State of Minnesota

Department of Economic Security

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Office of the Commissioner

03 - 0075

January 21, 2003

TO: Representative Gregory Davids
Representative Bob Gunther
Senator Linda Scheid
Senator Dallas Sams
Secretary of the Senate
Chief Clerk, House of Representatives
Legislative Reference Library

FROM: Jack Weidenbach
Unemployment Insurance Program Director

Please find attached the Unemployment Insurance Advisory Council report on unemployment insurance trust fund solvency. This report is required by Laws 2002, Chapter 380, Article 1, Section 8.

If you have questions concerning this report, please contact me at 651-296-1692 or Lynne Batzli at 651-297-3731.

JW/jc

Attachment

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SOLVENCY REPORT

Laws 2002, Chapter 380, Article 1, Section 8, provides:

> "Section 8. (ADVISORY COUNCIL REPORT TRUST FUND SOLVENCY.)
>
> The unemployment insurance advisory council shall present to the legislature, by January 15, 2003, a report, including proposals for any legislation, on the long-term solvency of the Minnesota unemployment insurance program trust fund."

The Unemployment Insurance Advisory Council, made up of the persons listed on Appendix B, met each month from July through December 2002.

The proposals advanced by the Unemployment Insurance Advisory Council minimize federal borrowing, modify present law to allow the trust fund to reach a higher level when the economy improves, and provide for quicker reaction to economic downturns in the future. However, a truly solvent Minnesota Unemployment Insurance Program Trust Fund is also dependent on a long-term improvement in the economy. The following paragraphs describe the major components of the proposal; the components are discussed in more detail in Appendix A.

Unemployment insurance is primarily an "experience rated" program in which up to 80 percent of total revenue is received from the experience rating portion of the premiums and as little as 20 percent received from the base rate which is assessed evenly on all employers. Revenue from experience rates rises or falls relatively slowly in response to the layoff history of a business, thus it is necessary to build a trust fund in good economic times that can withstand a moderate economic downturn. An experience rating system that responds more quickly will allow trust fund levels in good times to be somewhat lower than would be necessary with a system that responds slower. One of the features of the proposal is that the revenues raised through the experience rates will respond more quickly to increased payments.

The proposal also limits the impact of rate increases on businesses that have had few or no layoffs. The base rate maximum under the proposal is 0.4% rather than 0.6% as in current law. In addition, surcharges imposed when the fund is at extremely low levels will have less impact on those businesses with low rates.

The proposal addresses a major problem with the current law, which ties the base rate to static fund levels. Over time, the fund levels at which base rate increases are triggered have become far too low and also are too closely spaced

to be effective. The proposal sets base rate triggers at various percentages of the state's total covered wages. This provides a better relationship between the rates and the risk to the fund as well as moving the rate change triggers farther apart. There is also provision for a base rate increase in the event that fund levels decrease under certain circumstances, even though the trigger point for a rate increase may not be met. This is another feature intended to make the system respond more quickly to increased payments.

Under current law, revenues will trail payouts through CY 2005 and will only begin to exceed payments by the end of CY 2006. The proposal will reduce borrowing by bringing payments and revenues into balance during CY 2005.

Because achieving even that balance between payouts and revenues will require substantially increased revenues (and this happens under current law as well as under the proposal), the Council determined that it is unrealistic to expect substantial growth in the trust fund over the next three years. Building a solvent fund must be a long-term objective that will be reached not only through needed legislative changes, but also through an improved economy.

The Unemployment Insurance Advisory Council reached a consensus on the following proposals:

- Change the experience rating period from five years to four years.
- Change the "trigger points" on base tax rates to an indexed percentage of the state's total covered wages.
- Provide for assessments of 5 percent, 10 percent, or 20 percent, depending on the trust fund balance on March 31 rather than continuing to increase base tax rates over 0.4 percent.
- Provide for a "falling fund adjustment" of 0.1 percent increase in the base tax rate if the trust fund decreases 10 percent or more from the prior year, or if the trust fund has less on June 30 of any year than it had on March 31 of that year.
- Provide that new employers pay the higher of 1 percent or the present computed rate plus the base tax rate.
- Freeze the maximum weekly benefit amount based upon the high quarter calculation at $350 for at least three years.
- Delay the onset of unemployment benefits by the full effect of severance pay and vacation pay.

