CONGRESSIONAL BUDGET OFFICE
COST ESTIMATE

November 18, 2003

H.R. 1776
Pension Preservation and Savings Expansion Act of 2003

As ordered reported by the House Committee on Ways and Means
on July 18, 2003

SUMMARY

H.R. 1776 would make numerous changes to the Employee Retirement Income Security Act of 1974 (ERISA) and the Internal Revenue Code that would affect the operations of private pension plans. These include changes to pension contribution rules, increases in the age at which retirement assets must be tapped, modifications in premiums paid to the Pension Benefit Guaranty Corporation (PBGC), and other changes.

CBO and the Joint Committee on Taxation (JCT) estimate that enacting the bill would increase federal revenues by $1.6 billion in 2004, but would reduce revenues by $10.3 billion over the 2004-2008 period and by $47.9 billion over the 2004-2013 period. CBO estimates that the bill would increase direct spending by $3 million in 2004, by $378 million over the 2004-2008 period, and by $558 million over the 2004-2013 period. In addition, CBO estimates the bill would lead to an increase in spending subject to appropriation of $10 million in 2004, $40 million over the 2004-2008 period, and $80 million over the 2004-2013 period, assuming appropriation of the necessary amounts.

JCT has determined that the tax provisions of H.R. 1776 contain no intergovernmental mandates as defined in the Unfunded Mandates Reform Act (UMRA). CBO has reviewed all provisions of H.R. 1776 that are not amendments to the Internal Revenue Code and determined that those provisions contain no intergovernmental mandates and would not affect the budgets of state, local, or tribal governments.

JCT has determined that the tax provisions of H.R. 1776 contain no private-sector mandates as defined in UMRA. CBO has determined that the nontax provisions in the bill contain a mandate on sponsors of certain defined-contribution pension plans regarding the vesting of

pension benefits. CBO estimates that the direct cost of that mandate to affected entities would exceed the annual threshold specified in UMRA ($120 million in 2004, adjusted annually for inflation) in each of the first five years in which the mandate would be effective.

ESTIMATED COST TO THE FEDERAL GOVERNMENT

The estimated budgetary impact of H.R. 1776 is shown in the following table. The costs of this legislation would fall within budget function 600 (income security).

BASIS OF ESTIMATE

For the purposes of this estimate, CBO and JCT assume the bill will be enacted early in fiscal year 2004.

Revenues

Most of the bill's budgetary impact would be on federal revenues. CBO and JCT estimate that, if enacted, H.R. 1776 would increase receipts to the federal government in fiscal years 2004 and 2005, but decrease receipts after that.

H.R. 1776 would alter existing tax law related to the treatment of pension plans and retirement accounts. All estimates of the revenue effects of the bill were provided by JCT. JCT estimates that, in total, enacting H.R. 1776 would increase revenues by $1.6 billion in 2004, and reduce revenues by $10.3 billion over the 2004-2008 period and $47.9 billion over the 2004-2013 period.

Roughly half of this total change in revenues would result from simplifying and updating the minimum distribution rules for certain tax-favored retirement arrangements. Under current law, participants in such arrangements must begin receiving distributions upon reaching age 70½. H.R. 1776 would increase this age to 72 from 2004 through 2007, and then again to 75 for 2008 and beyond. As a result, participants in such arrangements would make taxable withdrawals later than under current law. JCT estimates that this change would reduce governmental receipts by $24.2 billion over the 2004-2013 period. JCT estimates the bill's other provisions relating to simplification would decrease revenues by $41 million over the 2004-2013 period.

