Congressional Research Service
Informing the legislative debate since 1914

Railroad Retirement Board: Trust Fund Investment Practices

Updated August 25, 2017

Congressional Research Service
https://crsreports.congress.gov
RS22782

CRS REPORT
Prepared for Members and
Committees of Congress

Summary

Beginning in 2002, a significant portion of the assets of the Railroad Retirement Board (RRB) has been invested in private stocks, bonds, and other investments. Prior to the Railroad Retirement and Survivors' Improvement Act of 2001, P.L. 107-90, surplus railroad retirement assets could only be invested in U.S. government securities—just as the Social Security trust funds must be invested. The 2001 act established the National Railroad Retirement Investment Trust (NRRIT; hereinafter, the Trust) to manage and invest part of the RRB's assets in the same way that the assets of private-sector and most state and local government pension plans are invested. The remainder of RRB's assets continues to be invested solely in U.S. government securities.

Congress structured the Trust to ensure independence of investment decisions and limit political interference. It also aimed to increase railroad retirement system funding, add enhanced benefits, potentially reduce taxes, and protect system financing in case of market downturns. The Trust's assets are invested in a diversified portfolio, both to minimize investment risk and to avoid disproportionate influence over an industry or firm. Since the Trust is a nongovernmental agency, it is not subject to the same oversight as federal agencies. However, the act requires an annual management report to Congress.

The Trust's investments have generally followed the markets' recent performance. From FY2003 to FY2016, the Trust's annual returns averaged 7.9%, nearly matching expectations of the bill's drafters, who assumed nominal annual returns of 8.0%. The economic downturn did not spare the Trust, which lost 19.1% in FY2008 and 0.7% in FY2009. The Trust rebounded with an 11.2% rate of return in FY2010. This was followed by a slightly negative rate of return of -0.1% in FY2011. However, the Trust exceeded its own strategic policy benchmarks in FY2012, FY2013, and in FY2014 with a FY2014 rate of return of 10.2%. FY2015 once again experienced negative returns for the Trust with a rate of return of -1.5%. In FY2016, the annual return was 8.1%. As the Trust's investment portfolio diversified over time, its administrative expenses steadily increased, to 36 basis points in FY2011, but fell to 28 basis points in FY2016 and remain low when compared with other mutual funds.

The Trust is designed to maintain four to six years' worth of benefits in case of lower-than-expected returns. To maintain this balance, the variable Railroad Retirement tier II tax rates automatically adjust as needed. This tax adjustment does not require congressional action. The Railroad Retirement tier II tax rates increased in 2013 and most recently in 2014.

Contents

Background 1
History of the Trust 1
Structure of the Trust 1
Independence 1
Goals 2
Impact on Railroad Retirement Tier II Tax Rates 2
Investment Guidelines 2
Oversight 3
Accounting in the Federal Budget 4
Performance of the Trust 5
Total RRB Assets 5
Comparison to Benchmarks 6
Administrative Expenses 7

Figures

Figure 1. Actual Trust Rates of Return Compared with Strategic Policy Benchmarks 6

Tables

Table 1. Current Trust Target Asset Allocations and Ranges 4
Table 2. Trust Expense Ratios 7

Contacts

Author Information 7
Acknowledgments 8

Background

The Railroad Retirement Act authorizes retirement, survivor, and disability benefits for railroad workers and their families.[1] The Railroad Retirement Board (RRB), an independent federal agency, administers these benefits. Workers covered by the RRB include those employed by railroads engaged in interstate commerce and related subsidiaries, railroad associations, and railroad labor organizations. These benefits are earned by railroad workers and their families in lieu of Social Security.

