



## CRS Report for Congress

# The Pension Benefit Guaranty Corporation and the Federal Budget

William Joseph Klunk  
Actuary  
Domestic Social Policy

### Summary

The Pension Benefit Guaranty Corporation (PBGC) is a wholly owned government corporation that insures private-sector defined benefit pension plans. The PBGC receives no appropriations, but some of its operational cash flows are included in the federal budget. In FY2006, the PBGC generated net revenue of \$2.6 billion. Since 1975, it has generated more than \$15 billion in revenue and has had net outlays (i.e., years in which its outlays exceed its receipts) in only two years, FY2003 and FY2005. The current budget, however, projects net outlays to continue in FY2007 and FY2008.

In August 2006, the President signed the Pension Protection Act (PPA) of 2006, which changes the premiums that plan sponsors must pay to the PBGC as well as the contributions they must make to their plans. Over the next 10 years, the PPA provisions related to the PBGC are expected to decrease federal spending by \$5.5 billion and decrease revenue by \$2.4 billion. This report outlines the operational cash flows of the PBGC and how they are affected by provisions of the PPA as well as certain provisions included in the President's budget proposal for FY2008.

### Cash Accounting and the PBGC

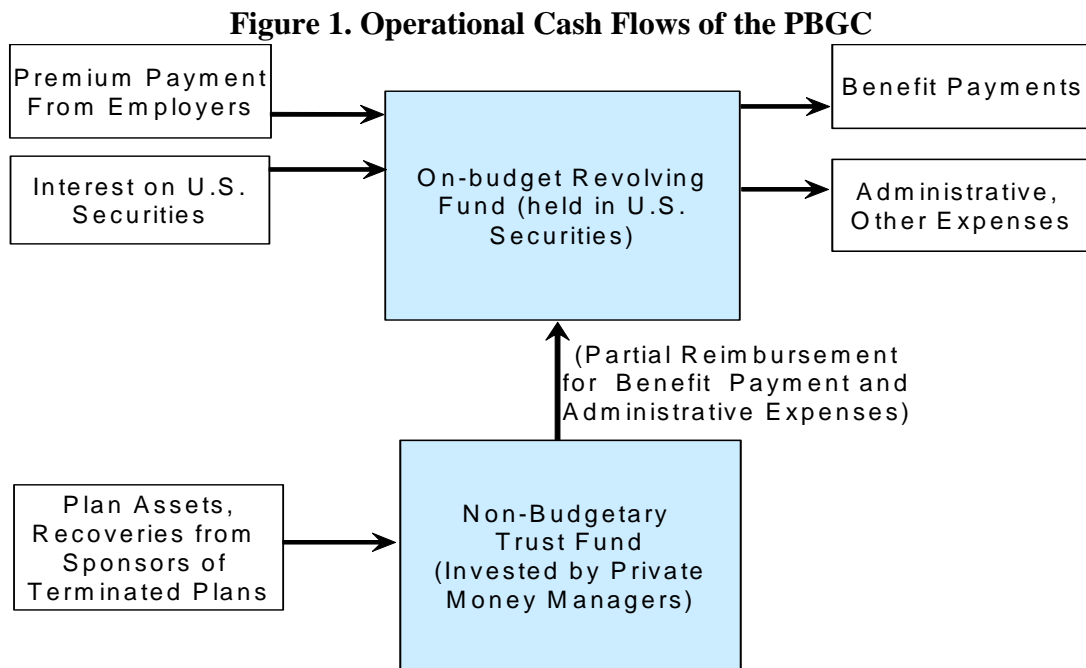
The Pension Benefit Guaranty Corporation (PBGC) is a wholly owned government corporation that insures the pension benefits of more than 44 million people participating in over 30,000 private-sector defined benefit pension plans.<sup>1</sup> It was created by the Employee Retirement Income Security Act (ERISA) of 1974. Although it receives no appropriations, some of its operational cash flows are included in the federal budget. Since 1975, these budgetary cash flows have generated more than \$15 billion in revenue. Net outlays (where gross outlays exceed receipts) have occurred in only two years:

---

<sup>1</sup> For more information on the PBGC see CRS Report 95-118, *Pension Benefit Guaranty Corporation: A Fact Sheet*, by Paul J. Graney.

