

Unemployment Insurance (UI) Financing

Overview of Connecticut's Ability to Maintain UI Trust Fund Solvency

Connecticut Department of Labor

UI Financing

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UI Financing Review

- All UI benefits paid to unemployed workers are funded by employers. All UI taxes received by CTDOL from employers are used solely to pay unemployment benefits.
- Two categories of tax treatment for employers
 - **Contributing** – a.k.a, Taxable. Most employers pay quarterly unemployment taxes on the first \$15,000 in wages paid to their employees each year – Taxable Wage Base.
 - **Reimbursing** – An option available to governmental (including the State, municipalities and Indian tribes) and nonprofit employers – dollar for dollar payments.

Contributing Employers - Experience Rate

- **Experience Tax Rate:** (a.k.a. Charged Tax Rate)

Determined for each individual employer based on their “experience with unemployment”
– range is 0.5% to 5.4%.

Principle of “experience rating” is federally required

Experience Rate calculation:

| | | | | |
|---------------|---|---|---|---|
| Benefit Ratio | = | Total benefits charged to employer's account for the 3 years ending June 30 | ÷ | Employer's taxable wages for the same 3-year period |
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Example:

During the 3 years ending June 30, 2008, Employer A had 10 employees, all earning more than \$15,000 annually. One employee was laid off during that time and collected \$450 per week for 20 weeks (\$9,000)

Taxable wages = 10 employees x \$15,000 = \$150,000 x 3 years = \$450,000

\$9,000 (benefits charged) divided by \$450,000 (taxable wages) = .02 = 2.0%.
Employer A's experience tax rate is 2.0%.

Contributing Employers - Fund Balance Reserve Rate

Fund Balance Reserve Rate: (a.k.a. Fund Balance Tax Rate)

- An additional percentage added to all taxable employers' experience rates when needed to maintain the reserve goal of the UI Trust Fund.
- Conceptually, the UI Trust Fund reserve goal is the amount needed in the UI Trust Fund in order to be able to pay unemployment benefits during the next economic downturn. (the concept of forward financing)
- Current Fund Balance Reserve Goal = Eight-tenths of one percent (0.8%) of total wages paid to workers by contributing employers during the year ending the June 30th preceding the tax year – currently about \$625 million.
- The Fund Balance Reserve Rate can vary from zero (0%) to 1.4%.
For 2009, it is 1.4%.

Contributing Employers - Contribution Rate

- Each employer's contribution rate is the sum of its charged (experience) rate and the fund balance (solvency) tax rate.
- The contribution rate is applied to the **Taxable Wage Base**: the first \$15,000 in wages paid during the tax year to each employee.

Example: Charged Rate: 2.0%
Fund Balance Tax Rate: 1.4%
3.4% X \$15,000 = \$510

This employer would pay \$510 for each employee earning at least \$15,000.

For 2009 and 2010:

Minimum Contribution Rate = 1.9% (X \$15,000 = \$285 per employee)

Maximum Contribution Rate = 6.8% (X \$15,000 = \$1,020 per employee)

Reimbursing Employers

- **Reimbursing employers are:**
 - 501 (c)(3) Non-profit employers
 - State government
 - Municipal government
 - Tribal government

These categories of employers have the option of being reimbursing employers or contributing employers.

Employers selecting the reimbursing method pay dollar-for-dollar the charges attributable to their prorated share of benefits paid.

- **Example:**
 - Claimant is paid \$200 in weekly benefits.
 - All of the claimant's base period wages were earned in the employ of a single reimbursing employer.
 - The employer is billed on a monthly basis for \$200 per week of benefits paid.

Benefit Payout Levels

- Reasons for Higher Benefit Payouts Over Time:
(At the Same or Lower Levels of Unemployment)
- Rising Wages: Benefits are tied to wage levels – as wages rise so do benefit payouts.
- Workforce Growth: Benefits are affected by growth in the labor force – a bigger labor force results in more claimants when the same percentage is unemployed and, thus, increased benefit payouts.
- Average Benefit Duration (the number of weeks of unemployment for which benefits are collected): Benefit duration has increased significantly since the recession of the early 1990s (from approximately 11 wks in the mid 80s to 17.8 weeks in 2009).

UI Tax Revenues

- Factors that Affect UI Tax Revenues:
 - UI Covered Employment: Total number of workers covered.
 - Experience Tax Rate: Fluctuates with economy; lagging feature.
 - Fund Balance Reserve Rate: Set by balance in UI Trust Fund.
 - Taxable Wage Base: Amount of wages subject to tax.

Counter-Cyclical Financing – Experience Rate

- Economic conditions not immediately reflected in experience tax rates.
- Three-year averaging smoothes changes in experience tax rates from year to year.
- Methodology designed to mitigate increased tax burdens on employers during recessions. By doing so, this feature limits UI Fund revenues during economic downturns.
- As economic conditions improve, employers pay higher experience rates until the higher benefit payout years are no longer included in their three-year experience period.
- Key feature to this approach is the insurance-based principle of forward financing: building a sufficient reserve to bear the burden of an economic downturn before it occurs.

Quick-Response Financing - Fund Balance Reserve Rate

- Quick-response financing mechanism. Adjusts annually to increase or decrease revenues needed to maintain required balance in the UI Trust Fund.
- The fund balance reserve rate is added to the experience rate of all contributing employers.
- The fund balance reserve rate finances benefits not charged to individual employers, such as charges for which individual employers are relieved (non-charges) and those that are not recouped from individual employers because their experience tax rates are at the maximum limit, or because they have gone out of business.
- Because the fund balance reserve rate is capped at 1.4%, benefit payouts can exceed contributions in times of rapid increases in unemployment levels.

Current Status of UI Trust Fund

- **UI Rate:** UI rate in CT rose from 4.6% in Dec. 2007 to 7.1% in Dec. 2008 and 8.8% in Oct. 2009.
- **Benefits Paid:** In 2007, \$540 million paid; in 2008, more than \$700 million paid; and in 2009, over \$1.3 billion is estimated to be paid. CT DOL will collect approximately \$640 million in taxes in 2009.
- **2008 UI Trust Fund Balance:** At the end of 2008, \$425 million – \$200 million short 2008's fund balance reserve goal of \$611 million.
- **2009 UI Trust Fund Balance :** Projected net deficit for end of 2009 is \$260 million. Year end fund balance reserve goal is \$625 million.

What Happens Next?

- CT began borrowing from the Federal Unemployment Account (FUA) in mid-October 2009 to continue to pay UI benefits; \$110 million borrowed to date, \$900 million projected borrowing.
- Federal loans are interest-free through 2010 (Stimulus program)
- Under federal law, mandatory interest on federal loans will be payable beginning in 2011 through a special assessment to taxable employers. Total interest costs to CT employers projected to be \$70-\$90 million.
- Under federal law, mandatory increases to FUTA taxes will begin in 2011 to pay outstanding loan principal. Total FUTA tax increases to CT employers projected to be \$180 million.

Summary

- Unemployment is rising; estimated at 8.0% in CY 2009, up from 4.6% in CY 2007.
- UI benefit payments in CY 2009 will be higher than in CY 2007 by \$800 million, and are expected to remain high in 2010 and 2011.
- Revenues will fall short of benefit payouts by \$700 million in 2009 alone.
- Next steps: Federal law mandates certain actions; repayment of federal loan principal and interest beginning in 2011 – paid by CT employers.