Railroad retirement benefits are divided into two tiers. Tier I benefits are generally computed using the Social Security benefit formula, on the basis of earnings covered by either program. In some cases, RRB tier I benefits can be higher than comparable Social Security benefits. For example, RRB beneficiaries may receive unreduced tier I retirement benefits as early as 60 years old if they have at least 30 years of railroad service; Social Security beneficiaries may receive unreduced retirement benefits only when they reach their full retirement ages, currently rising from age 65 to 67. RRB tier II benefits are similar to private pension benefits and are based only on railroad work.[2]

History of the Trust

Beginning in 2002, a significant portion of railroad retirement assets have been invested in private stocks, bonds, and other investments. Prior to the Railroad Retirement and Survivors' Improvement Act of 2001, P.L. 107-90, surplus railroad retirement assets could only be invested in U.S. government securities—just as the Social Security trust funds must be invested.[3] The 2001 act established the National Railroad Retirement Investment Trust (NRRIT; hereinafter, the Trust) to manage and invest assets in the Railroad Retirement Account in the same way that the assets of private-sector retirement plans are invested. The Railroad Retirement Account is used to fund RRB tier II benefits and supplemental annuities. This account is also used to pay for tier I benefits that are higher than equivalent Social Security benefits, such as early retirement benefits for railroad employees with at least 30 years of railroad service. Assets in the Social Security Equivalent Benefits Account, which is used for RRB tier I benefits that are equivalent to Social Security benefits, continue to be invested solely in U.S. government bonds, as required by law.

Structure of the Trust

Independence

Congress structured the Trust to be independent and to resist political interference. As such the Trust is independent of the RRB and is not part of the federal government. It has no responsibilities for administering RRB benefits. The Trustees of the Trust are required to act

[1] 45 U.S.C. §231 et seq. For additional information on the RRB, see CRS Report RS22350, *Railroad Retirement Board: Retirement, Survivor, Disability, Unemployment, and Sickness Benefits*.

[2] Railroad employers also finance a supplemental annuity program for certain railroad employees hired before October 1981. General revenues finance a vested dual benefit for certain railroad employees who were eligible for benefits before 1975.

[3] The Social Security trust funds may not be invested in private markets. For additional information on current practices, see CRS In Focus IF10564, *Social Security Trust Fund Investment Practices*.

solely in the interest of the RRB and the participants in the railroad retirement system. The fiduciary rules governing the Trustees are similar to those required by the law that governs the private pension system, the Employee Retirement Income Security Act (ERISA).[4]

The board of the Trust is made up of seven Trustees who have expertise in managing financial investments and pension plans. Three of the Trustees are selected by railroad labor unions, three by railroad management, and one by the other six Trustees. Each of the Trustees' terms is three years. The Trustees hire a professional staff to handle day-to-day operations of the Trust and independent investment managers to invest the assets of the Trust according to the investment guidelines established by the Trustees.

Each investment manager may control no more than 10% of the Trust's assets. Each manager must vote all proxies he or she holds in the Trust's portfolio in the sole interest of railroad retirement participants and beneficiaries, in accordance with written guidelines provided by the Trust. Votes must also be recorded and provided to the Trust upon request. Finally, all investment managers must certify each year that all proxies have been voted in the sole interest of railroad retirement participants and beneficiaries.[5]

Goals

Congress designed the Trust to increase RRB funding. Investing railroad retirement funds in private markets was expected to yield higher average annual returns than investing solely in government securities. The higher returns were intended to pay for the enhanced benefits that were established in the act and to potentially reduce future tax rates for railroad employers and employees.[6]

Impact on Railroad Retirement Tier II Tax Rates

The Trust is also designed to maintain four to six years' worth of benefits in case of lower-than-expected returns. To maintain this balance, the tier II tax is set to automatically adjust to maintain the fund balance at four to six years without congressional action. Since the inception of the Trust, the tier II tax rates have been lowered twice and increased twice. In 2005, the tier II tax rate on employers was automatically lowered from 13.1% to 12.6% and the tax rate on employees was lowered from 4.9% to 4.4%. Tier II tax rates were lowered again in 2007 to 12.1% on employers and 3.9% on employees. In 2013, the tax rates were raised to 12.6% and 4.4% on employers and employees, respectively, and in 2014, the rates were raised to their current levels of 13.1% on employers and 4.9% on employees. The statute requires that the tier II tax rate on employers range between 8.2% and 22.1% and caps the tax rate on employees at 4.9%.

