2012 Colorado Unemployment Insurance Trust Fund Summary Report

The financing structure of the Colorado unemployment insurance trust fund (UITF) was modified in HB11-1288. The legislation required that the Colorado Department of Labor and Employment (CDLE) issue a report on the fund's financial condition to several committees of the Colorado General Assembly by August 31 of each year beginning 2012.

This report provides a brief overview of recent UITF developments; presents the financial status of the UITF for the most recent calendar year; discusses the forecast for the fund under conditions of moderate economic growth; summarizes the recent issuance of unemployment compensation bonds; and reviews efforts the CDLE has taken to reduce unemployment benefit overpayments made from the UITF.

Overview of Recent UITF Developments. The UITF had a balance of nearly $700 million as recently as June 30, 2008. The acute financial crisis of fall 2007, however, resulted in a severe and protracted economic slump that began December 2007 and caused employer layoffs to rise sharply. While Colorado trailed the nation into recession by roughly 6-9 months, the State's seasonally adjusted unemployment rate climbed from 4.1 percent in December 2007 to 8.6 percent by year-end 2009—on an annual average basis the number of private sector jobs covered under unemployment insurance shrank by more than 6 percent or over 115,000 in 2009 alone.[1]

Unemployment benefit payments from the UITF more than tripled between 2007 and 2009, increasing from about $298 million to $1,056 million.[2] By mid-January 2010, the fund's reserves had been exhausted and, like more than thirty other states, the CDLE began drawing advances from the Federal Unemployment Account to pay unemployment insurance benefits. Although the State began experiencing a modest economic recovery in 2010 benefit payments remained extremely elevated and by March 2011 the net outstanding amount of federal borrowing had reached nearly $580 million. Continued improvement in the Colorado economy reduced the amount outstanding to $340 million by year-end 2011 but CDLE forecasts indicated that even under conditions of persistent moderate growth the UITF would not attain a consistent level of solvency until 2013 at the earliest. As a result, the CDLE initiated a series of discussions with the Colorado State Treasurer's Office, the Colorado Housing and Finance Authority (CHFA), the U.S. Department of Labor, and various department stakeholders and investment banks about the possibility of issuing unemployment compensation bonds in order to repay all outstanding federal advances as well as bringing the UITF to a desirable level of solvency. In June 2012 about $630 million in unemployment compensation bonds were

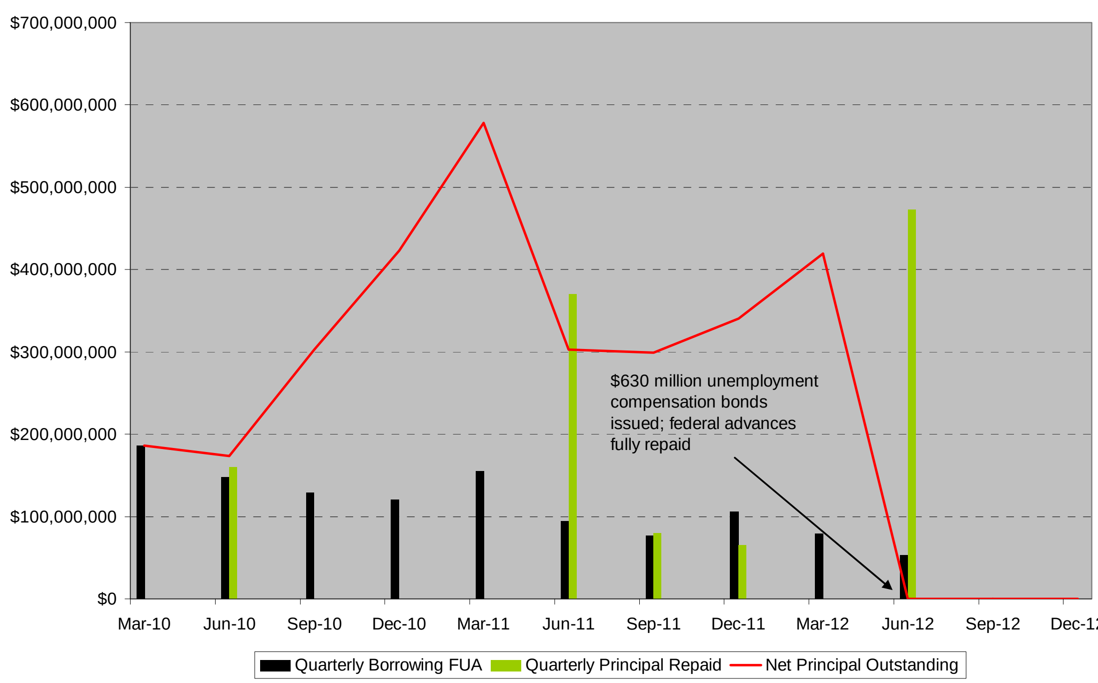
[1] By comparison, the annual decline in private sector jobs during Colorado's severe 2002-03 recession was about 3.4 percent in 2002 and 2.3 percent in 2003.

