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

July 31, 2006

Honorable Mike Enzi
Chairman
Committee on Health, Education,
Labor and Pensions
United States Senate
Washington, DC 20510

Dear Mr. Chairman:

As requested by your staff, the Congressional Budget Office (CBO) and the Joint Committee on Taxation (JCT) have estimated the direct spending and revenue effects of H.R. 4, the Pension Protection Act of 2006, as passed by the House of Representatives on July 28, 2006. That act would make 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. It would do so mostly by changing the funding requirements for tax-qualified, defined-benefit pension plans and the premiums paid to the Pension Benefit Guaranty Corporation (PBGC). It also would extend certain tax incentives for retirement savings, modify tax provisions related to spending for health care, and temporarily suspend certain customs duties.

CBO estimates that, under the act, direct spending would decrease by $1.8 billion over the 2007-2011 period and $6.5 billion over the 2007-2016 period. JCT and CBO estimate that the act would increase revenues by $510 million in 2007, but reduce revenues by $7.7 billion over the 2007-2011 period and by $72.9 billion through 2016.

CBO and JCT estimate that H.R. 4 would not significantly affect spending or revenues in 2006. For some budget enforcement procedures, the relevant budget periods are 2006-2010 and 2006-2015. Therefore, we are providing those summarized totals as well. CBO estimates that enacting this legislation would reduce direct spending by $1.093 billion over the 2006-2010 period and by $5.610 billion over the 2006-2015 period. The act would decrease revenues for those periods by $2.068 billion and $57.248 billion, respectively.

The estimated budgetary impact of the act over the fiscal years 2007 through 2016 is shown in the attached table.

Pursuant to section 407 of H. Con. Res. 95 (the Concurrent Resolution on the Budget , Fiscal Year 2006), CBO estimates that enacting H.R. 4 would not cause an increase in direct spending greater than $5 billion in any of the 10-year periods between 2016 and 2055.

Direct Spending Effects

The largest spending effects of the act would result from changes in premiums paid to PBGC. Spending for unemployment compensation, railroad retirement benefits, grants to wool producers and manufacturers of worsted wool fabrics would also be affected.

PBGC Premiums. H.R. 4 would affect the premium payments from the sponsors of defined-benefit pension plans in several ways. It would change the calculation for determining variable-rate premiums, change the amount of underfunding on which the variable-rate premiums are collected, and limit the premiums charged to small employers.

Under current law, sponsors of single-employer plans with assets less than liabilities are generally required to pay a variable premium, which is based on the amount of underfunding in the plan. The variable premium rate is $9 per $1,000 of underfunding, although some plans with underfunding are exempted from that premium because they recently were close to full funding (at least 90 percent funded). Beginning in 2006, the law now requires plan sponsors to discount their pension obligations using an interest rate based on the 30-year Treasury bond.

H.R. 4 would extend provisions that expired at the end of plan-year 2005 that allowed sponsors to use the interest rate on investment-grade corporate bonds for discounting liabilities. In addition, beginning with plan-year 2008, the act would phase in over three years a new requirement that plans use a higher grade of corporate bonds and a segmented yield curve (reflecting varying maturities that correspond to the timing of plan liabilities) to discount their pension obligations. The act also would require additional contributions from poorly funded plans and would limit certain benefits those plans can provide. Further, H.R. 4 would require PBGC's variable-rate premiums to be paid on

100 percent of a plan's underfunding. The combined effects of these various changes would be to increase PBGC's premium collections by $1.8 billion over the 2007-2011 period and $5.0 billion over the 2007-2016 period. Those changes would be partially offset by the provision limiting premiums to $5 per participant for plans with 25 or fewer employees. That change would reduce premium income by $5 million over the 2007-2011 period and $10 million over the 2007-2016 period.

Under current law, termination premiums of $1,250 per participant are charged, for three years, to sponsors of plans that are terminated on an involuntary or distressed termination basis. For sponsors whose plans are terminated while the program was being reorganized under chapter 11 of the bankruptcy code, the premium is levied after the sponsor emerges from bankruptcy. This premium does not apply to firms that are liquidated by a bankruptcy court, and expires after 2010. H.R. 4 would eliminate the 2010 sunset date for the premium. CBO estimates that additional collections would total $91 million in 2011 and $1.8 billion over the 2011-2016 period.

Special Funding Rules for Commercial Airlines. Under H.R. 4, commercial airlines would be eligible for special rules that would provide for relief from certain funding requirements. Under current law, commercial airlines are required to follow the same funding rules as all other plan sponsors, with the exception that they were provided temporary relief from deficit-reduction contribution requirements in 2004 and 2005.

H.R. 4 would provide commercial airlines with an additional two years (2006 and 2007) of relief from deficit-reduction contributions, and would allow sponsors that freeze their plans (that is, do not allow any further accrual of benefits) to amortize their unfunded liabilities over a 17-year period, compared with the seven years accorded other sponsors. Alternatively, airlines that do not cease future accruals would have to pay off their unfunded liabilities over 10 years.

