UI System Solvency, Consequences of Insolvency, and Relief Options from Consequences (Interest Charges and FUTA Credit Reductions)

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Overview

- Current solvency status
- Consequences of insolvency & borrowing from the Federal Unemployment Account (FUA) to pay UI benefits
  - Interest charges
  - Reduction of tax credits
- States potentially subject consequences in 2015
- Options and requirements for obtaining relief

Solvency Target

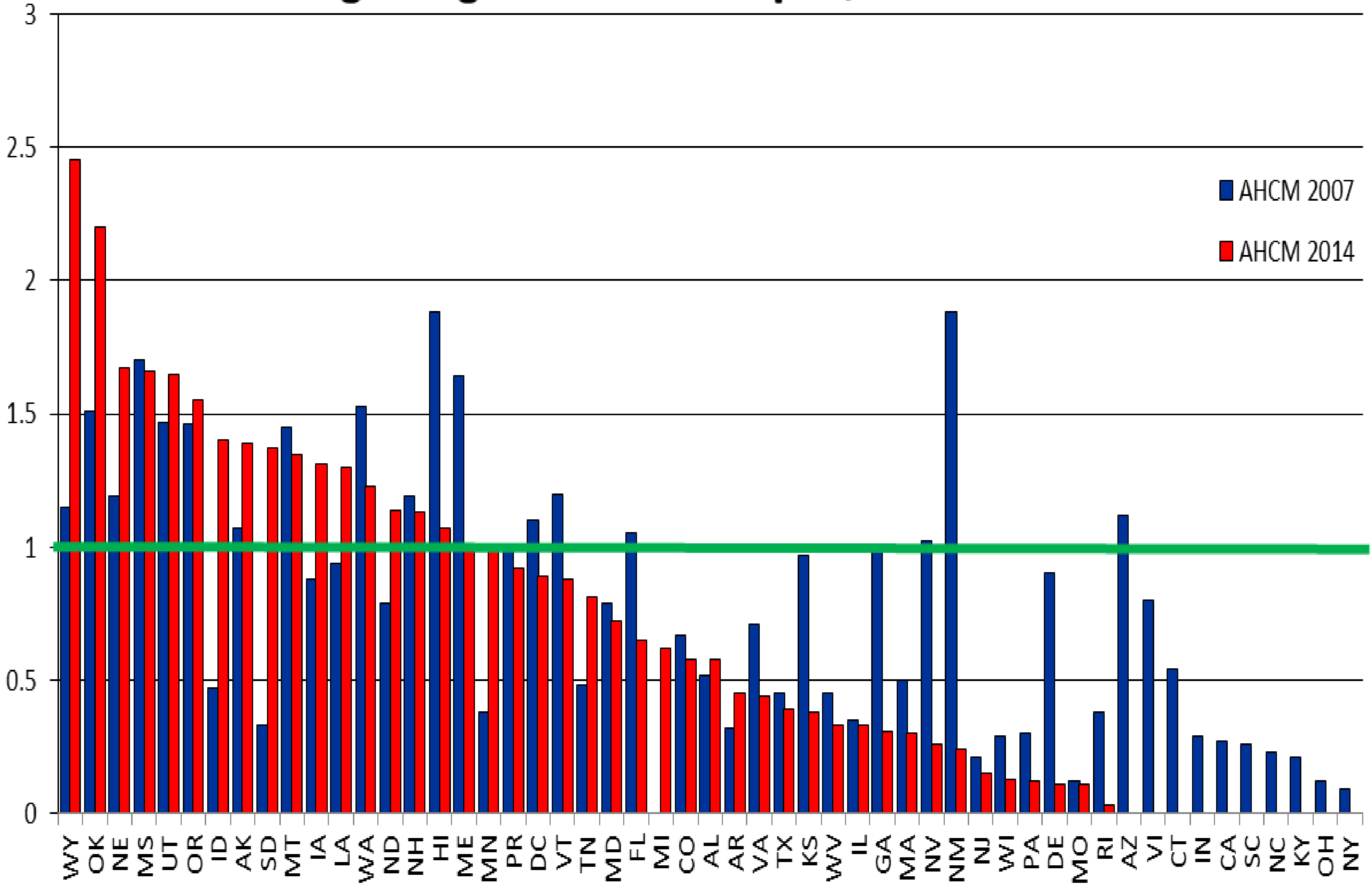
AVERAGE HIGH COST MULTIPLE

$$\text{AHCM} = \frac{\dfrac{\text{TF Balance (as of 12/31)}}{\text{Total Wages (calendar year)}}}{\dfrac{\text{Benefits Paid for a calendar year}}{\text{Total Wages for the same calendar year}}}$$

Average of 3 highest yrs over the last 20 yrs, or last 3 recessions, whichever is longer

The AHCM represents the number of years a State can pay out benefits if it paid at the rate it paid for the average of the three highest years over the previous 20 (or over the last 3 recessions, whichever is longer) without receiving any additional revenue.

