CONGRESSIONAL BUDGET OFFICE
COST ESTIMATE

August 21, 2002

S. 1971
National Employee Savings and Trust Equity Guarantee Act

As reported by the Senate Committee on Finance on August 2, 2002

SUMMARY

S. 1971 would make several changes to both the Internal Revenue Code and the Employee Retirement Income Security Act of 1974 (ERISA) that would affect the operations and taxation of private pension plans. These include changing the requirements for diversification options, providing information to assist participants in making investment decisions, and changing the premiums paid to the Pension Benefit Guaranty Corporation (PBGC). In addition, S. 1971 would modify the tax treatment of certain executive compensation and make other changes.

The Joint Committee on Taxation (JCT) estimates that the bill would increase governmental receipts by $437 million over the 2003-2007 period, and by $221 million over the 2003-2012 period. Most of the revenue increase would occur in 2003 ($578 million), and the bill would result in a loss of revenue from 2005 through 2010.

CBO estimates that the bill would increase direct spending by $36 million over the 2003-2007 period and by $89 million over the 2003-2012 period. Discretionary spending would also increase by $4 million over the 2003-2007 period, assuming appropriation of the necessary amounts. Because S. 1971 would affect revenues and direct spending, pay-as-you-go procedures would apply.

JCT has determined that the revenue provisions of the bill do not contain any mandates. CBO has determined that the other provisions contain no intergovernmental mandates, but they do contain several mandates on sponsors, administrators, and fiduciaries of private pension plans. CBO estimates that the direct cost of those new requirements on private-sector entities would exceed the annual threshold specified in the Unfunded Mandates Reform Act ($115 million in 2002, adjusted annually for inflation).

ESTIMATED COST TO THE FEDERAL GOVERNMENT

The estimated budgetary impact of the bill is shown in the following table.

	By Fiscal Year, in Millions of Dollars				
	2003	2004	2005	2006	2007
CHANGES IN REVENUES					
Executive Compensation Provisions	182	95	68	40	19
Change in Interest Rate for Calculating Plans' Funding Requirement	397	-54	-119	-97	-65
Voluntary Early Retirement Incentive Plans	-1	-4	-7	-10	-10
Total Revenues	578	37	-57	-66	-55
CHANGES IN DIRECT SPENDING					
Flat-Rate PBGC Premiums	*	*	1	1	1
Variable-Rate PBGC Premiums	0	3	4	5	6
Interest Rate Range for Funding Overpayment	9	-3	-3	-2	-1
Payment of Interest on Overpayments of PBGC Premiums	3	3	3	3	3
Total Direct Spending	12	3	5	7	9
TOTAL CHANGES IN DIRECT SPENDING AND REVENUES					
Net Increase or Decrease (-) in the Budget Deficit	-566	-34	62	73	64
SPENDING SUBJECT TO APPROPRIATION					
Studies by PBGC, Treasury, and Labor					
Estimated Authorization Level	4	0	0	0	0
Estimated Outlays	3	1	0	0	0

SOURCES: CBO and the Joint Committee on Taxation

NOTES: * = Less than $500,000.

Components may not sum to totals because of rounding.

BASIS OF ESTIMATE

This estimate assumes that S. 1971 will be enacted around October 1, 2002.

Revenues

All estimates of the revenue proposals of the bill were provided by JCT. The provisions relating to executive compensation would tax without deferral certain compensation provided through offshore trusts, and require wage withholding at the top marginal tax rate for certain supplemental wage payments in excess of $1 million. Those provisions would increase revenues by $182 million in 2003, by $402 million over the 2003-2007 period, and by $496 million over the 2003-2012 period. The pension-related provision with the largest revenue effect would alter the allowable interest rates used to calculate pension funding requirements (see discussion below). That provision would increase revenues by $62 million over the 2003-2007 period and reduce revenues by $199 million over the 2003-2012 period. Other pension provisions would reduce revenues by $1 million in 2003, by $32 million over the 2003-2007 period, and by $82 million over the 2003-2012 period.

