CONGRESSIONAL BUDGET OFFICE
U.S. Congress
Washington, DC 20515

Phillip L. Swagel, Director

September 30, 2022

Honorable Virginia Foxx
Ranking Member
Committee on Education and Labor
U.S. House of Representatives
Washington, DC 20515

Honorable Jason Smith
Ranking Member
Committee on the Budget
U.S. House of Representatives
Washington, DC 20515

Re: *Effect of the Pension Benefit Guaranty Corporation's Final Rule on Special Financial Assistance*

Dear Representative Foxx and Representative Smith:

This letter responds to your request for information on the effects of a final rule issued in July 2022 by the Pension Benefit Guaranty Corporation (PBGC) for special financial assistance (SFA) provided under the American Rescue Plan Act (ARPA), enacted in March 2021.[1] The Congressional Budget Office's initial estimates of SFA were based on how CBO expected that PBGC would implement ARPA. PBGC's July 2021 interim final rule was consistent with those expectations. The final rule, which was issued in July 2022, changed the method used to compute SFA, including the assumed rate of return. It also changed the type of assets in which pension plans may invest SFA, which changes the expected rate of return and risk profile of those investments.

CBO anticipates that the changes in the final rule will increase the total amount of SFA that plans will receive. The agency estimates that the amount of assistance will total $90.4 billion over the 2022-2032 period, which is $4.5 billion, or 5 percent, more than the $85.9 billion estimated in CBO's May 2022 baseline budgetary projections, which were based on expectations consistent with the July 2021 interim final rule.

1. For the final rule, see Special Financial Assistance by PBGC, 87 Fed. Reg. 40968 (July 8, 2022), https://tinyurl.com/mr3kn7nf. For the interim final rule, see Special Financial Assistance by PBGC, 86 Fed. Reg. 36598 (July 12, 2021), https://tinyurl.com/bddyb9vf.

The July 2022 final rule also allows pension plans more flexibility in investing the SFA they receive, which CBO expects will result in higher expected investment returns and in additional investment risk. With higher SFA amounts and higher expected investment returns, CBO projects that plans will remain solvent for a longer time than they would under the interim final rule. The estimate of SFA is unaffected by the expected return or the investment risk on actual plan investments, because SFA is computed based on specified rates of return.

Differences Between the Interim Final Rule and the Final Rule

The final rule made several notable alterations to the interim final rule, by:

- Changing the method and the interest rate used to calculate SFA,
- Providing plans with additional flexibility in selecting investments, and
- Providing additional benefits to plans that suspended benefits under the Multiemployer Pension Reform Act of 2014 (MPRA).

Changing the SFA Calculation. Under the July 2021 interim final rule, special financial assistance was to be computed, under specified assumptions, as the present value of a qualifying pension plan's projected shortfall through 2051.[2] Specifically, the assistance amount equaled the present value of projected benefit payments and administrative expenses, minus the sum of the current value of its assets and the present value of expected future contributions to the plan and other anticipated receipts. Under that rule, the discount rate was the lower of two rates: the rate used by the plan in its most recent filing of Internal Revenue Service Form 5500 or the interest rate limit, which equals the "third segment rate" (as described in section 303(h)(2)(C)(iii) of the Employee Retirement Income Security Act), plus 200 basis points (a basis point is one one-hundredth of a percentage point).

2. A present value is a single number that expresses a flow of current and future income or payments in terms of an equivalent lump sum received or paid at a specific time. The value depends on the rate of interest, known as the discount rate, used to translate future cash flows into current dollars.

In February 2021, CBO projected SFA costs in an estimate for the House Committee on Ways and Means' reconciliation recommendations.[3] CBO used a single discount rate in those projections and in subsequent baseline projections. A single rate also was specified in the July 2021 interim final rule.

The July 2022 final rule revised the SFA computation method. The rule directs use of a projection approach that accounts for estimated assets in each year through 2051. Qualifying pension plans will now receive the minimum amount of SFA necessary to end each plan year through 2051 with zero or positive assets.