Average High Cost Multiple, 2007 & 2014

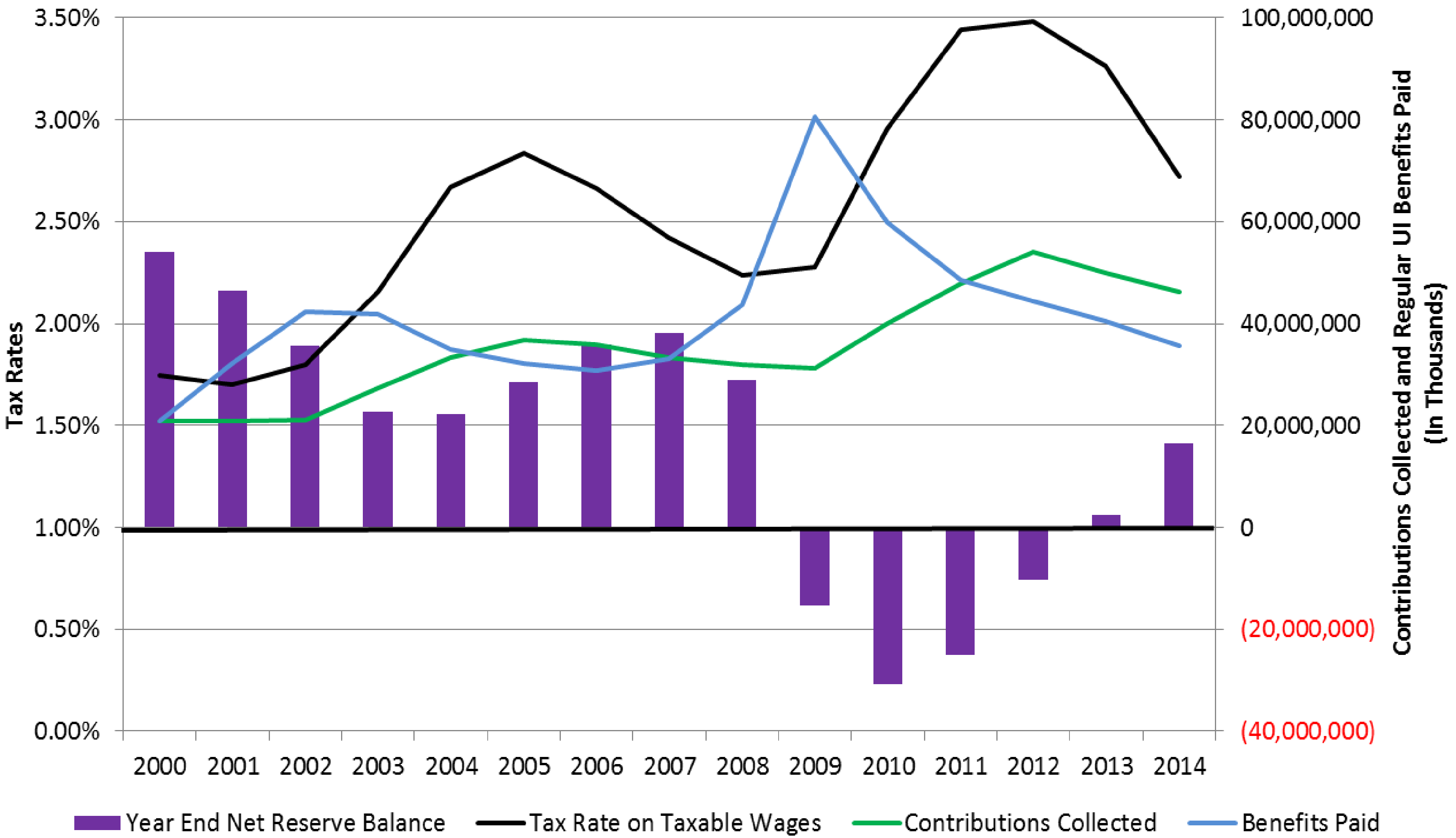


Source: DOL/OUI

2014 AHCM is Preliminary

Contributions Collected, Reg. Benefits Paid, Tax Rates & UTF from 2000 to 2014

(In Thousands)



2014 Tax Rate is Estimated

Outstanding Loans from the Federal Unemployment Account as of May 14, 2015

California	$5,251,462,780
Connecticut	340,443,101
Indiana	311,551,491
Kentucky	14,154,017
Ohio	1,028,348,294
South Carolina	120,473,189
Virgin Islands	74,780,972
Totals	$7,141,213,863

Outstanding Debt

- The Federal Unemployment Account (FUA) debt has been paid off.
- The Extended Unemployment Compensation Account (EUCA) has an outstanding balance of $18.1 billion owed to the General Fund.
- 6 States have $8.3 billion in bond issues outstanding.
- The above plus the state debt of about $7 billion has the system about $33 billion in debt.
- Not prepared for next recession.

Advances (Loans)

- If a state account in the UTF lacks funds to pay benefits, the Governor or designee may request an advance from the FUA in the UTF
- Requests must be for 3 months

Interest

- Interest accrues on a daily basis over a Federal fiscal year and is due and payable on September 30 each year.
- Interest rate applicable to a calendar year is the rate of interest paid on balances in the Unemployment Trust Fund (UTF) for the fourth quarter of the prior calendar year.

Interest

- Interest rate on outstanding balances for 2015 is: 2.3385 percent.
- Interest cannot be paid directly or indirectly from funds in a State's account in the UTF.
