labor-rail management agreement in support of the RRSIA, but was instead added to the legislation in 2000 during multi-committee consideration of the bill.

The rail industry supports continued use of the Treasury for several reasons. First, use of the Treasury is significantly less expensive for the Railroad Retirement Board (RRB) — approximately $800,000 per year compared with an estimated $2.9 million per year to utilize a nongovernmental disbursing agent.

Second, the RRB's Inspector General has reported that the use of a nongovernmental disbursing agent would make the collection of mistakenly overpaid benefits more difficult, more costly, and less efficient. The Treasury has the ability to use debt collection tools (*e.g.*, withholding tax refunds) that are not available to the private sector.

Third, unless the Treasury is the disbursing agent, it will be necessary to provide federally-held personal information regarding private individuals on a massive scale to an outside private vendor.

Conclusion

The Railroad Retirement and Survivors' Improvement Act of 2001 modernized the railroad retirement system by giving the rail industry greater responsibility for financing the system and greater flexibility in investing its assets. Retiree benefits have improved, the tax burden has been reduced, and railroads are on sounder financial footing than they would otherwise have been — and thus better able to make the investments in infrastructure and equipment needed to meet our country's future transportation needs.

The RRSIA was a "win" all the way around and is a testament to the tireless efforts of many of those in this committee and elsewhere in Congress. Railroads look forward to the opportunity to continue to work with policymakers and with rail labor to devise appropriate solutions to the problems we face.

NEWS

ASSOCIATION
OF AMERICAN
RAILROADS

Submitted by Mr Hamberger for the Record

Policy, Legislation & Communications Department
50 F Street, NW, Washington, DC 20001-1564
Telephone: (202) 639-2555
Facsimile: (202) 639-2558
www.aar.org

Contact: Tom White
(202) 639-2556

For Immediate Release

Railroads Encouraged By Labor Response

To Call for Broad Discussions on Railroad Retirement Reform

WASHINGTON, September 24, 1998 — The nation's railroads are encouraged by railroad labor's response to the railroads' call for wide-ranging discussions on reforming the Railroad Retirement System.

The call for negotiations came during testimony September 17 by Association of American Railroads (AAR) President and Chief Executive Officer Edward R. Hamberger before the House Transportation and Infrastructure's Railroad Subcommittee. Labor witnesses at the hearing indicated that they might be willing to engage in such wide-ranging talks.

"AAR enthusiastically supports discussions of the entire structure of the Railroad Retirement System," Mr. Hamberger said.

"Narrow discussions (that focus on single issues) without considering the implications on the entire system would be unproductive," he said, adding that the discussion should include tax levels, cost reductions and investment options that could increase returns.

(more)

"Railroad Retirement is a complex set of benefits, paid for by steep taxes imposed on railroad companies and workers," Mr. Hamberger explained. "The benefits provided under Railroad Retirement are far more generous than those offered by Social Security, and the taxes imposed on railroad companies and their workers are far more onerous."

Benefits paid under the Railroad Retirement System exceeded those that would be paid under Social Security by more than $2.8 billion in 1997, he said. These benefits are paid for by taxes that that are far higher than those paid by employees and employers covered by Social Security. "Together, the railroad employees and employers pay a total payroll tax of more than 36 percent — and that is more than twice the amount that would be paid under Social Security."

Mr. Hamberger applauded the Subcommittee for providing "a catalyst for talks on Railroad Retirement reform. We hope to schedule meetings with rail labor in the very near future."

The subject of the hearing was H. Con. Resolution 52, which urged negotiations between rail labor and management on certain benefit levels under Railroad Retirement.

#

Testimony of

James A. Hixon
Trustee, National Railroad Retirement Investment Trust

before the

Subcommittee on Railroads
Committee on Transportation and Infrastructure
U.S. House of Representatives

May 10, 2006

Mr. Chairman and Members of the Subcommittee, my name is Jim Hixon, and I am the Executive Vice President, Law and Corporate Relations, of Norfolk Southern Corporation, as well as a Member of the Board of Trustees of the National Railroad Retirement Investment Trust. I am pleased to be here today and would like to thank the Subcommittee for giving me this opportunity to testify about the Trust's operational experience since its inception just a few years ago.

In December 2001, years of collaboration between rail management, rail labor, and Congress resulted in the enactment of legislation forming the National Railroad Retirement Investment Trust, and on the day it was officially established, the $20 billion Trust became one of the largest pension investment trusts in the United States. This very successful collaboration has continued as we have worked to build this statutory concept into an actual institution, and the need for a collaborative effort has been magnified because of the Trust's very unique status as a public-private partnership. As a result, transforming the Trust into an entity that could effectively and efficiently manage and invest railroad retirement assets for the benefit of beneficiaries has presented many challenges in the Trust's formative years.

In the 41 days between enactment and the Trust's establishment date of February 1, 2002, a labor-management implementation task force worked almost around the clock to create this new entity. The group included representatives of all major railroads and several railway labor unions, and called on the expertise of a variety of senior executives from industry to provide advice on legal, investment, treasury functions, insurance, and human resources issues. The task force also met and coordinated closely with representatives of the Railroad Retirement Board on various start-up issues, and ultimately provided recommendations regarding the outline of a basic organizational structure to be considered by the new Board of Trustees when it first convened.