[2] During this period more than $750 million in benefits was also paid under the federal extended unemployment compensation program (EUC) which began in 2008 and state extended benefit (SEB) program which started in 2009. Because both EUC and SEB payments are fully paid with federal funds they have no direct financial impact to the Colorado UITF and are therefore excluded from discussion in this report.

issued through CHFA, of which approximately $105 million was used to repay all outstanding federal loans (including interest) and the residual deposited into the UITF. After completion of the bond issuance the June 30, 2012 fund balance was $513.1 million.

Calendar Year 2011 Fund Status. The UITF as of December 31, 2011 was in deficit roughly $343.6 million. This represented an improvement of about $80 million from twelve months earlier. Employer premiums for the year totaled $747.8 million, up from $455.9 million in 2010. The large increase in employer contributions in 2011 resulted from the shift to the highest premium rate schedule that occurred when the fund became insolvent on June 30, 2010.[3] Benefit payments, meanwhile, fell by $242.9 million during 2011. At $674.2 million, however, regular state unemployment insurance payments remained high by historical standards having been surpassed only in 2009 and 2010 when $1,056 million and $917.1 million were paid, respectively. No interest earnings accrued to the fund in 2011 due to its insolvent status throughout the year.

CDLE Borrowing from Federal Unemployment Account (FUA)



During 2011 the fund borrowed about $432 million from the Federal Unemployed Account and repaid $515 million in outstanding principal on federal advances. By contrast, $583 million was borrowed in 2010 and only $160 million repaid. As noted above, after the issuance of $630 million in unemployment compensation bonds all federal advances and associated interest expenses were repaid by June 30, 2012.

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[3] Employer premium rates for a given calendar year are inversely related to the prior year's June 30 fund balance so that a low fund balance results in relatively high premium rates and a high balance in relatively low rates. This financing structure is typical of state trust funds and similar to that of private insurers—after periods of large claims payouts insurers generally replenish reserves through future premium increases.

Colorado Unemployment Compensation Bonds. Several states have issued unemployment compensation bonds in recent years as a way of eliminating the federal debt resulting from having had to borrow from the Federal Unemployment Account in order to meet benefit payments. The Colorado unemployment bonds differ from those issued by other states in that the bond proceeds and principal repayments flow through the UITF. Structuring the bonds in this manner allows the bond principal repayments, which are made by Colorado employers, to be credited to their employer experience rate accounts and thus lower their premium rates below what they otherwise would have been.

The total amount of bonds issued was about $630 million and consisted of a tax-exempt and non-exempt series—the exempt portion, roughly $100 million, was used to repay the outstanding federal loan plus outstanding interest, with the non-exempt proceeds deposited into the UITF. The total all-in interest cost on the bonds was 1.4 percent, about half of the borrowing rate from the Federal Unemployment Account during 2012. The bond issuance was sized so as to trigger off the solvency surcharge which had been in effect since 2004 and provide additional fund reserves as a cushion against greater than expected levels of future benefit payments.[4]

The bonds have a five-year term and require fixed annual principal repayments of $125 million to be made each May 15 through 2017 with the first principal repayment due in 2013. The revenue for the principal repayments will come from Colorado employers who will be billed a bond principal repayment surcharge as part of their annual unemployment insurance premiums. This bond principal surcharge, which the CDLE has set at 19.39 percent of the base premium rate for 2013, will vary slightly each year.[5] Interest payments are due November 15 of each year beginning 2012 and decline as the outstanding balance falls. The initial bond interest repayment assessment, which will be mailed to employers early September 2012, is currently estimated at 0.09 percent to cover the first interest payment of about $9.7 million.

Current Trust Fund Forecast. Issuance of the unemployment compensation bonds made the UITF solvent on June 30 thereby making HB11-1288 effective beginning 2013. Some features of the bill designed to promote fund solvency included raising the taxable wage base to $11,000 in 2012 and indexing annual changes in the wage base to employee earnings; modifying the premium rate schedules; reducing the solvency surcharge trigger level; and adopting a 1.4 percent adequacy ratio standard for the fund.

The current CDLE fund forecast is predicated upon moderate economic growth continuing through the 2017 forecast horizon. Annual average job growth is assumed to gradually rise from 1 percent to 2.5 percent between 2012 and 2017 and unemployment fall from about 8 percent to about 5.5 percent. Wages are projected to rise modestly as labor markets experience a lukewarm recovery.