- A State cannot use grant funds or Reed Act funds to pay interest.

Interest

- Interest charged only on amounts actually borrowed.
- By taking an advance from the FUA, a State accepts the obligation to pay interest timely.
- Daily loan balances and accrued interest can be found at:

http://www.treasurydirect.gov/govt/reports/tfmp/tfmp_advactivitiessched.htm

Failure to Pay Interest Timely

- Section 303(c)(3) of the Social Security Act requires that interest on loans from FUA be paid timely in order for a State to receive administrative funding.
- Section 3304(a)(17) of FUTA requires timely payment of interest on loans from FUA in order for a state's law to be certified: without certification, the FUTA credit is lost.
  - All FUTA receipts then go to Federal accounts in the UTF none to the state's account.
- Both laws require "reasonable notice and opportunity for hearing" before penalty is imposed.

Title XII Advance Activities
As of: May 14, 2015

State	Outstanding Advance Balance	Interest for FY 2015
Arizona	0	830,392.12
Arkansas	0	195.05
California	5,251,462,799.84	121,119,951.44
Connecticut	340,443,100.65	5,978,829.24
Delaware	0	24,989.44
Indiana	311,551,490.69	11,850,958.67
Kentucky	14,154,016.53	4,951,509.11
New York	0	20,559,886.54
North Carolina	0	5,351,597.63
Ohio	1,028,348,294.43	19,181,487.75
Rhode Island	0	34,169.24
South Carolina	120,473,189.23	2,942,994.64
Virgin Islands	74,780,971.91	1,116,461.37
Totals	**7,141,213,863.28**	**193,943,422.25**

Interest Payment Relief

Interest is due and payable no later than 9/30, with exceptions.