	By Fiscal Year, in Millions of Dollars									
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
CHANGES IN REVENUES										
Simplification and Updating of the Minimum Distribution Rules	-393	-917	-1,057	-1,150	-2,058	-3,207	-3,676	-3,703	-3,949	-4,100
Other Provisions Relating to Simplification	-13	-3	-3	-3	-3	-3	-3	-3	-3	-3
Provisions Relating to Retirement Assets and Portability	-693	-1,217	-1,156	-1,276	-1,236	-1,210	-1,273	-1,260	-1,259	-1,279
Extension and Expansion of Saver's Credit	0	0	0	-710	-2,379	-2,213	-2,218	-1,580	-44	-44
Alteration of Defined-Benefit Pension Plans	2,788	3,714	1,082	-1,192	-1,763	-617	-1,260	-1,747	-1,174	-942
Expansion of Small Business Retirement Plan Coverage and Retirement Savings for Tax-Exempt Organizations and Government Employees	-77	-129	-139	-146	-154	-161	-168	-178	-187	-195
Total Changes in Revenue	1,612	1,448	-1,273	-4,477	-7,593	-7,411	-8,598	-8,471	-6,616	-6,563
CHANGES IN DIRECT SPENDING										
Temporarily Replace the 30-year Bond Rate										
Estimated Budget Authority	0	132	102	82	26	25	25	25	26	26
Estimated Outlays	0	132	102	82	26	25	25	25	26	26
Reduce Flat-Rate Premiums Paid to PBGC										
Estimated Budget Authority	*	*	1	1	1	1	1	1	1	1
Estimated Outlays	*	*	1	1	1	1	1	1	1	1
Changes in Variable Premiums Paid to PBGC										
Estimated Budget Authority	*	3	4	5	6	6	6	7	7	7
Estimated Outlays	*	3	4	5	6	6	6	7	7	7
Authorization for the PBGC to Pay Interest on Refunds of Premium Overpayments										
Estimated Budget Authority	3	3	3	3	3	3	3	3	3	3
Estimated Outlays	3	3	3	3	3	3	3	3	3	3
Total Changes in Direct Spending										
Estimated Budget Authority	3	138	110	91	36	35	35	36	37	37
Estimated Outlays	3	138	110	91	36	35	35	36	37	37
CHANGES IN SPENDING SUBJECT TO APPROPRIATION										
PBGC Administrative Costs										
Estimated Authorization Level	10	6	8	8	8	8	8	8	8	8
Estimated Outlays	10	6	8	8	8	8	8	8	8	8

SOURCES: Congressional Budget Office and Joint Committee on Taxation.

NOTES: PBGC = Pension Benefit Guaranty Corporation.
* = Less than $500,000.

H.R. 1776 also would:

- Make several changes to tax law relating to the accumulation and portability of retirement assets. The bill would accelerate scheduled increases in the contribution limits for pension plans and individual retirement accounts (IRAs), allow transfers to a spouse's retirement plan, exclude certain lifetime annuity payments, permit certain rollovers, and alter restrictions on IRA contributions by individuals with disabilities. JCT estimates that these changes would decrease revenues by $11.9 billion over the 2004-2013 period.

- Extend and expand the saver's credit, a nonrefundable tax credit for certain taxpayers for contributions to qualified retirement savings plans. The credit is currently scheduled to expire on December 31, 2006. H.R. 1776 would extend the credit through the end of 2010 and raise the applicable credit rate for certain taxpayers with income below $40,000. JCT estimates that enacting this provision would reduce governmental receipts by $9.2 billion over the 2007-2013 period.

- Alter tax law relating to defined benefit pension plans, including the treatment of certain employee contributions, the minimum participation rule, interest rates, and deduction rules for combinations of plans. JCT estimates that these provisions, together, would increase revenues over the 2004-2006 period, but decrease revenues over the 2007-2013 period. The increase would be $2.8 billion in 2004; overall, these changes would decrease revenues by $1.1 billion over the 2004-2013 period.

- Expand the coverage of small businesses' retirement plans and increase retirement savings opportunities for employees of governments and certain tax-exempt organizations. In total, JCT estimates these provisions would decrease revenues by $1.5 billion over the 2004-2013 period.

Direct Spending

CBO estimates that enacting H.R. 1776 would increase direct spending by $3 million in 2004, by $378 million over the 2004-2008 period, and by $558 million during the 2004-2013 period.

Temporary Replacement of the 30-Year Bond Rate. Under current law, pension plans are required to determine whether they are fully funded by discounting future pension liabilities using the interest rate based on the moving four-year average for 30-year Treasury bonds. Sponsors of plans that are considered underfunded must make contributions to their plans in addition to paying variable-rate premiums to the PBGC based on the amount of underfunding. H.R. 1776 would allow plans to use interest rates on high-grade, long-term corporate bonds to discount their liabilities during plan years 2004, 2005, and 2006. The exact rate to be used by plans would be determined by the Secretary of the Treasury.