NRRIT's Board of Trustees met for the first time on February 1, 2002, with participation by three appointees selected by rail management and three appointees selected by rail labor. Many of the initial challenges were organizational, including acceptance by the Trustees of their positions and notification to the Railroad Retirement Board, selection of a chair, adoption of bylaws, retention of counsel, and acquisition of insurance and bonding

coverages. During the initial months, the Board approved and adopted internal policies on administrative issues, including a conflicts of interest statement of policy and a confidentiality policy. We were also was successful in selecting, after conducting two nationwide searches, highly qualified candidates for the statutorily mandated independent Trustee and hiring our first full time employee, the Chief Investment Officer.

With these key individuals in place, and the broad outline of an entity beginning to take shape, the Board began the process of developing an investment structure to enable the receipt and management of railroad retirement assets for investment. In doing so, the Board turned its attention to fundamental investment issues, including the development of investment guidelines. As part of this process, the Trustees and industry experts met with senior investment professionals from some of the country's largest corporate pension plans and Taft-Hartley plans to explore a variety of investment and organizational issues. Among the advice received from these plans was the importance of hiring a dedicated staff, including specialized directors and advisors in various asset classes, that could have the primary responsibility for making investment recommendations to the Board of Trustees, rather than having the Board rely on outside investment advisors for such recommendations. My fellow Trustee, Joel Parker, will discuss these and other investment-related issues in greater detail.

Early on, the Board of Trustees evaluated proposals from all of the major accounting firms and selected Deloitte & Touche as its independent auditor. We also formed an Audit Committee to aid in the development of internal accounting procedures and administrative controls. The committee has continually reviewed key aspects of the Trust's auditing, financial reporting, internal accounting, and internal controls processes as it has grown, and through its relationships with Trust staff and the Trust's custodian bank and independent auditor, the committee has developed effective controls and reporting processes. As part of its ongoing review of new statutory and regulatory developments in the areas of internal accounting and controls contained in the Sarbanes-Oxley Act and pronouncements by various regulatory agencies, the Audit Committee has also implemented various best practices recommendations appropriate for application to the Trust.

Development of the Trust has also required a great deal of coordination with federal government agencies, and the Trust has maintained regular communications with the Railroad Retirement Board and the Department of Treasury. As a result of discussions with these agencies, the Trust became a party to a four-way Memorandum of Understanding which outlines the budgetary, transfer, accounting, and financial reporting responsibilities with respect to assets held by the Trust and assets held within the Treasury for the Trust.

Monthly Trust information reports submitted pursuant to the MOU, together with quarterly reports transmitted to the Congressional committees of jurisdiction and the annual management report that the Trust is required to submit to Congress and the Executive branch, have provided the means to communicate the status of Trust activities to interested parties. We have worked closely with the Railroad Retirement Board to develop a strong partnership, while maintaining the investment independence mandated by Congress. We recognize that the Congressional rationale for this separation was rooted in the fact that, although the Trust is responsible for the management and investment of federal government assets, there was a concern about the implications of the federal government itself investing in, and thereby

potentially influencing, the financial markets. Thus, while the Trust was established by federal statute, and the reporting requirements and fiduciary standards applicable to it are set forth in statute, Congress made clear that the Trust is not a department, agency, or instrumentality of the Government of the United States.

This unique status -- as a non-governmental entity that is responsible for the management and investment of government assets -- has presented some challenges in the Trust's first four-plus years. Among these challenges has been coordinating the audit of the Trust's year-end financial statement with that of the Railroad Retirement Board, so that the Trust's audited statement can be included in the RRB's own financial statement and Statement of Social Insurance, for eventual inclusion in the Financial Report of the United States Government.

The Trust's unique status has been recognized by the Internal Revenue Service, which has modified our IRS reporting requirement in light of the statutorily mandated annual management report. On a related matter, the Trust is preparing to submit a ruling request to the Service to clarify the application of other tax rules to the Trust. In addition, we have worked with the Congress to secure various technical corrections to address issues not anticipated in the original legislation.

Challenges like these are inevitable given the quasi-governmental nature of the Trust. However, they have been, and will continue to be, successfully resolved because of the continued cooperative relationship that exists between the Trust, the RRB, and other government agencies.

Mr. Chairman, there are a number of ways to measure success, and in my opinion, the National Railroad Retirement Investment Trust has been a categorical success by any of these. A little over four years ago, six Trustees were seeking a seventh Trustee and the Trust's first employee. Just last month, the Trust's newly hired chief accounting officer brought to twelve the number of full time professionals employed by the Trust. Trustees have transitioned on and off of the Board, but the spirit of cooperation that brought about railroad retirement reform is just as strong today as it was four years ago.

On behalf of my fellow Trustees, I again thank you for the opportunity to appear before you today, and would be happy to respond to any questions that you might have.