- –Cash flow loans.
- –May/September delay.
- –High insured unemployment rate deferral.
- –High total unemployment rate delay.

Cash Flow Loan

- "Cash Flow Loans" applies to funds borrowed from January 1 through September 30.
- No interest will be assessed if the State:
  - Repays all outstanding loan amounts by 9/30.
  - Does not borrow between 10/1 and 12/31 of the same year.
  - Satisfies the funding goal requirement.

Cash Flow Loan

- If a State meets the cash flow loan requirement as of 9/30 but borrows between 10/1 and 12/31, interest that would have been payable on 9/30 is due and payable the day after taking such a loan.

Cash Flow Loan

Funding Goal

In order to qualify for an interest-free advance beginning in 2014 and beyond, the additional Funding Goal criteria require States to: 1) meet a solvency target (phased in), and 2) demonstrate maintenance of tax effort:

1. The solvency target is an Average High Cost Multiple (AHCM) of at least 1.00 (0.60 for 2015), on December 31 in one of the five years prior to the year in which the cash flow loan is requested.

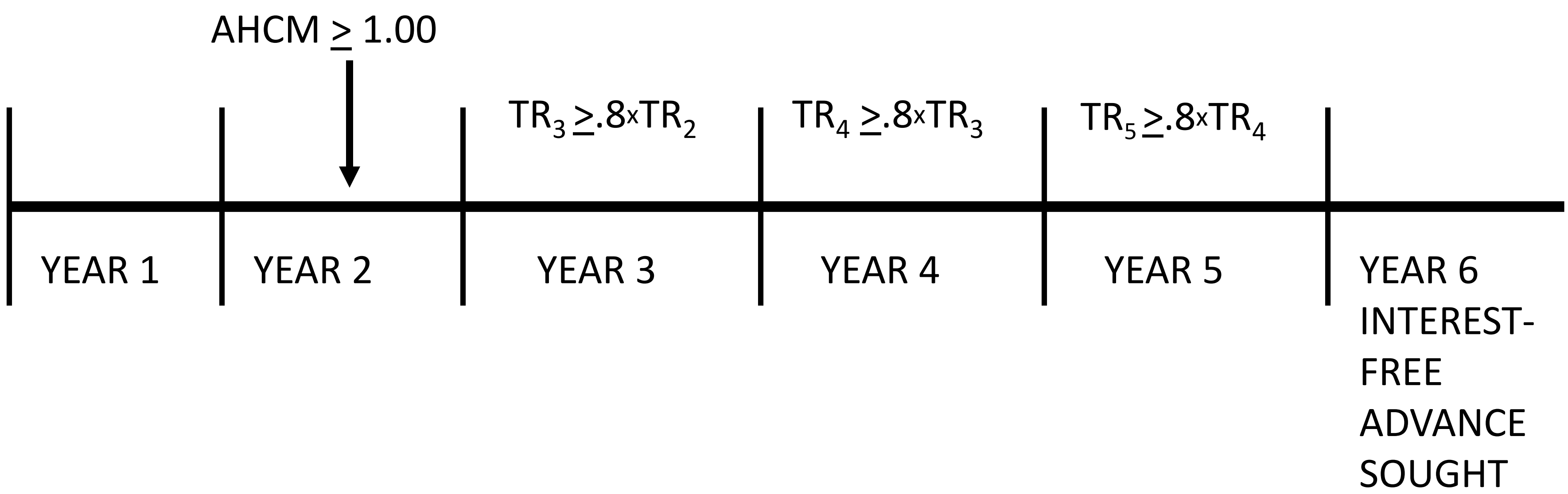
Maintenance of Tax Effort

2. Maintenance of tax effort has two parts that must be satisfied for each year between the year in which the solvency target was last met and the year for which an interest free advance is sought:

   A. The State's average unemployment tax rate on total wages is at least 80 percent of the prior year's average unemployment tax rate on total wages and
   B. The State's average unemployment tax rate on total wages is at least 75 percent of the State's average benefit-cost ratio in the prior five years.