Investment Guidelines

The assets in the Trust are invested in a diversified portfolio, both to minimize investment risk and to avoid disproportionate influence over a particular industry or firm. The investment

[4] For additional information on ERISA, see CRS Report 95-926, *Regulating Private Pensions: A Brief Summary of ERISA*.

[5] National Railroad Retirement Investment Trust, *Annual Management Report for Fiscal Year 2016*, January 31, 2017, https://www.rrb.gov/sites/default/files/2017-06/reportFY2016[1].pdf. Hereinafter cited as NRRIT, *Annual Management Report for Fiscal Year 2016*.

[6] U.S. Congress, House Committee on Transportation and Infrastructure, *Railroad Retirement and Survivors Improvement Act of 2001*, Report to accompany H.R. 1140, 107th Cong., 1st sess., May 24, 2001, H.Rept. 107-82, part 1 (Washington: GPO, 2001), pp. 14-15. Hereinafter cited as H.Rept. 107-82, part 1.

guidelines adopted by the Trustees include target asset allocations developed by the Trust's investment staff in consultation with an independent investment advisory firm. Outside investment managers hired by the Trust invest the assets according to these guidelines. The resulting investment performance is monitored by the Trustees and the Trust's Chief Investment Officer.

The Trust's target asset allocations change over time. For example, from FY2006 to FY2008, the Trust began to move away from fixed income investments (from 35% of total investments in FY2006 to 27% in FY2008) and toward private equity (from 5% to 10%) and real estate (from 5% to 10%). The Trust's adoption of a more aggressive investment strategy coincided with market downturns. In 2009, the Trust adjusted its target allocation ranges, but not its individual target allocations, to provide for greater flexibility during periods of market volatility.[7]

The investment guidelines were changed again in September 2011 to reflect current market expectations. These changes included continued movement away from fixed income investments (from 27% of total investments in 2009 to 22% in 2011); the elimination of the opportunistic investments category, which had a target allocation range of between 5% and 20% in 2009; and the adoption of a cash category with a target allocation range of between 0% and 3%.[8]

The Trust's current investment guidelines were most recently changed in August 2014 and continued the trend away from fixed income investments (from 22% of total investments in 2011 to 20% in 2014). These current investment guidelines are shown in detail in **Table 1**.

Oversight

Because the Trust is an independent nongovernmental agency, it is not subject to the same oversight as federal agencies. The act outlines specific reporting requirements including an annual management report to Congress. The report must include a statement of financial position, a statement of cash flows, a statement on internal accounting and administrative control systems, and any other information necessary to inform Congress about the operations and financial condition of the Trust. The financial statements must be audited by independent public accountants. A copy of the annual report and audit must be submitted to the President, the RRB, and the Director of the Office of Management and Budget (OMB). The RRB has the authority to bring a civil action to enforce provisions of the act.

However, the RRB Office of Inspector General (OIG) has expressed concern about the effectiveness of the oversight of the Trust. In 2008, the OIG argued that the annual financial audit required "is not adequate to support the RRB's enforcement responsibility because such audits are not intended to provide information about all areas of risk that could indicate the need for enforcement action."[9] The OIG noted that there are fewer safeguards protecting the Trust than there are for the retirement investments of federal government and private-sector workers. For example, there is no requirement for performance audits of the Trust, which would assess program effectiveness, economy and efficiency, internal control, and compliance with the law.

---

[7] National Railroad Retirement Investment Trust, *Annual Management Report for Fiscal Year 2009*, January 29, 2010, p. 15, https://www.rrb.gov/sites/default/files/2017-05/1002[1].pdf.

[8] National Railroad Retirement Investment Trust, *Annual Management Report for Fiscal Year 2013*, January 31, 2014, Appendix B, https://rrb.gov/sites/default/files/2017-02/appendicesFY2013.pdf.

[9] Railroad Retirement Board, Office of Inspector General, *Statement of Concern: National Railroad Retirement Investment Trust Lack of Provision for Performance Audits*, March 31, 2008, https://www.rrb.gov/sites/default/files/2017-05/nrritStatement.pdf.