SENIOR DEMOCRATIC WHIP

COMMITTEE ON TRANSPORTATION AND INFRASTRUCTURE
RANKING MEMBER, SUBCOMMITTEE ON WATER RESOURCES & ENVIRONMENT
SUBCOMMITTEE ON AVIATION
SUBCOMMITTEE ON RAILROADS

COMMITTEE ON SCIENCE
SUBCOMMITTEE ON RESEARCH
SUBCOMMITTEE ON ENERGY

DEMOCRATIC STEERING AND POLICY COMMITTEE

CHAIR, TEXAS DEMOCRATIC DELEGATION

CONGRESSIONAL BLACK CAUCUS
CHAIR, 107TH CONGRESS

Eddie Bernice Johnson
Congress of the United States
30th District, Texas

PLEASE RESPOND TO
WASHINGTON OFFICE:
1511 LONGWORTH BUILDING
WASHINGTON, DC 20515-4330
(202) 225-8885

DALLAS OFFICE:
3102 MAPLE AVENUE
SUITE 600
DALLAS, TX 75201
(214) 922-8885

SOUTH/EAST DALLAS OFFICE:
8344 EAST R.L. THORNTON FREEWAY
SUITE 222
DALLAS, TX 75228
(214) 324-0080

WWW.HOUSE.GOV/EBJOHNSON/

Eddie Bernice Johnson

Opening Statement for the Honorable Eddie Bernice Johnson
House Subcommittee on Railroads
"Hearing on the 2001 Railroad Retirement Reform Law"
Wednesday, May 10, 2006 – 2167 RHOB

Thank you Mr. Chairman.

I want to commend you and Ranking Member Brown for calling today's important hearing to discuss the performance of the Railroad Retirement Trust Fund.

Enactment of the 2001 Railroad Retirement and Survivors' Improvement Act marked a major milestone for railroad workers and their retirement structure.

PRINTED ON RECYCLED PAPER

The Act increased benefits for widowers of rail employees; lowered the minimum age at which workers with 30 years of employment are eligible to receive full benefits; reduced the number of years required to be vested for benefits; and established an independent, nongovernmental retirement trust fund—our topic of discussion today.

As authorized by the Act, seven trustees are charged with managing and investing Railroad Retirement assets and upon initial review, the structure and performance of the Trust appear to be serving the interest of the Railroad Retirement Board well.

According to the Trustees 2005 Annual Management Report, upon enactment of the law, $18.6 billion was transferred to the investment trust in 2002.

Upon the close of the 2005 fiscal year, the Trust reported a net asset value of roughly $27 billion and a fourteen percent rate of return on its assets for the year.

This type of performance is definitely good news.

As the Board services over half a million beneficiaries each year, it is imperative that the investment fund sustain its stability and solvency for the railroad workers and their families that depend on their hard-earned benefits.

Next to earning a living wage, I can think of no other issue more important to today's American worker than the issue of retirement security.

I want to thank our witnesses that have come before us to testify this afternoon and look forward to their testimony regarding the current and future outlook of the fund.

Thank you Mr. Chairman.

STATEMENT OF
THE HONORABLE JAMES L. OBERSTAR
SUBCOMMITTEE ON RAILROADS
HEARING ON
"OPERATIONAL EXPERIENCE UNDER THE 2001 RAILROAD RETIREMENT REFORM LAW"
MAY 10, 2006

Mr. Chairman, Ranking Member Brown, it's been almost five years since enactment of the Railroad Retirement and Survivors' Improvement Act of 2001. Enactment of this legislation brought substantial benefits to the more than one-quarter million men and women who work on our nation's railroads and the nearly 634,000 retirees and survivors of retired railroad workers.

The Act was the product of an historic agreement reached by railroad labor and management following two years of often-difficult negotiations. Concerns were raised about how the Trust's assets were to be reinvested, possible government manipulation of the stock market, and the Trust's impact on the Federal budget. Some even argued for eliminating the railroad retirement system all together.

Years later, we know we were right on track with this legislation; that it was a win-win situation for the railroad industry, for railroad labor, and for retired railroad workers and their survivors.

The Act lowered the retirement age from 62 to 60 with 30 years of service; expanded benefits for widows and widowers; eliminated caps on combined benefits of employees and their spouses; reduced the number of years required for vesting from 10 years to five years, putting the railroad retirement system in line with the pension plans of most other industries; and allowed for future benefit improvements or lower taxes should the retirement plan become over-funded.

At the same time, the Act allowed for a significant reduction in the railroads' taxes for Tier II benefits. The savings – estimated at about $400 million in 2001 – was to be used for capital investments and improvements to the wages and working conditions of railroad workers. I am interested to see if those funds were in fact used for those purposes.

Indeed, taxes have been reduced for railroads from 16.1 percent in 2001 to 15.6 percent in 2002, to 14.2 percent in 2003, to 13.1 percent in 2004, and to 12.6 percent in 2005. The Tier II tax for railroad workers was reduced for the first time in 2005 from 4.9 percent to 4.4 percent.