Direct Spending

Reduced Flat-Rate Premiums Paid to PBGC. Under current law, defined benefit pension plans operated by a single employer pay two types of annual premiums to the Pension Benefit Guaranty Corporation. 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 plans' operations. According to information obtained from the PBGC, approximately 7,500 plans would eventually qualify for this reduction. Those plans cover an average of 10 participants each. CBO estimates that the change would reduce the PBGC's premium income by less than $500,000 in 2003 and by $8 million over the 2003-2012 period. Since PBGC premiums are offsetting collections to a mandatory spending account, reductions in premium receipts are reflected as increases in direct spending.

Changes in Variable Premiums Paid to the PBGC. S. 1971 would make several changes affecting the variable-rate premium paid by underfunded plans. CBO estimates, in total, this section will decrease receipts from those premiums by $9 million in 2003 and $51 million over the 2003-2012 period.

First, for all new plans that are underfunded, the bill would phase in the variable-rate premium. In the first year, the 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. On the basis of 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 about $2 million in 2004 and by $41 million from 2004 through 2012.

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 $1 million in 2004 and by $10 million over the 2004-2012 period.

Finally, the bill would alter the allowable interest rates used to calculate pension funding requirements contained in ERISA and the Internal Revenue Code, which would allow plans to become more underfunded in plan year 2001 without subjecting them to tax and other penalties. Even though most plan-year 2001 accounts will be finalized in September 2002, the new interest rate requirement would give some plans credits that may be used in plan-year 2002, which would affect premiums paid in fiscal year 2003. JCT estimates that this provision initially would cause employers to reduce pension plan contributions, but later increase these contributions until funding returns to baseline levels. Some plans subsequently would have to pay higher premiums because their reduced contributions would further increase their level of underfunding. Other plans, however, would qualify for a special exemption and not be required to pay the variable premium for plan-year 2001. Based on information from the PBGC, CBO estimates the net effect would be a decrease of $9 million in premium receipts in 2003. From 2004 through 2007, premium income would then increase, resulting in a net change in receipts of less than $500,000 over the 2003-2007 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 on 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.

Substantial Owner Benefits in Terminated Plans. S. 1971 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.

Discretionary Spending

Studies. S. 1971 would direct the PBGC, the Department of Labor, and the Department of the Treasury to undertake four studies: one regarding establishing an insurance system for individual retirement plans, one on the fees charged by individual retirement plans, one on ways to revitalize defined benefits pension plans, and one on floor-offset employee stock ownership plans. Based on the costs of studies with comparable requirements, CBO estimates these studies would cost about $4 million over the 2003-2012 period, assuming the availability of appropriated funds.

PAY-AS-YOU-GO CONSIDERATIONS

The Balanced Budget and Emergency Deficit Control Act sets up pay-as-you-go procedures for legislation affecting direct spending or receipts. The net changes in governmental receipts that are subject to pay-as-you-go procedures are shown in the following table. For the purposes of enforcing pay-as-you-go procedures, only the effects through 2006 are counted.

	By Fiscal Year, in Millions of Dollars									
	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Changes in receipts	578	37	-57	-66	-55	-97	-94	-50	4	21
Changes in outlays	12	3	5	7	9	10	10	11	11	11

ESTIMATED IMPACT ON STATE, LOCAL, AND TRIBAL GOVERNMENTS

JCT has determined that the revenue provisions of S. 1971 contain no intergovernmental mandates as defined in the Unfunded Mandates Reform Act (UMRA).

CBO reviewed the non-revenue provisions of S. 1971 and has determined that they contain no intergovernmental mandates as defined in UMRA and would impose no costs on state, local, or tribal governments.

ESTIMATED IMPACT ON THE PRIVATE SECTOR

With only limited exceptions, private employers who provide pension plans for their workers must follow rules specified in ERISA. Therefore, CBO considers changes in ERISA that expand those rules to be private-sector mandates under UMRA. The nonrevenue provisions of S.1971 would make several such changes to ERISA that would affect sponsors, administrators, and fiduciaries of pension plans. CBO estimates that the direct cost to affected entities of the new requirements in the bill would exceed the annual threshold specified in UMRA ($115 million in 2002, adjusted annually for inflation). JCT has determined that the revenue provisions of S. 1971 do not contain any private-sector mandates.