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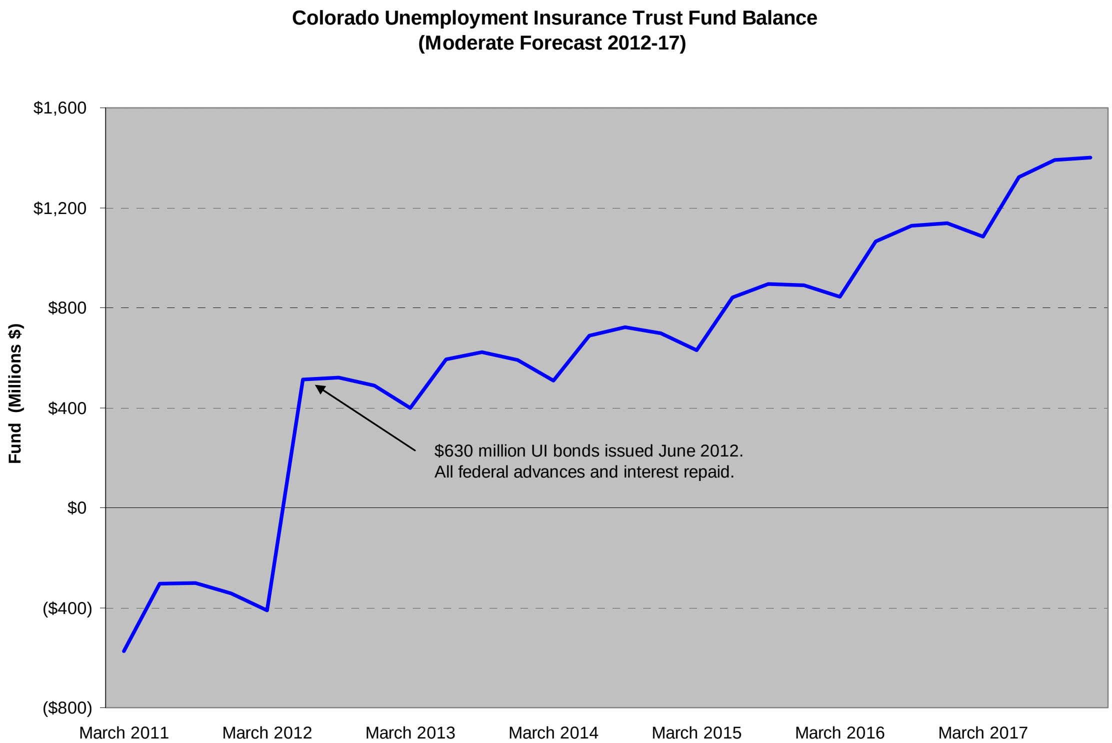
[4] Under HB11-1288 this required that the June 30, 2012 trust fund balance exceed $429.2 million.

[5] The CDLE currently forecasts the bond principal surcharge to be approximately 20 percent each year through the life of the bonds. The surcharge is the estimated amount each employer's base premium must increase in order to equal the required annual principal payment of $125 million.

Under these conditions fund reserves are anticipated to grow to $1.4 billion by year-end 2017. The solvency or reserve ratio, a simple measure of the fund's financial soundness, will double from 0.6 percent this year to just over 1.2 percent by 2017.[6] The last time the solvency ratio reached 1.2 percent was in 2000, just prior to the 2002-03 recession. The trust fund is considered fully solvent at an adequacy ratio of 1.4 percent so that although fund reserves are forecast to remain healthy over the next five years, the fund will not attain fully-funded status.



HB11-1288 increased the maximum taxable wage base to $11,000 beginning 2012 and adjusts it annually to the change in average weekly employee earnings.[7] Colorado's wage base had previously been fixed at $10,000 since 1988. The taxable wage base is forecast to expand to $12,600 by 2017.