FY2003 and FY2005. However, the FY2008 federal budget projects net outlays for the PBGC in both FY2007 and FY2008.<sup>2</sup>

The PBGC's budgetary cash flows are based on its premium income, interest income, benefit outlays, and the interaction of two funds: the trust fund and the revolving fund.<sup>3</sup> The trust fund includes assets obtained from terminated plans and is held primarily in corporate securities; it is managed by private money-managers. It is a non-budgetary account, meaning it is not found on the balance sheet of the federal government. The revolving fund is a budgetary account and is held exclusively in federal securities. Its gross outlays include PBGC benefit payments and administrative expenses. Its receipts include premiums paid, interest on federal securities, and reimbursements from the trust fund. As of September 30, 2006, the trust fund balance was \$44.0 billion, and the revolving fund balance was \$15.2 billion. **Figure 1** depicts the flow of funds into, out of, and between the two funds.



**Source:** Congressional Budget Office, *A Guide to Understanding the Pension Benefit Guaranty Corporation*, September 2005, p. 9.

<sup>2</sup> Operational cash flows represent one facet of the PBGC's finances. In its 2006 annual report, the PBGC reported an \$18.9 billion deficit, based on assets of \$61.1 billion and liabilities of \$80.0 billion. Accrual accounting measures such as these gauge the agency's ability to cover benefit payments that will be made over the next few decades. Accrual accounting is the norm in the pension industry, but it is not recognized by the federal budget. For more information on the long-term financial outlook for the PBGC, see CRS Report RL33937, *The Financial Health of the Pension Benefit Guaranty Corporation (PBGC)*, by William Klunk.

<sup>3</sup> Technically, the PBGC controls the operations of seven funds, but each individual fund is part of either the revolving fund or the trust fund.

The annual cash flows of the PBGC's revolving fund (as depicted in **Figure 1**) are synonymous with the PBGC's budgetary cash flows as reflected in the federal budget. In the appendix to the President's Budget for FY2008, OMB reports the actual FY2006 amounts for the PBGC as follows: premiums paid by employers (\$1.65 billion), interest on federal securities (\$3.90 billion), and reimbursements from the trust fund (\$1.51 billion) produced total receipts of \$7.06 billion. Benefit payments and associated expenses constituted gross outlays of \$4.44 billion. Thus, net revenue for FY2006 was \$2.62 billion.<sup>4</sup> These budget numbers are provided annually to the OMB by the PBGC.

Although some of the budget numbers (premiums, benefits, administrative expense) can be traced to values in the PBGC's annual report, other values (reimbursements from the trust fund, interest income on federal securities) are more difficult to ascertain.<sup>5</sup> The level of reimbursements from the trust fund to the revolving fund is based on the ratio of assets to liabilities for all plans taken over by the PBGC.<sup>6</sup> Interest on federal securities includes gains (or losses) realized due to the sale of securities.<sup>7</sup>

## **The Impact of the Pension Protection Act on the Federal Budget<sup>8</sup>**

The PPA overhauled pension funding rules, which has implications for projected spending and revenue of the federal budget. The Congressional Budget Office (CBO) projects that, over the 10-year period from 2007 to 2016, the PPA will decrease spending by \$5.5 billion and increase revenue by \$2.4 billion. Some of the changes in the PPA take effect or are phased in beginning in 2008, so their impact on the budget is not immediate.

---

<sup>4</sup> U.S. Office of Management and Budget, *Budget of the United States Government, FY2008, PUBLIC BUDGET DATABASE*, at [<http://www.whitehouse.gov/omb/budget/fy2008/db.html>].

<sup>5</sup> The budget uses cash accounting, which reflects, for example, actual premium received during the fiscal year. The annual report uses accrual accounting, which reflects premium earned (i.e., premium that was due) during the fiscal year.

<sup>6</sup> Generally, the ratio of assets to liabilities (i.e., the funding ratio) for all plans taken over by the PBGC determines the trust fund reimbursement amount as follows. The reimbursement amount equals the total benefit payments due in the year times the funding ratio. The balance of the benefit payments are made directly from the revolving fund.

<sup>7</sup> The PBGC adopted a new investment policy in 2004 aimed at improving the dollar duration match of invested assets to future benefit liabilities. To that end, the PBGC lengthened the duration of its portfolio by exchanging a significant portion of its treasury bond portfolio. The voluminous sales and purchases resulted in significant gains that were included in FY2006's \$3.9 billion interest income on federal securities. In FY2004 and FY2005, actual interest income on federal securities totaled \$1.21 billion and \$958 million, respectively. In FY2007 and FY2008, interest income on federal securities is projected to be \$725 million and \$691 million, respectively.