The Act also created the National Railroad Retirement Investment Trust, which invests railroad retirement funds in a diversified multi-asset class portfolio similar to those of other large U.S. pension plans.

I believe the Trust has been a resounding success as the net asset value of Trust-managed assets has soared to $28.9 billion as of March 2006, representing an increase of more than $10 billion above the net book value of assets transferred to the Trust for investment.

However, I would be remiss if I did not mention the concerns of some Members of Congress – both on and off this Committee – regarding survivor benefits. It is quite possible that there is a simple solution for dealing with their constituents' concerns. I look forward to exploring those issues further with the witnesses, and of course learning more about their experience with implementation of the 2001 railroad retirement reform law.

Testimony of

Joel Parker
Trustee, National Railroad Retirement Investment Trust

before the

Subcommittee on Railroads
Committee on Transportation and Infrastructure
U.S. House of Representatives

May 10, 2006

Mr. Chairman and Members of the Subcommittee, my name is Joel Parker and I am Special Assistant to the President and International Vice President of the Transportation Communications International Union, as well as a Member of the Board of Trustees of the National Railroad Retirement Investment Trust. I appreciate the opportunity to discuss with you the progress of the National Railroad Retirement Investment Trust. I will focus my remarks on the Trust's investment strategy and performance.

Fiscal Year 2002 - Establishing the Investment Framework

The Railroad Retirement and Survivors' Improvement Act of 2001 provided for the transfer of approximately $20 billion in railroad retirement system funds to the Trust for investment in a diversified portfolio similar to other large US pension plans.

Early in the process of establishing the Trust, the Board of Trustees met with leaders of some of the largest corporate and Taft-Hartley pension funds in the United States, soliciting their advice on staffing and advisor structures, investment philosophies, and implementation strategies. The advice we received and which we have followed, was to build a strong in-house capacity to develop and manage the Trust's investment strategy rather than rely on outside advisors.

As a first priority, the Trust conducted a detailed asset-liability study of the railroad retirement system to assess the Trust's projected funding obligations and alternative approaches to asset allocation in order to facilitate the development of the statutorily mandated investment guidelines. Based on the asset-liability study, the Trust developed and in August of 2002 adopted a set of Investment Guidelines. At the same time, after an extensive search process, the Trust retained Northern Trust as its master custodial institution to hold the Trust's assets and to coordinate relationships with investment managers.

The Trust recognized that it would not be possible to immediately diversify the Trust's assets into the full array of asset classes set forth in the Guidelines. As a result, the Trust

adopted an initial strategy of placing its assets in indexed accounts in three broad classes: domestic equities (45%), international equities (20%) and fixed income (35%). Indexation allowed us to diversify the Trust's investment exposure quickly and cost-effectively as it received railroad retirement system funds. With these arrangements in place at the end of fiscal year 2002 which ended September 30, 2002, the process of moving railroad retirement system assets to the Trust and investing them could begin.

Fiscal Year 2003 - First Year of Investment Activity

Working with the Railroad Retirement Board and the Treasury Department, the Trust developed a schedule for transferring railroad retirement system assets held by the Treasury over a period of approximately six months, beginning early in fiscal year 2003. When the final scheduled transfer took place in mid-March of 2003, the Trust had received a total of $19.3 billion of railroad retirement system assets.

During 2003, the Trust undertook a major planning process to develop a plan to move its investment portfolio beyond indexed-only investments. In the course of this process, the Trust reviewed a variety of investment strategies and methodologies to determine how active management could add value to expected returns at reasonable levels of risk. The product of this effort was an Investment Plan and Procedures Manual that identified the investment thesis, portfolio structure, performance benchmarks, and return and risk expectations for the Trust's entire portfolio and for each asset class. The Investment Plan includes a target for the level of the Trust's diversification within each asset class between indexed and actively-managed assets based on an assessment of the potential for active management to add value to expected returns at reasonable levels of risk. The Investment Plan is an internal working document subject to on-going review by the Trust to ensure its assumptions reflect the ever-changing investment environment.

Investment performance for the Trust's major asset classes was positive for fiscal year 2003, the first year of investment activity for the Trust. The Trust achieved overall performance returns of 19.9%, compared to its target index return of 18.8%. In fiscal year 2003, the full year performance return resulted in an increase of $2.7 billion in the Trust-managed portfolio as of September 30, 2003.

Fiscal Year 2004 - Expanding beyond Indexed Investments

Implementation of the Investment Plan began in fiscal year 2004. In US equity, the Trust's goals are a portfolio that combines indexation and active management in order to achieve performance in excess of the market at reasonable levels of risk. Execution of the US equity portion of Investment Plan focused primarily on large-capitalization enhanced indexation strategies whose performance tracks relatively closely with that of their benchmark index while adding modest value. In fiscal year 2004, the Trust hired active managers both in domestic large capitalization strategies and in large-cap value strategies.

For fixed income assets, the Trust hired three enhanced index bond index managers. As in equity, these managers take small and carefully calculated deviations from the index portfolios, aiming to add modest performance over the index without incurring significant risk.