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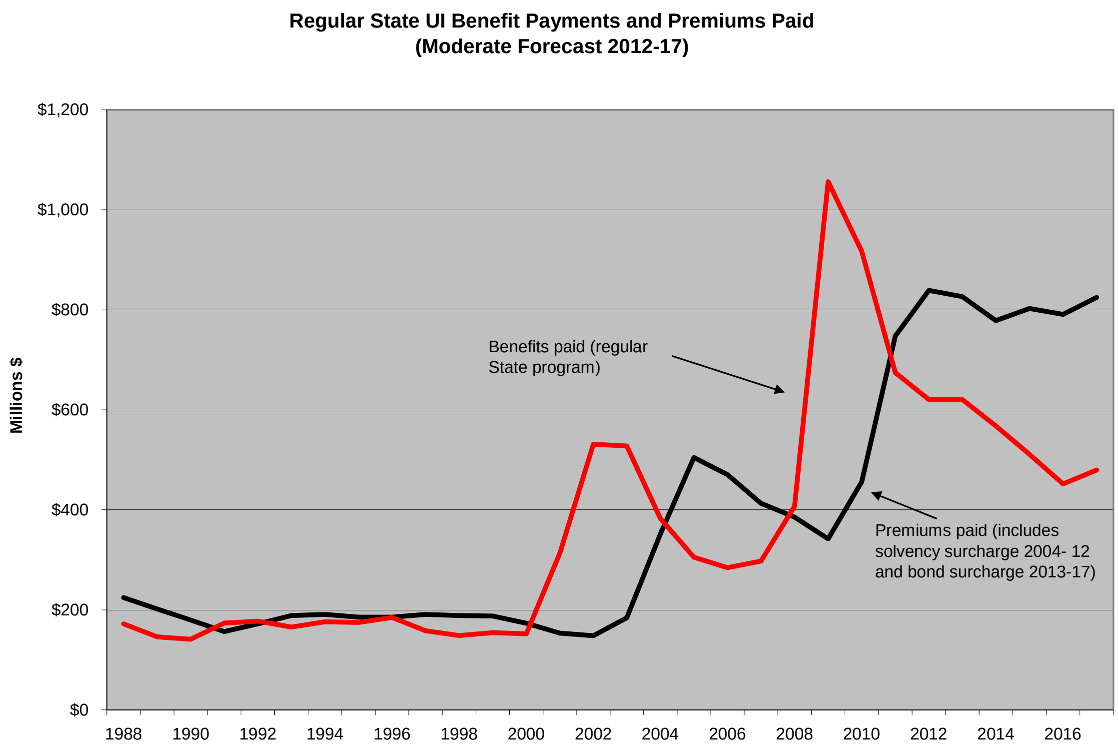
[6] The reserve ratio is the trust fund balance divided by annual total private wages. During past several recessions, a solvency ratio of about 1.4 percent measured from the start date of the recession would have been large enough to have allowed the fund to pay benefits without borrowing over the course of the recession.

[7] The taxable wage base is the amount of each UI covered worker's wages subject to the payment of unemployment premiums. In 2012 the average taxable wage base for all 50 states was about $12,800 and ranged from a low of $7,000 in several states to more than $38,000 in Washington and Hawaii. Thirty-one states had a taxable wage base greater than $11,000 in 2012. A key indicator of fund solvency is the relationship between the wage base and average annual employee earnings—higher ratios tend to be indicative of a more robust financing structure. In 2012 the ratio between Colorado's wage base and average annual private wages was 23 percent, about half of what it was in 1988 and lower than the 2012 national average of 27 percent.

Fund revenues (which include the bond principal surcharge) are forecast to advance from $747.8 million in 2011 to $839 million in 2012 and remain rather flat through 2017. The average premium rate is anticipated to decline from 0.95 percent to 0.73 percent over the forecast period. Benefits, meanwhile, are projected to drop from an estimated $620 million in 2012 to under $500 million by 2017 as labor markets progressively tighten and unemployment shrinks. The annual benefit cost rate will recede from 0.70 percent in 2012 to 0.42 percent by 2017.[8] The solvency surcharge, which had been assessed against Colorado employers since 2004 and was turned off as a result of UI bonding, is projected to remain off through the forecast period.



Overpayments. The CDLE has made considerable progress in reducing the rate of improper benefit payments over the past several years.[9] Between 2008 and 2011 Colorado's improper-payment rate was estimated to be 17 percent for a total of $305.4 million; however, the estimated error rate fell from 18.7 percent in 2010 to 11.2 percent by April 2012. Federal benefit-entitlement programs with improper-payment rates greater than 10 percent are considered to be out of compliance with federal performance standards.

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[8] The average premium rate is total premiums divided by total private wages while the average benefit cost rate is benefit payments divided by expected total private wages. For comparison purposes, the average premium rate for the twenty-year period 1991-2010 was 0.44 percent and the average benefit cost rate was 0.57 percent. The highest annual benefit cost rate was 1.3 percent and occurred in 2009 when over a billion dollars was paid in benefits.

[9] An improper-payment is one in which a claimant wrongly receives payment to which they are not entitled (overpayment) or is improperly denied payment to which they are entitled (underpayment). Most improper-payments are overpayments.

The following steps have been taken to detect, reduce and improve the recovery rate of improper-payments:

- increase staff resources and training related to prevention and detection of overpayments;

- clarify work-search requirements and reporting requirements for claimant earnings;

- establish a targeted call campaign centered on claimants who report hours and earnings when filing for benefits;

- issue warning letters and perform random audits on claimants not meeting work-search requirements.

The CDLE has made significant steps toward improving the overpayment collection rate. In addition to assigning a new employee to overpayment recovery, CDLE collectors began using skip-tracing software to aid in payment recoveries. Nearly two-thirds or more than $54 million of the total regular unemployment benefits that have been overpaid since 2008 have been successfully recovered and the department has established an objective of increasing recovery rates by more than 10 percent each year through 2014.