In 2011, the OIG reiterated its concerns with the oversight of the Trust and stated,

> The lack of NRRIT investment fund management accountability, transparency, and stringent financial oversight can be precursors to fraud, waste and abuse. Within the Federal agency spectrum there is no comparable example where Federal program assets are completely outside the jurisdiction of a Federal agency's appointed Inspector General. However, the NRRIT fund which supports the Railroad Retirement program remains outside the purview of those appointed to protect the interests of the program's beneficiaries and the tax-paying public.[10]

Table 1. Current Trust Target Asset Allocations and Ranges

(since August 19, 2014)

Asset Class	Target Allocation (%)	Target Allocation Range (%)
Equity	**54**	
Domestic	22	17-27
International	22	17-27
Private	10	5-15
Fixed Income	**20**	
Domestic	13	9-17
International	7	4-10
Real Assets	**15**	
Commodities	5	2-8
Real Estate	10	2-15
Other	**11**	
Absolute Return	10	5-15
Cash	1	0-3

Source: National Railroad Retirement Investment Trust, *Annual Management Report for Fiscal Year 2016*, January 31, 2017, p. 15, https://www.rrb.gov/sites/default/files/2017-06/reportFY2016[1].pdf. See pages 15-17 for detailed definitions of assets.

Accounting in the Federal Budget

As required in the 2001 act, purchases and sales by the Trust initially produce no direct budgetary cost or income.[11] The law did not prescribe the treatment of unrealized capital gains and losses on the Trust's investments. The Congressional Budget Office (CBO) and OMB agreed that any capital loss or gain resulting from changes in market prices would be recognized in the year in which the price change occurs, and interest payments and dividends would be recorded as

[10] Railroad Retirement Board, Office of the Inspector General, *Office of the Inspector General's Proposal to Improve Business Efficiency at the Railroad Retirement Board*, September 21, 2011, p. 5, https://rrb.gov/sites/default/files/2017-05/SR_092111.pdf.

[11] For budgetary purposes, purchases by the Trust are not considered outlays, but as an exchange of assets of equal value; redemptions are not considered offsetting receipts. This differs from long-standing budgetary rules, which usually treat an investment in nonfederal securities as the purchase of an asset, recording both an obligation and an outlay equal to the purchase price during the year of the purchase.

offsetting receipts.[12] As a result, income and capital gains reduce outlays and the deficit, and losses increase them. This reflects the change in real economic resources available to the government as the value of the Trust changes. As for future performance, both CBO and OMB use risk-adjusted rate of return assumptions—that is, they assume that the Trust's investments will earn the Treasury bond rate.

Performance of the Trust

To date, the Trust's average annual performance almost meets expectations expressed by the act's drafters, which had assumed that investments by the Trust would earn an average annual return of 8.0%.[13] From FY2003 to FY2015, the Trust's annual returns have averaged 7.9%. For the first half of the Trust's existence, its returns exceeded expectations. Prior to FY2008, the average rate of return on Trust investments was 14.7% and the average rate of return exceeded the expected rate of 8.0% through FY2010. The Trust had negative rates of return in FY2008 (-19.1%) and FY2009 (-0.7%) but rebounded with an 11.2% rate of return in FY2010 followed by a slightly negative rate of return of -0.1% in FY2011. The FY2012 rate of return of 16.4% brought the average annual rate of return of the Trust above the expected level of 8.0% for the first time in two years (since FY2010). The rate of return was 10.2% in FY2014, -1.5% in FY2015, and 8.1% in FY2016.[14]

Since railroad retirement funds were first invested through the Trust in September 2002, a total of $21.3 billion has been transferred to the Trust, with no transfers taking place after the end of FY2004.[15] The Trust has earned a total of $23.1 billion from its inception to the end of FY2016.[16] At the end of FY2016, the market value of the Trust's managed assets was $25.1 billion. Since 2002, $19.2 billion in earnings have been used to pay RRB benefits and administrative expenses.[17]

Total RRB Assets

At the inception of the Trust in February 2002, the value of the total assets of the RRB, including assets in the Trust and assets held in reserve in accounts at the Department of the Treasury, was $20.7 billion. As of the end of FY2016, the value of total RRB assets was $26.3 billion, with $25.1 billion held by the Trust and $1.5 billion held in reserve accounts at the Department of the Treasury. The net increase in total RRB assets since the inception of the Trust is $5.8 billion.[18]

[12] For more information on accounting for government investment in private markets, see Congressional Budget Office, *Evaluating and Accounting for Federal Investment in Corporate Stocks and Other Private Securities*, January 2003, http://www.cbo.gov/sites/default/files/cbofiles/ftpdocs/40xx/doc4023/01-08-03-stocks.pdf.