Title I of the bill would impose restrictions on individual-account (that is, defined contribution) plans regarding assets held in the plans in the form of securities issued by the plan's sponsor. The bill would require affected plans to allow participants to immediately sell those securities that have been acquired through the employee's contributions, and to allow participants to sell certain securities acquired through the employer's contributions after three years of service with the firm. The latter requirement would be phased in over three years. CBO estimates that the added administrative and record-keeping costs of this provision would be approximately $20 million annually, with larger amounts in the first year.

Title I also would require plans to offer a range of investment options. This requirement would add little to plans' costs because many plans now abide by a safe harbor provision in ERISA that has similar requirements.

Title II of the bill would impose restrictions on plan administrators during transaction suspension periods. (Transaction suspension periods are periods of time when participants are unable to direct the investment of assets in their accounts—for example, when a plan is changing recordkeepers.) To avoid financial liability during those time periods, fiduciaries would be required to abide by certain conditions. The bill also would increase the maximum bond required to be held by fiduciaries from $500,000 to $1 million. CBO estimates that the direct cost of these provisions to plan sponsors and fiduciaries would be small.

Title III of the bill would impose a number of requirements on plans regarding information they must provide to their participants. Administrators of defined contribution plans would be required to provide quarterly statements to participants. Those statements would have to contain several items, including the amount of accrued benefits and vested accrued benefits, the value of investments held in the form of securities of the employing firm, and an explanation of any limitations or restrictions on the right of the individual to direct the investments. Currently, plans must provide more limited statements to participants upon request. CBO estimates that, while many plans now provide pension statements on a quarterly basis, about 30 million participants would begin to receive quarterly statements as a result of this bill. The added cost of this requirement would be about $100 million annually.

Title III also would require administrators of private defined-benefit pension plans to provide vested participants currently employed by the sponsor with a benefit statement at least once every three years, or to provide notice to participants of the availability of benefit statements on an annual basis. CBO estimates that the cost of this provision would be less than $5 million annually.

In addition, Title III would require plans to provide participants with basic investment guidelines and information on optional forms of benefits, as well as information that plan sponsors must provide to other investors under securities laws. Plans also would have to make available on a web site any disclosures required of officers and directors of the plan's sponsor by the Securities and Exchange Commission. CBO estimates that the cost of these provisions would exceed $25 million annually.

PREVIOUS CBO ESTIMATES

CBO has prepared cost estimates for three other bills that contain provisions similar to those in S. 1971. These are:

- H.R. 3669, the Employee Retirement Savings Bill of Rights, as reported by the House Committee on Ways and Means on March 14, 2002 (CBO estimate dated March 20, 2002),

- H.R. 3762, the Pension Security Act of 2002, as ordered reported by the House Committee on Education and the Workforce on March 20, 2002 (CBO estimate dated April 4, 2002), and

- S. 1992, the Protecting America’s Pensions Act of 2002, as ordered reported by the Senate Committee on Health, Education, Labor, and Pensions on March 21, 2002 (CBO estimate dated May 7, 2002).

The major budgetary effects of H.R. 3669, like S. 1971, pertain to revenue provisions that relate to pension plan funding. (H.R. 3669 also included a provision excluding certain stock options from wages.) H.R. 3669's provisions affecting pensions would produce an estimated revenue loss of $1.2 billion over the 2002-2012 period, compared with the $277 million revenue loss projected for the pension provisions of S. 1971 over the 2003-2012 period.

Like S. 1971, both H.R. 3669 and H.R. 3762 would make several changes to ERISA affecting premiums collected by the PBGC. CBO estimated that H.R. 3669 would increase direct spending by $104 million over from 2003-2012 and H.R. 3762 would increase direct spending by $185 million over the same period. Unlike S. 1971, H.R. 3762 included a provision amending the underlying formula used to determine variable rate-premiums for plan-year 2003. Also, one of the changes made by H.R. 3762 would first apply to plan-year 2002, while that provision in S. 1971 would start with plan-year 2003. Both bills also contained somewhat different language than S. 1971 affecting the interest rates used to calculate variable-rate premiums in plan-year 2001.

S. 1992 did not have any estimated impact on either revenues or direct spending.

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