The final rule also changed the interest rate used for SFA computations—in the interim final rule, to discount future cash flows, and in the final rule, as the rate of return to project earnings. That change results in a higher total amount of assistance. ARPA specified the interest rate to be used to determine the amount of assistance.[4] Some public comments submitted to PBGC argued that a single rate was inconsistent with the requirement in ARPA that plans segregate SFA assets and any earnings on those assets from other plan assets, and with the stated goal in ARPA of ensuring solvency through 2051.[5] In the interim final rule, PBGC concluded that that it did not have the authority to allow plans to use "a different rate or bifurcate the statutorily mandated interest rate."[6] In the final rule, PBGC concluded that it could permit a different rate for SFA assets, provided that plans used the required rate for non-SFA assets.[7]

The interest rate for SFA assets is capped at the average of all three segment rates, plus 67 basis points. Based on information about interest rates used in December 2021 for plan year 2021, CBO calculates that the

3. Congressional Budget Office, cost estimate for reconciliation recommendations of the House Committee on Ways and Means (February 15, 2021), www.cbo.gov/publication/57005.
4. Sec. 4262(e) of the Employee Retirement Income Security Act of 1974 (ERISA), P.L 93-406 (codified at 29 U.S.C. § 1432(e) (2018 & Supp.)), as added by sec. 9704(b) of the American Rescue Plan Act of 2021, P.L. 117-2.
5. Special Financial Assistance by PBGC, 87 Fed. Reg. at 40978.
6. Special Financial Assistance by PBGC, 86 Fed. Reg. at 36603.
7. Special Financial Assistance by PBGC, 87 Fed. Reg. at 40978–80.

non-SFA rate is 5.29 percent and the new lower SFA rate is 2.95 percent.[8] The use of the lower assumed rate of return results in lower total assumed earnings on SFA assets and therefore a larger amount of total assistance.

Adding Flexibility for Selection of Investments. The July 2022 final rule also allows pension plans more flexibility in selecting investments for their SFA assets than the interim final rule allowed. That change affects investment income but not the SFA amount, which is based in part on the interest rates described above. The interim final rule required plans to invest all SFA assets and earnings in investment-grade bonds. In its 2021 estimate of ARPA and in subsequent baseline projections, CBO assumed that those SFA assets would be invested in investment-grade bonds. Under the final rule, as much as 33 percent may be invested in equities or other return-seeking assets.

CBO expects that under the final rule, pension plans will maximize expected returns by investing 33 percent of SFA assets in equities and 67 percent in corporate bonds. Under CBO's economic projections, the annual return on SFA assets under the final rule will be 1.37 percentage points higher than it would have been under the interim final rule. The projected returns are less certain, however, because investing in equities is riskier than investing in bonds.

Providing Additional Benefits to "MPRA Plans." The July 2022 final rule increases the amount of special financial assistance given to pension plans, often called MPRA plans, that suspended benefits under the Multiemployer Pension Reform Act of 2014. Although those plans have been allowed to reduce benefits to avoid insolvency, they must reinstate benefits to qualify for SFA.

Under the final rule, MPRA plans receive "the greatest of: (1) the amount of SFA calculated for a plan that is not a MPRA plan [the standard calculation described above]; (2) the lowest amount of SFA that is sufficient to ensure that the plan will project rising assets at the end of the 2051 plan year; and (3) an amount of SFA equal to the present value of reinstated benefits." Under the July 2021 interim final rule, assistance for MPRA plans was calculated as it was for other pension plans.

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8. See Internal Revenue Service, Pension Plan Funding Segment Rates, Funding Table 3A for 2022 (September 20, 2022), https://tinyurl.com/3macwp6z.

Estimating the Effects of the Final Rule

Your letter asked about the effects of the final rule on the number of plans that will receive special financial assistance and the amounts they will receive. CBO has updated projections underlying the May 2022 baseline to reflect only the changes in the final rule.