In addition, under the investment guidelines and the Investment Plan, five percent of the overall Trust portfolio, to be funded from the 45 percent US equity allocation, was designated for private equity investments. In fiscal year 2004, the first private equity commitments were made and funded out of the US equity index investments.

Also during fiscal year 2004, the Trust performed a multi-phased asset allocation study to re-examine assumptions about return and risk in different asset classes in order to determine whether the Trust's asset allocation policy should be updated to improve potential returns and portfolio diversification. As a result of this new study, the Trustees authorized the investment staff to examine strategies in three new asset classes, real estate, commodities and hedge funds. Work continues in these areas, but no funds have yet been allocated to these asset classes.

For twelve months of fiscal year 2004, the investment return on all Trust-managed assets was 13.3%. This compared favorably with the Trust's composite benchmark, which returned 12.7%. At the end of FY 2004, assets overseen by NRRIT totaled $25 billion, and the total value of railroad retirement system assets, including those held in the RRB accounts at the Treasury, was $26.4 billion.

Fiscal Year 2005 - Expansion of Actively Managed Investment

During fiscal year 2005, continued diversification away from indexation in most major asset classes resulted in retaining 21 new managers during the fiscal year. At year end, 34% of the Trust investments were actively managed by more than 40 investment managers.

With respect to US equities, the Trust focused primarily on active large-capitalization strategies during fiscal year 2005 adding managers in several segments of this asset class.

During fiscal year 2005, the Trust's continued to manage its non-US equity investments through investment in indexed funds, but during this period, the Trust adopted the non-US equity portion of its Investment Plan and took steps to begin adding enhanced index strategies.

The Trust also continued moving beyond indexation in fixed income assets during fiscal year 2005, retaining additional active managers. In private equity, the Trustees approved investments in nine additional private equity limited partnerships.

For fiscal year 2005, the investment return on Trust-managed assets was 14.0%. This compared favorably with the Trust's composite benchmark, which returned 13.0%. At fiscal year-end, the net asset value of assets overseen by the Trust totaled $27.7 billion, and the total value of railroad retirement system assets, including those held at the Treasury, was $29.0 billion.

Summary

From its inception in February 2002 to September 30, 2005, the Trust received $21.3 billion from the Treasury and transferred $2.7 billion back to the Treasury. The net book value of funds received from the Treasury since inception, therefore, is $18.6 billion.

The assets received by the Trust were invested in a diversified multi-asset class portfolio in accordance with the Trust's investment policy. This diversification of assets has allowed the Trust's assets to grow significantly beyond their original book value. As of September 30, 2005, the net asset value of the Trust-managed assets totaled $27.7 billion, representing an increase of $9.1 billion above the net book value of assets transferred to the Trust for investment.

At the end of the most recent quarter, March 31, 2006, the net asset value of assets overseen by the Trust totaled $28.9 billion. The total value of railroad retirement system assets stood at $30.3 billion, about $10 billion more than the total value of assets held by the system at the time the Trust began its investment activities. This $10 billion increase is net of an additional $3.2 billion transferred from the Trust to the Treasury for benefit payments during this period.

Mr. Chairman, we believe the Trust has provided the kind of value to the railroad retirement system and its beneficiaries that was envisioned by the authors of the legislation that created this new and unique structure. We appreciate that the early years have been good ones for the financial markets and the Trust. We also recognize that markets have their cycles. Our goal has been to (i) establish a solid professional organization, (ii) develop a prudent investment plan that provides for a broad diversification of assets, and (iii) take steps to judiciously implement this plan. We believe that this three-pronged approach will serve us well in strong markets and also help to maintain stability in more challenging times.

I would be pleased to respond to any questions you may have.

Testimony

of

Robert A. Scardelletti
International President
Transportation Communications International Union

before the

Subcommittee on Railroads
Committee on Transportation and Infrastructure
U.S. House of Representatives

May 10, 2006

Mr. Chairman and Members of the Subcommittee, my name is Robert A. Scardelletti and I am International President of the Transportation Communications International Union. I appreciate the opportunity to appear before you today to discuss the National Railroad Retirement Investment Trust on behalf of railroad labor.

Mr. Chairman, I was part of the railroad labor team that worked with rail management to develop the initial outlines of the proposal for improving the railroad retirement system that ultimately became the Railroad Retirement and Survivors' Improvement Act of 2001. While the measure was under consideration by the Congress, I had the privilege of working with Members of this Committee as you improved and perfected the proposal that rail labor and management brought to you.

The record shows that these collaborations, between labor and management, and between the combined forces of labor and management and forward-looking Members of this Committee, have borne fruit.

First, the Act provided better railroad retirement benefits for rail workers, their dependents and survivors. Surviving spouses of deceased retirees now inherit the full tier 2 annuity of the retiree, rather than no more than 50 percent of the annuity allowed under previous law. The age at which a worker with 30 years service may retire was reduced from 62 to 60. And the vesting period for tier 1 and tier 2 benefits was cut in half from ten to five years.