Maintenance of Tax Effort

First Criterion



TR_i = Average Tax Rate on Total Wages in Year i
AHCM= Average High Cost Multiple

Part B

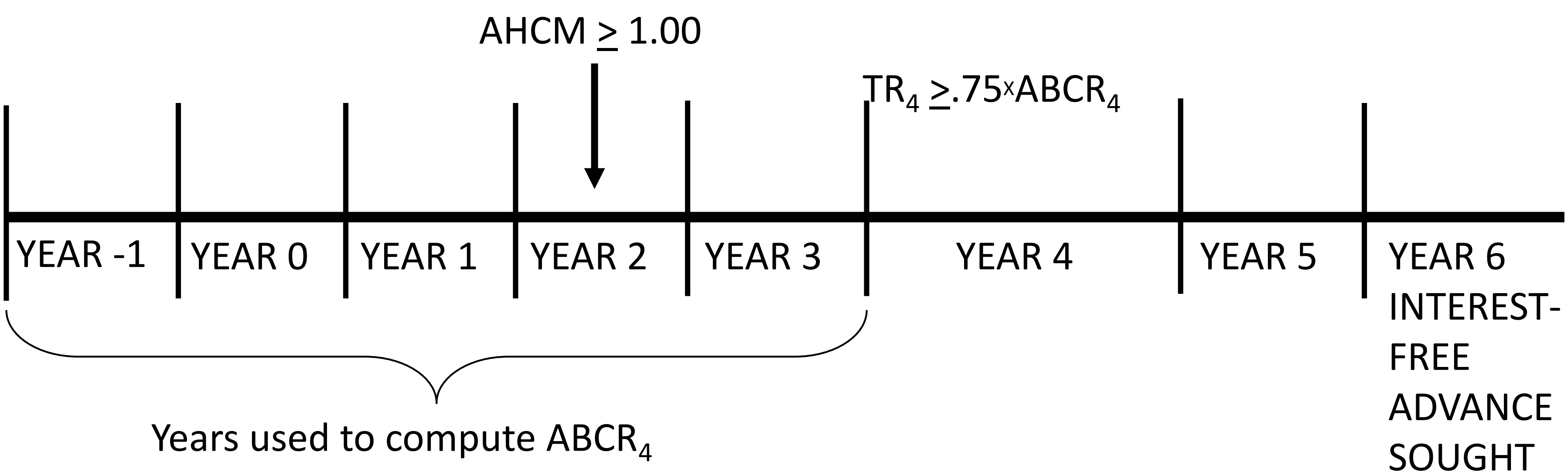
- The benefit cost ratio for a year is all UI compensation paid under State law for the year plus interest paid for Title XII advances during the year divided by total wages. (See 20 CFR 606.3(c).)

- The five-year average benefit cost ratio is calculated by dividing the sum of the five benefit cost ratios by five. (See 20 CFR 606.21(d).)

Part B

Maintenance of Tax Effort

Second Criterion



TR_i = Average Tax Rate on total Wages in Year i

$ABCR_i$ = Average Benefit Cost Ratio Applicable for Comparison to TR_i

AHCM = Average High Cost Multiple

Implementation Timeline

Implementation:

The Funding Goal criterion will first applied to advances taken in 2014

Phase-In:

The applicable solvency requirement for 2014 advances was an AHCM of at least 0.50 on December 31 in one of the preceding five years.

Going Forward:

The solvency requirement will be incremented by 0.10 in each year until it reaches 1.00 in 2019 and the Funding Goal will be fully implemented.

