CONGRESSIONAL BUDGET OFFICE
COST ESTIMATE

May 6, 2004

H.R. 3108

Pension Funding Equity Act of 2004

As cleared by the Congress on April 8, 2004,
and signed by the President on April 10, 2004

SUMMARY

H.R. 3108, enacted as Public Law 108-218, makes 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. Specifically, the law changes the way pension liabilities are calculated for certain plans, which will affect both pension contributions and premiums paid to the Pension Benefit Guaranty Corporation (PBGC). The law also allows sponsors of certain plans to reduce scheduled contributions to their plans for a period of time.

CBO and the Joint Committee on Taxation (JCT) estimate that P.L. 108-218 will increase federal revenues by about $3.4 billion in 2004 and by $6.2 billion over the 2004-2009 period; it will decrease revenues by $412 million over the 2004-2014 period. CBO estimates that the act will increase direct spending by $333 million over the 2006-2009 period and $307 million over the 2006-2014 period.

ESTIMATED COST TO THE FEDERAL GOVERNMENT

The estimated budgetary impact of Public Law 108-218 is shown in the following table. The costs of this legislation fall within budget function 600 (income security).

	By Fiscal Year, in Millions of Dollars										
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
CHANGES IN DIRECT SPENDING											
Temporarily Replace the 30-year Bond Rate											
Estimated Budget Authority	0	0	153	166	34	29	0	0	0	0	0
Estimated Outlays	0	0	153	166	34	29	0	0	0	0	0
Temporarily Reduce Firms' Deficit Reduction Contributions to Pension Plans											
Estimated Budget Authority	0	0	-7	-14	-15	-13	-10	-8	-5	-3	0
Estimated Outlays	0	0	-7	-14	-15	-13	-10	-8	-5	-3	0
Total Changes in Direct Spending	0	0	146	152	19	16	-10	-8	-5	-3	0
CHANGES IN REVENUES											
Temporarily Replace the 30-year Bond Rate	3,299	5,563	1,247	-1,261	-1,004	-2,216	-2,737	-1,888	-1,160	-828	-558
Clarify Tax Treatment of Small Insurance Companies	47	105	118	120	127	134	137	141	146	152	157
Temporarily Reduce Firms' Deficit Reduction Contributions to Pension Plans	14	44	32	-46	-72	-47	-31	-33	-28	-20	-17
Repeal Section 809 Related to Policyholders' Dividends	0	-25	-33	-43	-47	-43	-38	-39	-39	-39	-40
Allow Transfer of Excess Pension Assets to Health Accounts	0	0	18	38	40	40	40	40	40	40	40
Other Provisions	3	10	5	-8	-6	-2	-2	-1	-1	*	*
Total Changes in Revenues	3,363	5,697	1,387	-1,200	-962	-2,134	-2,631	-1,780	-1,042	-695	-418

SOURCES: Congressional Budget Office and Joint Committee on Taxation.

NOTES: * = revenue loss of less than $500,000.

BASIS OF ESTIMATE

Direct Spending

Temporary Replacement of the 30-Year Bond Rate. Under prior law, pension plans were required to determine whether they were fully funded by discounting future pension liabilities using the interest rate based on the four-year moving average for 30-year Treasury bonds. The Department of the Treasury stopped issuing the 30-year securities in 2001. Sponsors of plans that are considered underfunded generally must pay a variable-rate premium to the PBGC based on the amount of underfunding ($9 for every $1,000 of underfunding). P.L. 108-218 will allow plans to use interest rates on high-grade, long-term corporate bonds to discount their liabilities during plan-years 2004 and 2005. The exact rate to be used by plans will 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 will 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 will be roughly 150 basis points higher than the interest rate on 30-year Treasury bonds. CBO estimates that using this higher rate to discount liabilities will reduce the number of plans that are considered underfunded and the liabilities of remaining underfunded plans by about $20 billion by plan-year 2006. As a result, we estimate that premium receipts will decrease by $382 million, or 4.2 percent, over the 2006-2014 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 will reduce sponsors' contributions, improve their financial position, and make it less likely that they will eventually become bankrupt. Thus, the act may reduce the number of plans that the PBGC ultimately takes over. On the other hand, the lower contributions could mean that the underfunding for plans that eventually become the responsibility of the PBGC will be greater, thus adding to the agency's costs.

Temporary Relief from Deficit Reduction Contributions. Sponsors of defined-benefit pension plans that are considered underfunded are required to make a series of supplemental payments to their plans. These payments, referred to as deficit reduction contributions, are amortized over a number of years until the plan reaches full-funding status.

P.L. 108-218 provides plan sponsors in certain industries the option of reducing any required deficit reduction contributions in plan-years 2004 and 2005. This relief is extended only to passenger airline companies and the iron ore pellet and steel industries. In order to qualify, plans must have been considered fully funded in plan-year 2000. For plans that elect to receive such relief, the law restricts the increase in benefits that can be initiated in 2004 and 2005.