Appendix A - Explanation of Proposed Changes

Shortening the "experience rating" period from five years to four years will, in the event of any future downturns in the economy, allow revenues to come in quicker, thus lowering the amount of reserves which would be necessary to sustain a downturn in the economy. Presently, the trust fund recoups over a five-year period, through higher premiums, 125 percent of the benefits paid out. Under the proposal, the trust fund essentially would recoup that same amount, but over a four-year period. In other words, an employer would not pay more because of the layoff of a particular individual, but would simply pay that amount quicker, over a four-year period rather than a five-year period.

Presently, the base tax rate, which accounts for approximately 20 percent of annual revenues, is tied to fixed dollar levels in the trust fund. Those levels were set in 1987 and have not been adjusted and are very compacted. The levels set presently have no relationship to payouts or adequate trust fund levels. The proposal is to tie changes in the base tax rate to trust fund levels as a portion of total covered wages.

The proposal sets the maximum base tax rate at 0.4 percent. Present law sets that maximum at 0.6 percent. The proposal replaces increases in the base tax rate over 0.4 percent, with assessments on the total taxes due of 5 percent, 10 percent, or 20 percent. Limiting the base tax rate while providing for percentage assessments will result in those employers who create layoffs paying more of the costs, rather than placing the burden on those employers who never had layoffs.

The proposal provides for a "falling fund adjustment" of an increase in the base tax rate of 0.1 percent (thus the base tax rate can go to an absolute maximum of 0.5 percent), but only if the trust fund is falling in relation to what it was a year prior, or if the trust fund is falling during a critical portion of the year, a period from March 31 through June 30. The trust fund receives its highest revenues during the period March 31 through June 30 (first quarter collections are due April 30). If benefit payouts are exceeding revenues during the period for which the highest revenues are received, it means that the trust fund is in need of additional revenues. This falling fund adjustment would only trigger if the overall trust fund levels are below a relatively high level.

Presently, employers who are just starting in business (in business for less than one year) pay premiums at a rate the higher of 1 percent or a computed rate which does not include the base tax rate. All other employers pay a total rate which is their calculated experience rating plus the base tax rate. It was determined that it is appropriate that all employers, including new employers, pay

the base tax rate. Under the proposal, however, should the economy substantially improve, the new employer rate could fall as low as 1 percent (same as current law).

The consensus was that it was neither desirable nor feasible to bring a degree of solvency to the trust fund by a large unemployment benefit reduction. Unemployment benefits go to support basic needs (housing, food, transportation, etcetera) of those who have lost employment, and it is good public policy to provide a level of benefits equal to 50 percent of the average weekly wage the unemployed worker lost (to certain maximums). However, it was also recognized that in certain instances, because of the receipt of other money considered "wages," and because an individual's average weekly wage, in certain instances, is determined on a relatively short period of time, that changes which result in some benefit reduction could reasonably be made.

Presently, only a portion of severance pay and vacation pay in certain instances, received upon the individual becoming unemployed, affects the payment of benefits.

Because severance pay and vacation may subsequently be used to establish an unemployment benefit claim, and because unemployment benefits should not be used to supplement money already being received, and because of distinctions between those portions which are considered and those portions which are not considered has no rational basis, it was decided that all severance pay and all vacation pay should be taken into account. The proposal is that the receipt of all severance pay and all vacation pay paid upon temporary or permanent separation from employment, will delay the onset of unemployment benefit entitlement. This does <u>not</u> reduce the total amount of unemployment benefits available, should an individual remain unemployed.

Under present law, an individual's weekly unemployment benefit is the higher of, 50 percent of the individual's average weekly wage over a four-quarter base period (to a maximum which is a percentage of the state's average weekly wage) or 50 percent of the individual's average weekly wage during the high quarter of that base period (to a maximum that is a lower percentage of the state's average weekly wage). Because only one quarter of employment may be used, the high quarter, to calculate an individual's weekly benefit amount, it does, at times, result in an individual receiving a disproportionate benefit amount in relation to what unemployment benefits were meant to cover. Basic expenses (housing, food, transportation, et cetera) for which unemployment benefits are meant to cover most often are incurred based upon the individual's annual income. Some individuals receive bonuses, some work overtime, or some work only a portion of the year, so that their high quarter is disproportionate to the individual's annual income. This results in the individual's receipt of a disproportionate weekly benefit amount. A consensus was reached that the present maximum weekly benefit amount, based upon the high quarter calculation, which is $350, should

be "frozen" at that amount for at least three years. After that, the high quarter maximum would become 45 percent of the state's average weekly wage (down from the present 50 percent).

Appendix B

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