CBO generated a probability distribution of pension plans' potential financial outcomes by running 500 simulations in which many factors (such as investment returns, benefits, and contributions) were varied, and then used the average of those simulations to produce the projections.

Estimating the Number of Plans Receiving Special Financial Assistance. CBO anticipates that the final rule will increase the number of pension plans receiving SFA. Under CBO's May 2022 baseline, which used the specifications in the interim final rule, 333 pension plans would receive SFA in at least one of the 500 simulations, and 203 would receive assistance in at least half of the simulations. Using CBO's May 2022 baseline projections and the specifications in the final rule, 336 plans would receive assistance in at least one of the 500 simulations, and 213 would receive it in at least half of the simulations.

Estimating Amounts of Special Financial Assistance. Your letter also requested information about how the final rule would affect the amount of SFA paid to pension plans, including the effect of the bifurcated interest rate and the treatment of MPRA plans. CBO estimates that the final rule would increase the total amount of SFA by $4.5 billion compared with the interim final rule.

CBO estimates that if the computation method changed for ongoing, non-MPRA plans but interest rates remained as specified in the interim final rule, total assistance would increase by $1.7 billion. Incorporating the bifurcated interest rates would increase that amount by an additional $1.6 billion. On net, applying the final rule would increase CBO's May 2022 baseline projections of SFA for ongoing, non-MPRA plans by $3.3 billion (or 4 percent), from $85.9 billion to $89.2 billion.

CBO does not have sufficient data to estimate how much assistance the MPRA plans will receive. PBGC has estimated that the final rule will benefit 18 MPRA plans, thereby increasing special financial assistance by

$1.2 billion.[9] Incorporating that change would increase CBO's projections of total SFA from $89.2 billion to $90.4 billion (an additional 1 percent).

That estimate includes effects on the plans already receiving assistance under the interim final rule, although CBO has not analyzed those plans separately. Because our projections are probabilistic, we do not report the effects of the changes in the final rule for individual plans. In addition, the total amount of SFA granted to those plans will differ from the total amount in CBO's projections because the granted amounts were based on detailed data for benefits and contributions that plans included in their SFA applications. PBGC has announced SFA amounts for all pension plans with approved applications; any revisions will be announced upon future approvals.

CBO estimates that the final rule will increase SFA amounts for all non-MPRA plans, including those that have already received payments, by 4 percent, and anticipates a similar percentage change for the subset of plans that have already received payments under the interim final rule.

Projecting Effects on Plan Assets and Liabilities. Your letter also asked how the final rule affects CBO's projections of assets and liabilities for plans receiving special financial assistance. CBO projects that with larger SFA amounts and higher expected investment returns under the final rule, on average, plans will have more assets, but their gross liabilities will not change.

Under the interim final rule, CBO estimates, assets would total $219 billion in 2052 for the pension plans that would receive SFA in at least half of the 500 simulations. Under the final rule, those plans' assets would total $239 billion in 2052. (A plan's projected assets are the average over 500 simulations. In simulations in which a pension plan becomes insolvent, its assets in 2052 would be zero.) Projected actuarial liabilities for those plans in 2052 would total $85 billion under the interim final rule and essentially would be unchanged, at $86 billion, under the final rule. In CBO's projections, the probability that one of those plans would be

9. See Gordon Hartogensis, Director, Pension Benefit Guaranty Corporation, "Special Financial Assistance Final Rule, Changes in Estimated SFA Program Costs" (briefing on the Special Financial Assistance Final Rule, July 2022), slide 13, https://tinyurl.com/p6yy22du (PDF, 649 KB).

insolvent by 2052 decreased from an average of 46 percent under the interim final rule to 41 percent under the final rule.

I hope this information is helpful to you. Please let me know if you have any further questions.

Sincerely,

Phillip L. Swagel
Director

cc: Honorable Bobby Scott
Chairman
House Committee on Education and Labor

Honorable John Yarmuth
Chairman
House Committee on the Budget