Technical Details

- The average unemployment tax rate for a year is determined by dividing the contributions collected for a year by total wages as computed for the Quarterly Census of Employment and Wages. (See 20 CFR 606.3(j) and (l))
- The average unemployment tax rate is not rounded.
- All other components of the Funding Goal are rounded to two decimal places.

Obtaining a Cash-Flow Loan

- The administrator of the State agency notifies the Secretary of Labor no later than September 10 (see 20 CFR 606.32 (b)) which advances should be interest-free.
- Secretary will determine interest-free status and respond to appropriate parties within 10 business days.
- Methodology is provided here so you can estimate during the year if your State will qualify. UI actuaries will be available for technical assistance.

Interest Payment Relief

May/September Delay

- Payment of interest accrued on loans taken in May through September may be delayed until December 31 of the following calendar year.
  - Interest is due on 9/30 on balances between October 1 of the previous year and April 30 of the current year
  - Interest will accrue on the delayed interest.
  - Governor, or designee, must notify Secretary of Labor of decision to delay such interest payment no later than September 1. (See 20 CFR 606.40)

Interest Payment Relief

High Insured Unemployment Rate Deferral

- State may defer interest payments if IUR equals or exceeds 7.5% for the first six months of the previous calendar year. (See 20 CFR 606.41)
  - State must pay ¼ of the interest due at 9/30 and one-third of the remaining interest balance on 9/30 of the 3 years following the 1st payment.

Interest Payment Relief

High Insured Unemployment Rate Deferral

- Governor or designee must request deferral no later than 7/1 of the year for which the deferral is requested.

- State may accelerate the payment schedule.

Interest Payment Relief

High Total Unemployment Rate Delay

- State may request to delay interest payment for nine months after 9/30 if the TUR averaged 13.5% or higher for the most recent 12 months. (See 20 CFR 606.42)
  - State must repay interest in full by 7/1 of following year.
  - No interest accrues on delayed interest.
  - State may accelerate the payment schedule.
  - Governor or designee must apply no later than July 1.

FUTA Tax

- FUTA tax is 6.0% of first $7,000 earned in covered employment
- Employers get a 5.4% tax credit if state law meets minimum Federal requirements
- Effective tax rate is 0.6% or a maximum of $42 per covered employee, per year
- Revenues are deposited into the Unemployment Trust Fund maintained by Treasury

FUTA Credit Reduction

- If a State has an outstanding FUA loan balance on two consecutive January firsts, and does not have a zero loan balance on November 10 of the year in which the second January first occurs, employers are subject to a reduction of FUTA credit for that second year and the amount of the credit reduction is due by the following January 31.
- For each additional consecutive January first a State has an outstanding balance and not repaid before Nov 10, the FUTA tax credit is reduced according to a schedule.
- Funds collected as a result of the credit reduction are credited against a State’s loan balance.