Interest rates on corporate bonds are generally higher than those on Treasury bonds. Using a higher interest rate to discount liabilities results in lower projections of the cost of future liabilities. Therefore, firms would have to contribute less to their plans and pay less in variable-rate premiums. Based on information provided by the PBGC, CBO assumes that the applicable corporate bond rate would be roughly 150 basis points higher than the interest rate on 30-year Treasury bonds. CBO estimates using this higher rate to discount liabilities would reduce the liabilities of underfunded plans by about $30 billion by plan-year 2007. As a result, we estimate that premium receipts would decrease by $469 million over the 2005-2013 period. Because the PBGC's premiums are offsetting collections to a mandatory spending account, reductions in premium receipts are reflected as increases in direct spending.

The use of higher interest rates could have other effects on the PBGC's costs, but the direction and magnitude of these effects are uncertain. On the one hand, the use of higher interest rates to discount future liabilities would reduce sponsors' contributions, improve their financial position, and make it less likely that they would eventually become bankrupt. Thus, the policy might reduce the number of plans that the PBGC ultimately takes over. On the other hand, the lower contributions would mean that the underfunding for plans that eventually become the responsibility of the PBGC would be greater, thus adding to the agency's costs.

Reduced Flat-Rate Premiums Paid to the PBGC. Under current law, defined-benefit pension plans operated by a single employer pay two types of annual premiums to the PBGC. All covered plans are subject to a flat-rate premium of $19 per participant. In addition, underfunded plans must also pay a variable-rate premium that depends on the amount by which the plan's liabilities exceed its assets.

The bill would reduce the flat-rate premium from $19 to $5 per participant for plans established by employers with 100 or fewer employees during the first five years of the plan's operation. According to information obtained from the PBGC, approximately 8,300 plans would eventually qualify for this reduction. Those plans cover an average of about 10 participants. CBO estimates that the change would reduce the PBGC's premium income by $8 million from 2004 through 2013.

Changes in Variable Premiums Paid to the PBGC. H.R. 1776 would make several changes affecting the variable-rate premium structure paid by underfunded plans. CBO estimates these provisions would decrease premium receipts by $51 million over the 2004-2013 period.

First, for all new plans that are underfunded, the bill would phase in the variable-rate premium. In the first year, plans would pay nothing. In the succeeding four years, they would pay 20 percent, 40 percent, 60 percent, and 80 percent, respectively, of the full amount. In the sixth and later years, they would pay the full variable-rate premium determined by their funding status. Based on information from the PBGC, CBO estimates that this change would affect the premiums of approximately 250 plans each year. It would reduce the PBGC's total premium receipts by $41 million over the 2004-2013 period.

Second, the bill would reduce the variable-rate premium paid by all underfunded plans (not just new plans) established by employers with 25 or fewer employees. Under the bill, the variable-rate premium per participant paid by those plans would not exceed $5 multiplied by the number of participants in the plan. CBO estimates that approximately 2,500 plans would have their premium payments to the PBGC reduced by this provision beginning in 2004. As a result, premium receipts would decline by $9 million over the 2004-2013 period.

In total, H.R. 1776 would reduce all types of premiums paid to the PBGC by $528 million (or about 6 percent) over the 2004-2013 period.

Authorization for the PBGC to Pay Interest on Refunds of Premium Overpayments. The legislation would authorize the PBGC to pay interest to plan sponsors on premium overpayments. Interest paid on overpayments would be calculated at the same rate as interest charged on premium underpayments. On average, the PBGC receives $19 million per year in premium overpayments, charges an interest rate of 8 percent for underpayments, and experiences a two-year lag between the receipt of payments and the issuance of refunds. Based on this information, CBO estimates that direct spending would increase by $3 million annually.

Benefits Paid to Substantial Owners of Terminated Plans. H.R. 1776 would simplify the rules by which the PBGC pays benefits to substantial owners (those with an ownership interest of at least 10 percent) of terminated pension plans. Only about one-third of the plans taken over by the PBGC involve substantial owners, and the change in benefits paid to owner-employees under this provision would be less than $500,000 annually.