Second, the financial security of the railroad retirement system has been strengthened. The total assets of the system now stand at $ 30.3 billion, about $10 billion more than when the Trust first began its investment activities in the Fall of 2002. That's a 50 percent increase.

Third, the cost of the system to employers and employees has declined. For calendar year 2006, the tier 2 tax rate on employees is 4.4 percent, down from 4.9 percent prior to the Act, and the employer tax rate has dropped from 16.1 percent to 12.6 percent.

The structure of the Trust has worked well. The balance of three labor and three management members of the Board of Trustees, along with one Independent Trustee, has produced a cooperative, team-oriented approach to meeting a common goal – protecting and growing the assets held by the Trust for the benefit of current and future railroad retirees and their dependents, spouses and survivors. I am not aware of a single instance to date in which Trust decisions have been discussed or decided based on labor or management affiliation.

The success to date of the Trust is testimony not only to the Trustees and staff who are directly responsible for its operation, but also to the leadership of this Committee and the Congress in passing the legislation in 2001. In addition, the cooperation and assistance of the Railroad Retirement Board has been vital to the start-up and smooth functioning of the Trust. Likewise, the Treasury Department has played a key role in developing new policies and procedures to facilitate the work of this unique organization and its special mission.

One issue of concern to active workers and retirees, especially in light of the favorable position of the Trust Fund, is that future appropriations for the Railroad Retirement Board may not be adequate to maintain the level of service the railroad community expects and deserves. We would ask for your assistance in monitoring this situation.

Mr. Chairman, we in the rail labor movement keep a close eye on the activities of the Trust. After all, our members have much to gain, or lose, from its success or failure. So far, we like what we see.

I appreciate the opportunity to speak to you on this important subject, and would be pleased to answer any questions you may have. Thank you.

U. S. House of Representatives
Committee on Transportation and Infrastructure
Railroads Subcommittee

Statement for the Record - May 10, 2006

Michael S. Schwartz
Chairman, Railroad Retirement Board

Good afternoon, Chairman LaTourette, Ranking Member Brown, and distinguished members of the Committee. My name is Michael S. Schwartz and I am Chairman of the Railroad Retirement Board. I am here today with V. M. Speakman, Jr., Labor Member of the Railroad Retirement Board, and Jerome F. Kever, Management Member of the Railroad Retirement Board. It is indeed a pleasure to appear before you today to testify on behalf of the Railroad Retirement Board concerning our experience under the Railroad Retirement and Survivors' Improvement Act.

As you know, the Railroad Retirement and Survivors' Improvement Act of 2001 originated in this committee, and it made a number of changes in railroad retirement benefits and in the financing of the railroad retirement program. The Railroad Retirement and Survivors' Improvement Act of 2001 was the product of an agreement between railroad labor and railroad management. On the benefit side, the 2001 Act reduced the minimum retirement age for full benefits for employees with 30 years of service from age 62 to age 60. Another change was the elimination of the so-called railroad retirement maximum, which had imposed a cap on the combined benefits of an employee and the employee's spouse. The Act added a new minimum initial benefit amount for widows and widowers so that the amount of the benefit payable when a

widow's or widower's annuity is awarded is equal to what the employee received prior to his or her death. Another change on the benefit side was a reduction in the number of years needed to be eligible for tier II railroad retirement benefits. Tier II benefits are now available to employees who have 5 years of railroad service after 1995. These changes are all fully operational.

In addition to the benefit changes I just mentioned, the Railroad Retirement and Survivors' Improvement Act of 2001 made significant and far-reaching changes in the financing of railroad retirement benefits. The Act called for the creation of a new entity, the National Railroad Retirement Investment Trust, to handle investment of railroad retirement funds. The Trust is not a Federal agency or instrumentality and is separate and apart from the Railroad Retirement Board. Prior to the 2001 legislation, railroad retirement funds were invested only in government securities or certain government-backed securities. The 2001 law changed this by authorizing the Trust to invest railroad retirement funds in a wide array of investments, including stocks and bonds, as well as government securities. In addition to the investment changes, the Railroad Retirement and Survivors' Improvement Act of 2001 substituted for the flat tax rates in prior law, a new tax ratchet mechanism for setting the tier II tax rate for employers and employees. Under the tax ratchet, tier II tax rates for employers and employees can increase or decrease depending on the account benefits ratio. The account benefits ratio is determined by comparing the market value of railroad retirement assets to benefit payments. Thus, the tax rate is adjustable to meet the financing needs of the railroad retirement system.

Almost immediately after President Bush signed the Railroad Retirement and Survivors' Improvement Act of 2001 into law on December 21, 2001, steps were initiated to form the National Railroad Retirement Investment Trust. The Trust is comprised of seven Trustees. Three Trustees represent the interests of railroad management. Three Trustees represent the interests of railroad employees. The seventh Trustee is the independent member of the Board of Trustees and is selected by a majority of the other six Trustees. Trustees representing railroad employees and railroad management were appointed and first met on February 1, 2002. The original Trustees, as well as Trustees who have been appointed after the Trust was formed, all have had strong backgrounds in investment and pension plan management, as required by the statute.