[13] H.Rept. 107-82, Part 1, p. 14.

[14] National Railroad Retirement Investment Trust, *Annual Management Report for Fiscal Year 2014*, January 31, 2015, p. 13, https://rrb.gov/sites/default/files/2017-02/reportFY2014.pdf; NRRIT, *Annual Management Report for Fiscal Year 2015*, p. 14; and NRRIT, *Annual Management Report for Fiscal Year 2016*, p. 14.

[15] NRRIT, *Annual Management Report for Fiscal Year 2016*, p. 11.

[16] Ibid.

[17] Ibid.

[18] Ibid., p. 6.

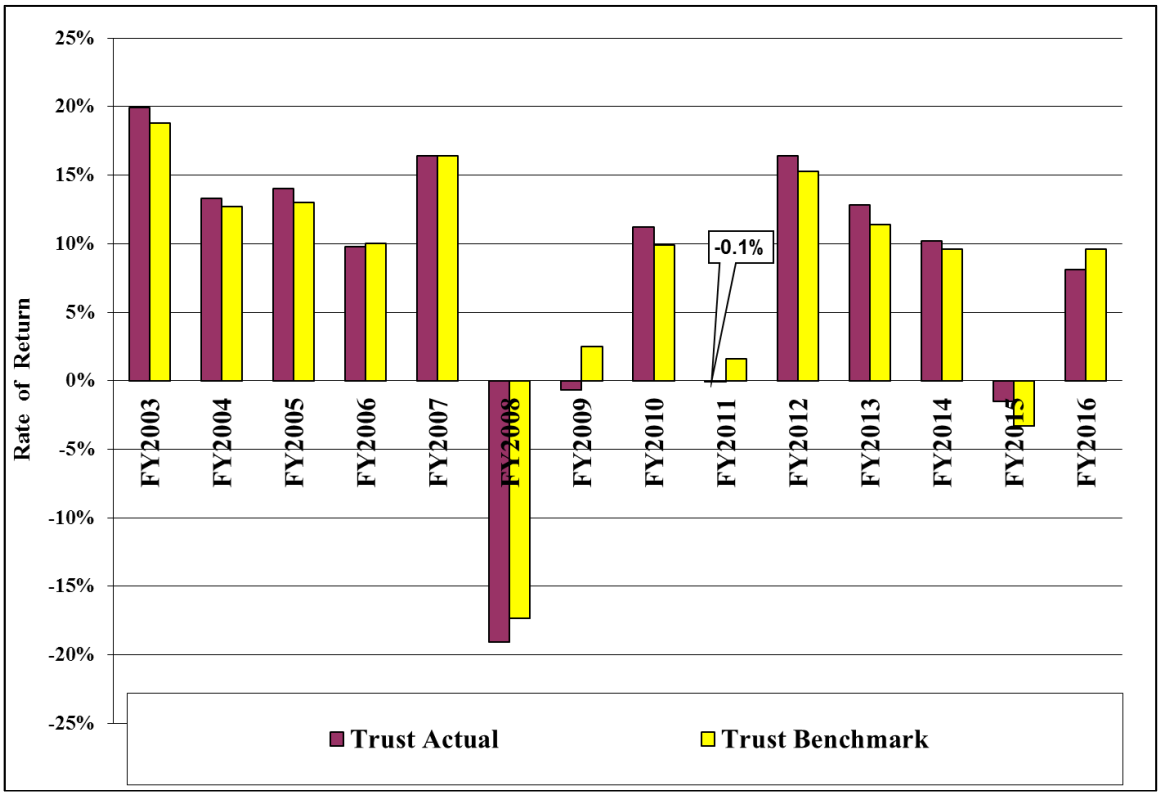
Comparison to Benchmarks

The Trust's annual rates of return have generally compared favorably to its benchmarks. A benchmark is a standard used for comparison when measuring investment performance and the NRRIT strategic policy benchmark is based on a series of benchmarks corresponding to each of the major asset classes in the Trust.[19] For example, the current benchmark for the Trust's investments in domestic equities is the Russell 3000 Index.[20]