Spending Subject to Appropriation

H.R. 1776 would expand the PBGC's role in locating and making benefit payments to missing participants in terminating pension plans. It also would require the PBGC to assume responsibility for small pension benefits owed to participants in ongoing plans. CBO estimates this provision would increase the agency's administrative costs, which are subject to appropriation, by $10 million in 2004, $40 million from 2004 through 2008, and $80 million over the 2004-2013 period.

Under current law, the PBGC is required to assume liabilities for missing participants in single-employer, defined-benefit pension plans that terminate. The PBGC attempts to locate missing participants from such plans and either pay them an annuity or make a lump-sum payment, depending on the amount of benefits accrued by the participant. Section 503 of the bill would require the PBGC to assume pension liabilities for missing participants of terminated multiemployer plans as well. In addition, section 503 would require the PBGC to perform the same services for missing participants of defined-contribution plans that terminate.

Finally, section 503 would provide sponsors of ongoing pension plans with the option of having the PBGC assume responsibility for pension assets of employees who leave those plans without indicating what they would like done with the accrued pension assets. This provision would only apply to plan participants with pension assets valued between $1,000 and $5,000. Under current law, employers will soon be required to deposit such pension assets into an individual retirement account, unless the participant elects either a cash payment or another type of retirement account.

Section 503 would not increase the PBGC's net spending on pension benefits because the amount of additional benefit payments would be offset by the additional assets it would receive. However, this section would affect the agency's administrative costs. Based on data from the PBGC, CBO estimates section 503 would increase the number of participants whose benefits are covered through the PBGC by more than 400,000 during 2004. The number of participants added to the PBGC's rolls would increase by another 350,000 in 2005, with the annual increase slowing to about 100,000 by 2009. CBO anticipates that most of the increase would be from participants who leave ongoing plans and whose assets are rolled into PBGC-managed accounts. The next largest group would come from missing participants of ongoing plans.

By requiring the agency to track down hundreds of thousands of additional missing participants and administer new individual pension asset accounts, section 503 would require the PBGC to increase spending on computer tracking systems, searches, and maintenance of individual accounts. CBO's estimate of the resulting administrative costs is based on data about the average cost to search for a missing participant (about $19 per participant for initial searches and $9 for subsequent searches), how much it costs to maintain individual pension accounts (about 0.1 percent of assets being managed), and how much it would cost to update and maintain the agency's record-keeping system (about $5 million in the first year and $300,000 each year thereafter).

ESTIMATED IMPACT ON STATE, LOCAL, AND TRIBAL GOVERNMENTS

JCT has determined that the tax provisions of H.R. 1776 contain no intergovernmental mandates as defined in UMRA. CBO has reviewed all provisions of H.R. 1776 that are not amendments to the Internal Revenue Code and determined that those provisions contain no intergovernmental mandates and would not affect the budgets of state, local, or tribal governments.

ESTIMATED IMPACT ON THE PRIVATE SECTOR

JCT has determined that the tax provisions of H.R. 1776 contain no private-sector mandates as defined in UMRA. CBO has determined that the nontax provisions in the bill contain a mandate on sponsors of certain defined-contribution pension plans regarding the vesting of pension benefits.

Under current law, sponsors of defined-contribution plans are required to grant an employee full, nonforfeitable rights to the employee's accrued benefits derived from the employer's non-matching contributions after five years of service, or to grant the employee nonforfeitable right to specified percentages of such benefits over a multiple-year period, with nonforfeitable rights to 100 percent of such benefits after seven years of service. Section 104 of the bill would require sponsors to grant the employee full, nonforfeitable rights to those benefits after three years of service, or to grant the employee full, nonforfeitable rights to specified percentages of those benefits over a multiple-year period, with nonforfeitable rights to 100 percent of such benefits after six years of service. These provisions would cause a reduction in the forfeitures of assets by affected plan participants, which would increase the cost to plans' sponsors. CBO estimates that assets in private, defined-contribution plans will total approximately $2 trillion in 2004. Based on information from the Department of Labor and the Employee Benefit Research Institute, CBO estimates that these provisions would increase the annual cost to the sponsors of such plans by roughly 0.01 percent to 0.02 percent of plan assets—or by approximately $300 million per year.

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