Based on data from PBGC and its own modeling, CBO estimates that these special funding rules would increase PBGC's premium collections by $115 million over the 2007-2011 period and by $399 million over the 2007-2016 period.

Benefit Payments. The changes in the funding of pension plans and the limitations on benefits that can be provided by severely underfunded plans would affect the future costs of PBGC. Based on data provided by PBGC and its own modeling, CBO estimates the act would increase net claims over the next 10 years because the plans taken over by the agency would be less well funded than under current law. As a result, CBO estimates that these additional benefit payments would total $53 million over the 2007-2011 period and $274 million over the 2007-2016 period.

Special Rules for Certain Government Contractors. H.R. 4 would defer the implementation of the new single-employer funding rules for the defined-benefit plans sponsored by certain government contractors, and give time for the accounting requirements for government contracts to be modified to accommodate the changes in the act. In addition, those plans would be able to use a higher discount rate than those permitted other plans for valuing liabilities. Based on information provided by PBGC, CBO estimates that the special rules would increase net benefit payments by $2 million over the next five years and by $8 million over the next decade. The effects on premium collections are likely to be negligible, CBO estimates.

Other PBGC Provisions. The act includes several other provisions that would affect direct spending by PBGC. Among those provisions, the only one that CBO estimates has significant costs is the requirement that the agency pay interest on refunds of premium overpayments. That change would increase direct spending by $15 million over the next five years and $31 million over the next 10 years.

Other Direct Spending Provisions. H.R. 4 also contains provisions affecting other mandatory spending programs. One change would increase spending on unemployment insurance benefits by ensuring that distributions from certain employer-sponsored retirement plans or individual retirement accounts (IRAs) that are rolled over into other tax-deferred accounts could not offset a person's unemployment benefits. That change would increase outlays by an estimated $156 million over the 2007-2011 period and $391 million over the 2007-2016 period. (Consequently, unemployment insurance taxes would increase over time; the resulting revenue effects are noted below.)

The act also would increase railroad retirement benefits by allowing a divorced spouse to continue to receive tier II benefits after the former spouse (a one-time railroad worker) dies. CBO estimates these additional costs would total

$12 million over the 2007-2016 period. Another provision that would allow divorced spouses to receive railroad retirement benefits even if the former spouse continues to work would have a negligible effect on spending.

H.R. 4 also would extend the authority of the Departments of Agriculture and Commerce to provide grants to wool producers through 2010 and to U.S. manufacturers of worsted wool fabrics through 2009. CBO estimates that enacting this provision would increase direct spending by $14 million over the 2008-2010 period.

Revenues

The legislation would affect revenues by:

- Altering the funding rules for single-employer, defined-benefit plans; that change would result in lower contributions to plans initially and higher contributions later in the projection period, thereby increasing taxable corporate profits and revenues initially and lowering profits and revenues later;

- Permanently extending the higher contribution limits for individual retirement accounts and qualified pension plans that are scheduled to expire at the end of 2010;

- Extending a tax credit for contributions to certain retirement savings accounts (the "saver's credit") that is set to expire at the end of 2006;

- Making it easier for firms to offer automatic enrollment in defined-contribution pension plans, thereby increasing participation in plans and the amount of contributions that would be made on a pre-tax basis;

- Changing the rules that apply to combinations of life and long-term care insurance to allow certain withdrawals from annuities to be tax-free;

- Allowing certain public safety officers to withdraw limited amounts from government retirement plans tax-free to pay for premiums for health and long-term care insurance;

- Changing funding rules for multi-employer, defined-benefit plans;

- Ensuring that pension and IRA distributions do not reduce unemployment benefits, thereby generating a response by states to increase state and federal unemployment taxes;

- Making numerous other changes that include providing temporary suspensions of customs duties on certain products;

- Allowing rollovers by nonspouse beneficiaries of certain retirement plan distributions; and

- Providing incentives for certain charitable contributions and changing certain rules relating to activities of tax-exempt organizations.

Altogether, these provisions would reduce revenues by an estimated $7.7 billion over the 2007-2011 period and $72.9 billion over the 2007-2016 period. JCT provided most of the revenue estimates, and its estimates are detailed in JCX-36-06, issued on July 28, 2006.

Estimated Impact on State, Local, and Tribal Goverments

H.R. 4 would preempt state laws that require written permission from employees before an employer can withhold funds from the employee's pay and deposit those funds into a 401(k) plan. Although the preemption would limit the application of state law, it would impose no duty on states that would result in additional spending. Consequently, the costs of the mandate would not exceed the threshold established in the Unfunded Mandates Reform Act (UMRA), which is $64 million in 2006, adjusted annually for inflation.

CBO has reviewed the remaining non-tax provisions of the act and determined that they contain no intergovernmental mandates and would impose no costs on state, local, or tribal governments. (Such governments are exempt from the provisions of ERISA that would be amended by the act.)