FUTA Credit Reduction

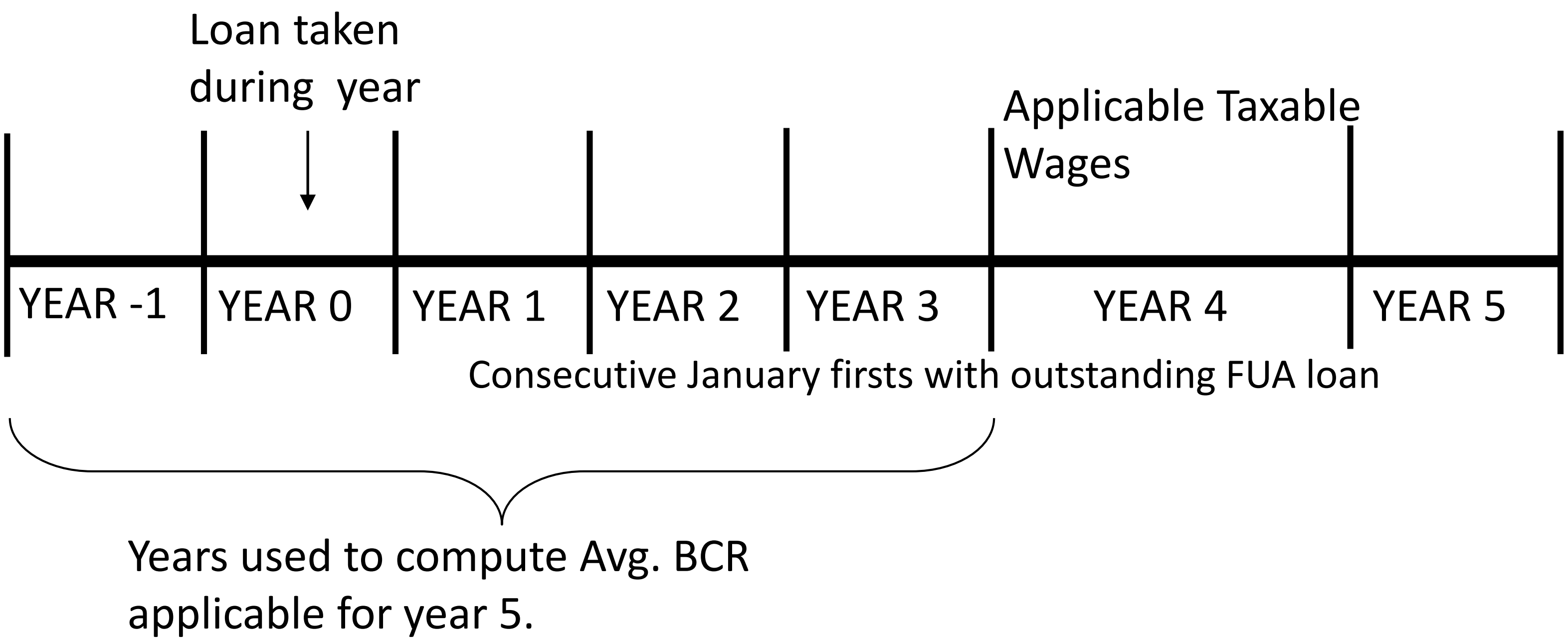
Year	Basic Reduction	Additional Reduction	FUTA Rate
1	0.0%	0.0%	0.6%
2	0.3	0.0	0.9
3	0.6	2.7 Add-on	1.2 or more
4	0.9	2.7 Add-on	1.5 or more
5	1.2	BCR Add-on	1.8 or more
.	.	.	.
.	.	.	.
19	5.4	BCR Add-on	6.0

2.7 Add-on = [(2.7% X 7000/US AAW)-ST ATR_tot] X (ST AAW/7000)

BCR Add-on = (higher of: BCR_tax and 2.7%) – ATR_tax

where AAW = estimated average annual wage (current year)
ATR_tot=average tax rate on total wages (prior year)
ATR_tax = average tax rate on taxable wages (prior year)
BCR_tax = 5-year average benefit cost (ending second prior year) as a percent of taxable wages (prior year)

Benefit Cost Rate



BCR_5 = Avg. Benefit Cost Rate = 1/5 * (sum of benefits year -1 through year 3) / (taxable wages year 4)

Estimated Federal Tax Rate Increases

Potential 2015 Federal Unemployment Tax Act (FUTA) Credit Reductions

These states had Title XII advance balances on January 1, 2015 and are potentially subject to a reduction in FUTA credit on their IRS Form 940 for 2015, if the outstanding advance is not repaid by November 10, 2015:

State(1)	2015 Potential Credit Reduction Due to Outstanding Advance(2)	Preliminary Estimate 2015 Potential "2.7 add-on" (3)	Preliminary Estimate 2015 Estimated "BCR add-on"(4)	Preliminary Estimate 2015 Potential Total Credit Reduction(5)
California	1.5%	0.0%	1.4%	2.9%
Connecticut	1.5%	0.0%	0.7%	2.2%
Indiana	1.8%	0.0%	0.9%	2.7%
Kentucky	1.5%	0.0%	0.7%	2.2%
New York	1.5%	0.0%	0.0%	1.5%
North Carolina	1.5%	0.0%	0.6%	2.1%
Ohio	1.5%	0.0%	1.2%	2.7%
South Carolina	1.8%	0.0%	0.3%	2.1%
Virgin Islands	1.5%	0.0%	1.6%	3.1%