<sup>8</sup> The PPA includes changes that impact the federal budget but are not directly related to the PBGC. In addition to the PBGC-related changes outlined in this report, the PPA is expected to increase spending by \$0.4 billion over 2007-2016 and decrease revenue by \$70.5 billion over 2007-2016. A description of these broader changes is beyond the scope of this report. For more information on the PPA, see CRS Report RL33703, *Summary of the Pension Protection Act of 2006*, by Patrick Purcell. For more information on the PPA's impact on the federal budget, see Congressional Budget Office Cost Estimate for H.R. 4, *Pension Protection Act of 2006*, August 16, 2006.

**Impact on Federal Spending.** The CBO estimates that the PPA will reduce spending by \$1.9 billion over 2007-2011 and by \$5.5 billion over 2007-2016. **Table 1** shows details of the CBO's estimates of the PPA on the PBGC's budgetary cash flows and (equivalently) on federal spending.

**Table 1. The PPA's Impact on Direct Spending (Outlays)**  
(\$ in millions)

	2007-2011	2007-2016
Variable-Rate Premiums	-\$1,846	-\$4,976
Termination Premiums	-23	-411
Funding Relief for Airlines	-115	-399
Net Benefit Payments	53	274
Other Provisions	22	48
<b>Total</b>	<b>-1,910</b>	<b>-5,463</b>

**Source:** U.S. Congressional Budget Office, *Cost Estimate, H.R. 4, Pension Protection Act of 2006*, August 16, 2006, p. 6.

**Note:** Numbers may not add due to rounding.

The net impact of the PPA on the PBGC's budgetary cash flows is confined to the spending side of the federal budget. While the PBGC is said to generate revenue, its revenue is accounted for within the revolving fund, which is a spending account.<sup>9</sup> For example, negative values in **Table 1** represent expected decreases in spending. These can be either decreases in direct outlays (e.g., decreases in benefits) or, equivalently, increases in receipts also known as offsets to outlays (e.g., increases in premiums).

**Variable Rate Premiums.** Underfunded plans must pay variable rate premiums (VRPs) to the PBGC equal to \$9 per \$1,000 of plan underfunding. The PPA increased funding thresholds and removed provisions that exempted many plans from paying VRPs. This is expected to increase both the number of plans paying VRPs and the level of premiums that they pay, starting in FY2008. VRP income was \$550 million in FY2006.<sup>10</sup>

---

<sup>9</sup> The revolving fund balance serves as a buffer between the PBGC's budgetary cash flows and direct federal spending. Although PBGC outlays are counted in the federal budget, they flow through the revolving fund, which had a balance of \$15.2 billion as of September 30, 2006. In addition, the revolving fund is partially reimbursed for benefit payments by the trust fund, which had a balance of \$44.0 billion as of September 30, 2006. Even though net outlays are projected for FY2007 and FY2008, the balances in these funds enable the PBGC "...to meet its obligations for a number of years." PBGC, *Annual Management Report, 2006*, p.3.

<sup>10</sup> PBGC, *Annual Management Report, 2006*, p. 10.

CBO estimates that premium income will increase by \$1.8 billion over 2007-2011 and by \$5.0 billion over 2007-2016.<sup>11</sup>

**Termination Premiums.** Plan sponsors that terminate their plans while under chapter 11 bankruptcy reorganization and then later emerge from reorganization must pay termination premiums to the PBGC. The premium is \$1,250 per participant per year, payable for three years. This provision was enacted under the Deficit Reduction Act of 2005 (P.L. 109-171) and contained a December 31, 2010 sunset date, which the PPA removes.<sup>12</sup> CBO estimates that collections from termination premiums will increase PBGC's premium revenue by \$23 million in 2011 and by \$411 million over 2007-2016.<sup>13</sup>

**Special Funding Relief for Commercial Airlines.** Prior to the enactment of the PPA, airlines were required to follow the same rules as other plan sponsors (with the exception that they were provided temporary relief from deficit-reduction contribution requirements in 2004 and 2005).<sup>14</sup> The PPA allows airlines to choose special funding rules for airlines that will significantly reduce — or possibly eliminate — their required contributions over the next 17 years. Airlines that choose the special funding rules must freeze benefit accruals in their plans and will incur higher termination premiums (\$2,500 instead of \$1,250) if they subsequently terminate plans within five years of choosing the special funding rules. Although CBO assumes that no airlines that choose the special funding rules will incur the higher termination premium charges, they do expect underfunding for these airlines to increase, which would result in increased VRP payments to the PBGC. CBO estimates that these provisions will increase VRPs by \$115 million over 2007-2011 and by \$399 million over 2007-2016.