Estimated Impact on the Private Sector

Some of the act's changes to ERISA would impose mandates on sponsors and administrators of single-employer and multiemployer private pension plans. CBO expects that the cost of those mandates would exceed the annual threshold specified in UMRA ($128 million in 2006, adjusted annually for inflation) in one or more of the first five years the mandates would be effective.

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contact for this estimate is Craig Meklir.

Sincerely,

Donald B. Marron

Donald B. Marron
Acting Director

Enclosure

cc: Honorable Edward M. Kennedy
Ranking Member

Honorable Charles E. Grassley
Chairman
Committee on Finance

Honorable Max Baucus
Ranking Democratic Member

Honorable Judd Gregg
Chairman
Committee on the Budget

Honorable Kent Conrad
Ranking Member

Honorable Howard P. “Buck” McKeon
Chairman
House Committee on Education and the Workforce

Honorable George Miller
Ranking Minority Member

Honorable William “Bill” M. Thomas
Chairman
House Committee on Ways and Means

Honorable Charles B. Rangel
Ranking Democrat

Honorable Jim Nussle
Chairman
House Committee on the Budget

Honorable John M. Spratt Jr.
Ranking Member

ESTIMATED CHANGES IN DIRECT SPENDING AND REVENUES UNDER H.R. 4, THE PENSION PROTECTION ACT OF 2006

	By Fiscal Year, in Millions of Dollars											
	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2007-2011	2007-2016
CHANGES IN DIRECT SPENDING (OUTLAYS)												
Pension Benefit Guaranty Corporation:												
Variable-Rate Premium	107	-356	-406	-539	-652	-708	-681	-640	-584	-518	-1,846	-4,976
Variable-Rate Premium for Small Plans	1	1	1	1	1	1	1	1	1	1	5	10
Termination Premiums	0	0	0	0	-91	-216	-345	-386	-398	-410	-91	-1,846
Special Funding Rules for Commercial Airlines	-7	-15	-23	-31	-40	-49	-58	-59	-59	-59	-115	-399
Net Benefit Payments	1	3	9	16	25	32	39	45	50	54	53	274
Special Rules for Plans of Certain Government Contractors	*	*	*	*	1	1	1	1	1	2	2	8
Interest on Refunds of Premium Overpayments	3	3	3	3	3	3	3	3	3	3	15	31
Unemployment Compensation:												
UI Offsets of 401(k) Rollover	15	26	37	38	40	42	45	47	49	52	156	391
Railroad Retirement:												
Tier II Benefits to Surviving Divorced Spouses	*	*	1	1	1	1	2	2	2	2	2	12
Wool Provisions	0	5	7	2	0	0	0	0	0	0	14	14
Total Change in Outlays	119	-332	-371	-509	-712	-892	-993	-986	-934	-872	-1,805	-6,482
CHANGES IN REVENUES												
Funding Rules (Single-Employer)	1,526	2,127	916	279	-75	-770	-1,677	-2,120	-1,685	-912	4,772	-2,392
Funding Rules (Multi-Employer)	-1	-6	-14	-22	-28	-34	-41	-47	-53	-59	-72	-306
Permanency of Expanded IRA and Pension Coverage	0	0	0	0	-2,642	-4,857	-5,705	-6,677	-7,686	-8,628	-2,642	-36,197
Saver's Credit	-245	-989	-1,010	-1,014	-1,071	-1,142	-1,147	-1,163	-1,153	-1,142	-4,329	-10,076
Health and Medical Benefits	-292	-303	-331	-412	-624	-959	-1,301	-1,652	-2,008	-2,363	-1,962	-10,244

(Continued)

ESTIMATED CHANGES IN DIRECT SPENDING AND REVENUES UNDER H.R. 4, THE PENSION PROTECTION ACT OF 2006 (CONTINUED)

	By Fiscal Year, in Millions of Dollars											
	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2007 - 2011	2007-2016
Diversification and Participation Protection	0	-137	-321	-501	-668	-802	-897	-992	-1,080	-1,196	-1,628	-6,591
Portability, Distribution, and Contribution Rules	-51	-117	-161	-187	-219	-257	-308	-382	-454	-514	-739	-2,656
Administrative Provisions	-1	-1	-4	-10	-14	-16	-14	-12	-9	-7	-29	-87
UI Offsets of 401(k) Rollovers	0	2	8	18	28	36	43	47	50	52	56	284
Exempt Organizations	-394	-148	-23	59	46	38	40	41	46	47	-456	-241
Other Provisions	-32	-92	-120	-63	-325	-624	-666	-714	-825	-953	-633	-4,415
Total Change in Revenues	510	336	-1,060	-1,853	-5,592	-9,387	-11,673	-13,671	-14,857	-15,675	-7,660	-72,923
NET INCREASE OR DECREASE (-) IN BUDGET DEFICITS												
Net Change in Budget Deficit	-391	-668	689	1,344	4,880	8,495	10,680	12,685	13,923	14,803	5,855	66,441

SOURCES: Congressional Budget Office and the Joint Committee on Taxation.

NOTES: Components may not add up to totals because of rounding.
UI = unemployment insurance; IRA = individual retirement account.

* = less than $500,000.

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