(1) These states have passed at least two consecutive January 1's with an outstanding Federal advance and are therefore subject to a FUTA credit reduction

(2) For each January 1 a state passes with an outstanding advance, following the second one, employers in the state are subject to an additional 0.3% reduction in their FUTA credit.

(3) Following their third January 1 with an outstanding advance states are subject to an additional FUTA credit reduction called the 2.7 Add-on. a description of this add-on is in FUTA 3302(c)(2)(B). This value was preliminarily estimated based on extrapolated wages and tax contributions for the third and fourth quarter of 2014.

(4) These states are also potentially subject to the Benefit Cost Rate (BCR) additional credit reduction formula for having passed. five consecutive January 1's with an outstanding Federal advance- FUTA section 3302 (c) (2). This value was preliminarily estimated based on extrapolated wages and tax contributions for the third and fourth quarter of 2014.

(5) The FUTA credit reduction for 2015 is calculated by adding the credit reduction due to having an outstanding advance plus the reduction from the 2.7% add-on or the BCR add-on, which if it is zero is replaced by the 2.7 add-on.

Credit Reduction Relief

AVOIDANCE

- To avoid a credit reduction for a taxable year, a State must:
  - Have the Governor or designee submit an application to the Secretary of Labor prior to July1 of the year for which avoidance is sought. (See 20 CFR 606.24)
  - Pay the amount that the credit reduction would produce prior to November 10.
  - Repay all FUA loans received during the one-year period ending November 9 prior to November 10.

Credit Reduction Relief

AVOIDANCE Continued

- To avoid a credit reduction for a taxable year, a State must:
  - Increase solvency for the taxable year through legislative action by an amount equal to or greater than the amount of the FUTA credit reduction.
  - Have the Governor or designee submit prior to Oct. 16 an update to the original submission
  - Not borrow before the next January 31.
  - UI actuaries review application and determine if conditions are met.
  - The year on the consecutive January firsts schedule increments.
  - See 20 CFR 606.23.

Credit Reduction Relief

CAP

- To qualify for a cap on credit reductions, beginning with the second taxable year credit reductions are applicable, a State must:
  - Have the Governor or designee submit an application to the Secretary of Labor prior to July1 of the year for which a cap is sought.
  - Take no action (legislative, judicial, or administrative) during the 12-month period ending September 30 of the year for which a cap is requested that would reduce taxes or solvency for the period ending September 30.

Credit Reduction Relief

CAP Continued

- To qualify for a cap on credit reductions, beginning with the second taxable year credit reductions are applicable, a State must:
  - Have an average tax rate on total wages for the taxable year that equals or exceeds the average benefit cost ratio for the five years ending with the preceding calendar year (similar to Part B for the maintenance of tax effort for the Funding Goal)
  - The loan balance on September 30 of the taxable year is less than the loan balance on September 30 of the third preceding year.
  - UI actuaries review application and determine if conditions are met.

Credit Reduction Relief

CAP

- A cap is set at the greater of 0.6 percent or the prior year's level.
- Year number on the credit reduction schedule is not incremented.
- See 20 CFR 606.20 and 606.21.

Credit Reduction Relief

Fifth-Year Waiver

- The Governor or designee must submit an application to the Secretary of Labor prior to July 1 of the year for which the waiver is requested.
- If approved, the Benefit Cost Rate add-on is waived and the 2.7 add-on applies instead (see 20 CFR 606.25).
- Criterion: Take no action (legislative, judicial, or administrative) during the 12-month period ending September 30 of the year for which the waiver is requested that would reduce solvency for the period ending September 30.
- UI actuaries review application and determine if condition is met.

Presenter

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