**Net Benefit Payments.** The PPA contains several changes that affect plan funding, liability calculations and how much plan sponsors will contribute to their plans. The CBO expects that these changes will increase plan underfunding among plans that terminate in the next 10 years, which equates to higher outlays by the PBGC. CBO estimates that benefit payments will increase by \$53 million over 2007-2011 and by \$274 million over 2007-2016.<sup>15</sup>

**Other Provisions.** The PPA contains other provisions that are expected to increase spending. These provisions include authorization for the PBGC to pay interest to plans for premium overpayments, special funding rules for certain government contractors, and a cap on VRPs for small plans (those with 25 or fewer employees). CBO

---

<sup>11</sup> CBO, *H.R. 4, Pension Protection Act of 2006*, p. 5.

<sup>12</sup> The Pension Protection Act of 2006, “*Law, Explanation and Analysis*,” CCH Editorial Staff Publications, p. 205.

<sup>13</sup> CBO, *H.R. 4, Pension Protection Act of 2006*, p. 5.

<sup>14</sup> For more information, see CRS Report RL32991, *Defined Benefit Pension Reform for Single-Employer Plans*, by Neela K. Ranade and Paul J. Graney.

<sup>15</sup> CBO, *H.R. 4, Pension Protection Act of 2006*, p. 7.

expects these provisions to increase spending by \$22 million over 2007-2011 and by \$48 million over 2007-2016.<sup>16</sup>

**The Impact of the PPA on Federal Revenue.** Unlike the PPA's impact on the PBGC's budgetary cash flows (and consequently on federal spending), its impact on federal revenue is indirect. The PPA affects corporate profits by raising or lowering the contributions that plan sponsors must make to their defined benefit pension plans. In turn, the impact on corporate profits is reflected in revenues collected by the government in the form of corporate taxes.

The PPA imposes more stringent funding requirements on many plans, but the impact on the budget is not immediate due to phased-in or delayed effective dates. Therefore, the expectation is that the PPA will decrease revenue in the near term and increase revenue in the long-term. The Joint Committee on Taxation (JCT) estimates that the PPA will increase revenue by \$4.8 billion over 2007-2011 and reduce revenue by \$2.4 billion over 2007-2016.<sup>17</sup>

## **The Impact of the President's Federal Budget Proposal on the Budget Projections**

The President's budget for FY2008 projects net outlays (i.e., outlays exceed receipts) for the PBGC of \$316 million and \$1.1 billion for FY2007 and FY2008, respectively. In FY2006, the PBGC net generated revenue of \$2.6 billion. Since 1975, the PBGC's operations have generated net outlays in only two years. If the current budget projections prove true, that total will increase to four years in 2008.

The President's budget proposes provisions that would increase premium revenue for the PBGC beginning in 2009. Currently, underfunded plans pay \$9 per \$1,000 of underfunding to the PBGC in variable rate premiums (VRPs). The current VRP rate was set by the Deficit Reduction Act of 2005; Congressional action would be required to change it. The FY2008 federal budget indicates that, "...[t]he Administration will propose to authorize PBGC's Board of Directors to set the variable premium rate, and extend the variable rate premium to a plan's non-vested as well as its vested liabilities."<sup>18</sup> This change is projected to decrease spending by \$5.5 billion over 2008-2012 and by \$10.6 billion over 2008-2017.<sup>19</sup>

---

<sup>16</sup> CBO, *H.R. 4, Pension Protection Act of 2006*, p. 6.

<sup>17</sup> CBO, *H.R. 4, Pension Protection Act of 2006*, p. 13.

<sup>18</sup> U.S. Office of Management and Budget, *Appendix of the Budget of the United States Government, FY 2008*, p. 691.

<sup>19</sup> U.S. Office of Management and Budget, *Budget of the United States Government, FY 2008*, p. 158.