Based on information provided by the PBGC, CBO estimates that providing temporary relief from deficit reduction contributions will decrease pension contributions by approximately $1.6 billion in plan-years 2004 and 2005. The forgone contributions will eventually be paid over a number of years. Because decreasing required contributions will effectively increase underfunding among these plans, CBO anticipates that variable-rate premium payments to the PBGC, which are based on underfunding, will increase. As a result, CBO estimates that direct spending will decrease by $7 million in 2006 and $75 million over the 2006-2014 period.

Revenues

P.L. 108-218 amends the tax law as it relates to the treatment of pension plans. CBO and JCT estimate that the act will increase receipts to the federal government during the 2004-2006 period, but decrease receipts after that. In total, P.L. 108-218 will increase revenues by about $6.2 billion over the 2004-2009 period, but reduce revenues by about $412 million over the 2004-2014 period.

Much of the impact on federal revenues comes from two provisions. The largest change in revenues will result from temporarily allowing firms to use a higher interest rate for determining pension funding and variable-rate premiums paid to the PBGC. Because this change will initially reduce the contributions sponsors will have to make toward their pension plans, their taxable profits and federal tax liabilities will increase for calendar years 2004 and 2005. In addition, employers can elect to continue to use prior-law interest rates when determining limits on deductible contributions. The change in interest rates will increase federal revenues by an estimated $10.4 billion over the 2004-2006 period and then decrease receipts after that, when employers will have to increase their contributions to compensate for the low contributions in 2004 and 2005. Over the entire 2004-2014 period, it will reduce governmental receipts by about $1.5 billion, JCT estimates.

P.L. 108-218 also will significantly affect federal revenues by modifying the eligibility rules that exempt qualifying small property and casualty insurance companies from the income tax. JCT estimates that doing so will increase governmental receipts by $651 million over the 2004-2009 period and by about $1.4 billion over the 2004-2014 period.

P.L. 108-218 will also affect federal revenues by:

- Partially waiving required deficit reduction contributions for two years for plans of certain employers who were not subject to deficit reduction contribution rules in 2000. JCT estimates this will increase revenues by $90 million between 2004 and 2006, and then decrease revenues by $294 million between 2007 and 2014.

- Repealing permanently the reduced deduction for policyholder dividends of mutual life insurance companies provided under Section 809 of the Internal Revenue Code. The reduced deduction had been repealed in previously enacted legislation but expired at the end of calendar year 2003. JCT estimates doing so will reduce revenues by $387 million over the 2005-2014 period.

- Allowing employers to transfer excess assets in defined-benefit plans to a special account for retired employees. Under prior law, such transfers could be made through December 31, 2005. The act allows such transfers through December 31, 2013. These transfers will reduce the new contributions sponsors have to make to cover retirees' health benefits, thereby increasing the taxable income of the sponsors. JCT estimates this provision will increase federal revenues by $338 million over the 2006-2014 period.

- Allowing certain plans with actual liabilities that exceeded those initially anticipated to defer paying a portion of the charges associated with such losses. JCT estimates the provision will increase governmental receipts by $8 million between 2004 and 2006 and reduce receipts by $9 million between 2007 and 2008, with negligible effects thereafter.

- Extending a transition rule to pension funding requirements for interstate bus companies for two years, through 2005. JCT estimates the provision will increase governmental receipts by $10 million between 2004 and 2006, and reduce receipts by $11 million between 2007 and 2014.

PREVIOUS CBO ESTIMATES

On November 21, 2003, CBO transmitted a cost estimate for H.R. 3108 as passed by the House of Representatives on October 8, 2003. That version of the bill would have replaced the 30-year Treasury rate with a corporate bond rate for two years (plan-years 2004 and 2005). CBO estimated that H.R. 3108 would decrease the PBGC's premium receipts by $279 million over the 2005-2013 period and increase federal revenues by $304 million over the 2004-2013 period.

On November 18, 2003, CBO transmitted a cost estimate for H.R. 1776, the Pension Preservation and Savings Expansion Act of 2003, as reported by the House Committee on Ways and Means. H.R. 1776 contained various pension reform proposals, including a provision to replace the 30-year Treasury bond rate with a corporate bond rate for three years (plan-years 2004-2007). CBO estimated that this provision of H.R. 1776 would decrease the PBGC's premium receipts by $469 million over the 2005-2013 period.

On December 4, 2003, CBO transmitted a cost estimate for S. 2005, the Pension Stability Act, as ordered reported by the Senate Committee on Health Education, Labor, and Pensions on October 29, 2003. The Pension Stability Act would have replaced the 30-year Treasury rate with a corporate bond rate for the same three-year period specified in H.R. 1776. CBO estimated that this provision would decrease premium receipts by $367 million over the 2005-2013 period and reduce federal revenues by $190 million over the 2004-2013 period.

This estimate for H.R. 3108 differs from those for other pension reform bills because of differences in the number of years the corporate bond rate would be used; because CBO revised the methodology it used to determine premium receipts once the Treasury rate is reinstated; and because of new assumptions used to project the PBGC's premium receipts under prior law. In addition, none of the other bills provided plans with relief from deficit reduction contributions.

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