As shown in **Figure 1**, in FY2003 through FY2005, the performance of the Trust exceeded its strategic policy benchmarks. In FY2006 and FY2007, the Trust's performance was roughly equal to its benchmarks, whereas in FY2008, FY2009, and FY2011, the Trust's investments had lower returns than its strategic policy benchmarks. In FY2015, the Trust's negative rate of return of -1.5% exceeded the benchmark of -3.3%. In FY2016, the Trust's 8.1% return rate was below the 9.6% benchmark.[21]

Figure 1. Actual Trust Rates of Return Compared with Strategic Policy Benchmarks

(FY2003 to FY2016)



Source: National Railroad Retirement Investment Trust, *Annual Management Report for Fiscal Year 2016*, January 31, 2017, p. 14; and previous editions.

[19] Benchmarks for each of the Trust's asset classes are provided in NRRIT, *Annual Management Report for Fiscal Year 2016*, Appendix B.

[20] Additional information on the Russell 3000 Index is available on the website of Russell Investments at http://www.ftse.com/Analytics/FactSheets/temp/44c7ed53-1026-4910-9fda-55fb203f8744.pdf.

[21] NRRIT, *Annual Management Report for FY2016*, p. 14; and previous editions.

Administrative Expenses

The Trust's administrative expenses steadily increased through FY2011 as its investment portfolio diversified. However, as shown in **Table 2**, beginning in FY2012, the Trust's administrative expense ratio decreased, mirroring a national trend of decreasing expense ratios for mutual and money market funds. The Trust's administrative expenses remain low compared with industry standards. In FY2016, the Trust's expense ratio was 28 basis points (expenses were 0.28% of average net assets).[22] In comparison, in 2013, the average expense ratio for all investors was 74 basis points for equity funds, 61 basis points for bond funds, 80 basis points for hybrid funds, and 17 basis points for money market funds.[23]

Table 2. Trust Expense Ratios

(FY2003-FY2016)

Fiscal Year	Basis Points
2003	2
2004	4
2005	9
2006	15
2007	24
2008	25
2009	26
2010	33
2011	36
2012	30
2013	29
2014	29
2015	27
2016	28

Source: National Railroad Retirement Investment Trust, *Annual Management Report for Fiscal Year 2016* p. 18; and previous editions.

Notes: One basis point is equal to 1/100th of 1% of the average net assets of a fund. For example an expense ratio of 29 basis points indicates that expenses were 0.29% of average net assets.

Author Information

Julie M. Whittaker
Specialist in Income Security

[22] NRRIT, *Annual Management Report for Fiscal Year 2016*, p. 18.

[23] Investment Company Institute, *Trends in the Fees and Expenses of Mutual Funds, 2013*, May 2014, http://www.ici.org/pdf/per20-02.pdf.

Acknowledgments

CRS Analyst Scott Szymendera originally authored an earlier version of this report.

Disclaimer

This document was prepared by the Congressional Research Service (CRS). CRS serves as nonpartisan shared staff to congressional committees and Members of Congress. It operates solely at the behest of and under the direction of Congress. Information in a CRS Report should not be relied upon for purposes other than public understanding of information that has been provided by CRS to Members of Congress in connection with CRS's institutional role. CRS Reports, as a work of the United States Government, are not subject to copyright protection in the United States. Any CRS Report may be reproduced and distributed in its entirety without permission from CRS. However, as a CRS Report may include copyrighted images or material from a third party, you may need to obtain the permission of the copyright holder if you wish to copy or otherwise use copyrighted material.