The first transfer of funds for investment occurred in September 2002. For several months thereafter, additional transfers of significant amounts were made until a total of about $21.3 billion had been transferred to the Trust. Initially, the Trust limited its investments to index funds, but as the Trust's staff has grown, the Trust has moved funds into a combination of index funds and actively managed investments handled by an increasing number of investment managers. Today, the Board of Trustees and the Trust's professional staff are responsible for investment of $28.9 billion of railroad retirement funds.

Although the Railroad Retirement and Survivors' Improvement Act of 2001 makes it clear that the Railroad Retirement Board and the National Railroad Retirement

Investment Trust are separate entities, the responsibilities of the two organizations are such that the Board and Trust must work together in order to serve the needs of the plan participants and stakeholders. Today, I am pleased to report that the Board and the Trust have worked closely from the inception of the Trust and that we are accomplishing our respective responsibilities under the Act. The three Members of the Railroad Retirement Board meet at least twice each year with the Board of Trustees and the Railroad Retirement Board's General Counsel meets on a frequent basis with the Counsel to the Trust and the Trust's Chief Investment Officer to discuss issues of mutual concern. The Railroad Retirement Board, the Trust, the Office of Management and Budget, and the Department of the Treasury, are all parties to a Memorandum of Understanding under which the Board receives monthly reports from the Trust showing the market valuation of the Trust's portfolio. Moreover, the Trust provides the Board with copies of its annual management report to Congress showing details of the Trust's operations for the previous fiscal year. The Railroad Retirement Board receives quarterly updates of the annual report from the Trust. Information about the Trust, including the annual management report and quarterly updates, is posted to the Railroad Retirement Board's website and is available for public review.

Since the inception of the Trust, the market value of the Trust's portfolio has increased significantly. As I noted earlier, the Railroad Retirement Tax Act was amended by the 2001 law to provide a tax ratchet mechanism for setting Tier II tax rates for employers and employees. Before the tax ratchet became effective in 2004, the 2001 Act had already reduced the tier II tax rate on employers from 16.1% in 2001 to 15.6% and 14.2%

in 2002 and 2003, respectively. When the tax ratchet took effect in 2004, the employer tax rate was further reduced to 13.1%, and in 2005, both the employer and employee tier II tax rates were reduced. In 2005, the employer tax rate declined to 12.6% and the employee tax rate declined from 4.9% to 4.4%. The tax rates for 2006 are the same as applicable in 2005. These reductions in the tier II tax rates for both employers and employees were almost entirely the result of good investment performance over the past few years.

In closing, I would like to say that, in the view of the Railroad Retirement Board, the Railroad Retirement and Survivors' Improvement Act of 2001 has been very successful and that the goals sought by the legislation are being achieved.

We would be happy to answer any questions the committee may have.

UNITED STATES OF AMERICA
RAILROAD RETIREMENT BOARD
844 NORTH RUSH STREET
CHICAGO, ILLINOIS 60611-2092

JUN 9 2006

BOARD MEMBERS:

MICHAEL S. SCHWARTZ, CHAIRMAN
V.M. SPEAKMAN, JR., LABOR MEMBER
JEROME F. KEVER, MANAGEMENT MEMBER

The Honorable Steven C. LaTourette
Chairman, Railroads Subcommittee
Committee on Transportation and Infrastructure
U. S. House of Representatives
589 Ford House Office Building
Washington, D.C. 20515-6261

The Honorable Corrine Brown
Ranking Member, Railroads Subcommittee
Committee on Transportation and Infrastructure
U. S. House of Representatives
589 Ford House Office Building
Washington, D.C. 20515-6261

Dear Chairman LaTourette and Ranking Member Brown:

During the May 10, 2006 hearing concerning operational experience under the Railroad Retirement and Survivors' Improvement Act, questions were raised concerning the amendment that provides for the widow(er)s' initial minimum benefit amount (WIMA) and the review procedures where an applicant for benefits may have been provided inaccurate information concerning benefit entitlement and thereafter acted in a manner that had a negative impact on receipt of benefits under the Railroad Retirement Act. After the hearing, we agreed to provide additional information concerning these questions.

The WIMA benefit was added to the Railroad Retirement Act by the Railroad Retirement and Survivors' Improvement Act of 2001. The WIMA was intended to lessen the economic impact of the death of a railroad employee on his or her surviving widow or widower. Under prior law, upon the death of a railroad employee, the surviving widow or widower, if otherwise entitled to benefits, would receive an annuity comprised of a tier I benefit equal to the tier I benefit the employee was receiving at the time of death plus a tier II benefit equal to 50 percent of the tier II benefit the employee was receiving. The WIMA provides an initial benefit for the widow or widower comprised of a tier I benefit equal to the tier I the employee was receiving plus a tier II equal to 100 percent of the

Printed on recycled paper

tier II benefit the employee was receiving prior to death. Thus, the amount of the benefit awarded to the widow or widower is greater under the WIMA provision because the tier II benefit is double the amount that would have been awarded under prior law.

The WIMA benefit is not increased for cost-of-living increases. The WIMA benefit is payable at a constant level until the amount computed under the old widow(er)s' formula (100% tier I plus 50% tier II), as increased annually for cost-of-living, exceeds the amount computed under the WIMA. Thereafter, the widow(er)s' benefit is increased for cost-of-living. The following example illustrates this computation:

Widow(er) annuity beginning date of May 2005

Pre-WIMA annuity formula

	May 2005	December 2005 (increased for cost-of-living)
Tier I	$1,433.00	$1,492.00
Tier II	$ 518.50	$ 525.24
Total	$1,951.50	$2,017.24

WIMA

	May 2005	December 2005 (not increased for cost-of-living)
Tier I	$1,433.00	$1,433.00
Tier II	$1,037.00	$1,037.00
Total	$2,470.00	$2,470.00

The annuity in this case was awarded in the amount of $2,470.00. The monthly annuity will be paid at this rate until the benefit computed under the Pre-WIMA annuity formula, with annual increases for cost-of-living, equals $2,470.00. Thereafter, the annuity will be adjusted for yearly cost-of-living increases in both tier I and tier II.

The second question concerns a situation where an applicant for benefits believes he or she has been misinformed concerning eligibility or entitlement to benefits and based on this misinformation has taken an action that has negatively affected the applicant's status under the Railroad Retirement Act. The Railroad Retirement Board has an established administrative review process, whereby an applicant who believes his or her claim for benefits has been mishandled can seek review of the decision. The administrative process is comprised of three steps. The first step is a reconsideration of the initial decision. If the claimant is still dissatisfied, he or she may appeal to the Bureau of Hearings and Appeals where the claimant may receive a hearing before an impartial hearings officer. The final review step is an appeal to the three-member Board. Decisions by the three-member Board may be appealed to a United States Court of Appeals. Erroneous decisions may be corrected at any of these review stages.

Although the administrative review process is available to all claimants who believe their claim has been mishandled, the agency must nevertheless apply the law as it is written. It

is, of course, unfortunate if a claimant has disadvantaged himself by an action taken based on inaccurate advice from the Railroad Retirement Board, but we cannot pay a benefit inconsistent with the terms of the statute.

We hope that the above information is helpful to the Committee.

Sincerely,

Michael S. Schwartz

V. M. Speakman, Jr.

Jerome F. Kever

STATEMENT OF HONORABLE DON YOUNG
RAILROAD SUBCOMMITTEE HEARING:
OPERATIONAL EXPERIENCE UNDER THE 2001
RAILROAD RETIREMENT REFORM LAW
MAY 10, 2006

THANK YOU, MR. CHAIRMAN. I COMMEND YOU ON HOLDING THIS TIMELY HEARING TO CHECK ON THE PERFORMANCE OF THE RAILROAD RETIREMENT SYSTEM AFTER WE ENACTED THE FIRST COMPREHENSIVE REFORMS IN ALMOST TWO DECADES IN 2001.

THE 2001 LEGISLATION WAS A CLASSIC NEGOTIATED CONSENSUS PRODUCT, THE OUTCOME OF YEARS OF LABOR-MANAGEMENT NEGOTIATIONS. BOTH SIDES CLEARLY HAD THEIR THINKING CAPS ON STRAIGHT, BECAUSE ALL THE REPORTS I HAVE SEEN SHOW THE NEW TRUST-INVESTMENT SETUP TO BE A RESOUNDING SUCCESS.

THIS WAS A "WIN-WIN-WIN," BECAUSE THE FINANCIAL ENGINE OF PENSION INVESTMENT ALLOWED IMMEDIATELY HIGHER TIER II RETIREMENT BENEFITS FOR WORKERS, IMMEDIATELY LOWER PAYROLL TAXES FOR THE RAILROADS, AND A BETTER FINANCIAL FOOTING FOR FUTURE BENEFIT PAYMENTS. GIVEN THE NEARLY 50 PER CENT INCREASE IN PENSION ASSETS VALUES IN A MERE THREE YEARS, WE SHOULD ALL ASPIRE TO SUCH A SUCCESSFUL INVESTMENT STRATEGY WITH OUR OWN PERSONAL PORTFOLIOS.

I WANT TO EMPHASIZE THAT THIS PATTERN OF SUCCESSFUL LABOR-MANAGEMENT CONSENSUS BUILDING SHOULD BE APPLIED MORE BROADLY IN THE RAIL INDUSTRY. NO ONE BENEFITS FROM THE CONFRONTATIONAL APPROACH, BUT A GOOD FAITH JOINT EFFORT BETWEEN LABOR AND MANAGEMENT IS USUALLY A WINNING COMBINATION.

I WOULD LIKE TO SEE THIS APPROACH APPLIED IN A VARIETY OF SITUATIONS, INCLUDING THE ONGOING LABOR-MANAGEMENT NEGOTIATIONS ON ISSUES LIKE SINGLE-MAN CREWS.

THANK YOU, MR. CHAIRMAN.

○