2018 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 including the present financial condition of the UITF; the status of the 2012 unemployment compensation bonds; the fund outlook under conditions of high economic growth and recession; and efforts the CDLE has taken to reduce improper payments of unemployment benefit made from the UITF.

Current Fund Status. Trust fund reserves, which stood at $700 million as of June 2008, were quickly depleted by the sharp, unprecedented rise in job losses experienced between mid-2008 and early 2010.[1] The fund regained solvency in 2012 due to the issuance of $630 million in Colorado unemployment bonds in June 2012. Solid employment gains over the past six years, combined with steadily falling numbers of unemployed persons have led to a gradual replenishment of fund reserves. By December 31, 2017, reserves held in the UITF totaled $766.4 million, an improvement of $94.8 million from twelve months earlier when the fund balance stood at $671.6 million.

Still, despite Colorado's impressive economic rebound, by June 30 of this year the fund balance will have only grown by $410 million since mid-2012. Although the June 30, 2018 fund balance reached a record-high balance of $922.3 million, just 45 percent of current fund reserves are attributable to organic expansion of the fund due to its current financing structure. In other words, the majority of fund reserves still originate from the bond proceeds deposited into the UITF in June 2012.

Employer premiums paid into the UITF, including those from reimbursable employers, totaled $628.8 million during 2017, up slightly from $621.6 million the prior year. Interest earnings on fund reserves totaled $16.7 million in 2017 compared with $15.4 million in 2016.

At $428 million, 2017 regular unemployment insurance benefit payments were down substantially from the $505.3 million paid in 2016. Reflecting Colorado's extremely tight labor market, the number of weeks paid to UI claimants in 2017 slipped about 16 percent from the previous year. Payments from the UITF, which had averaged about $330 million each year between 2006 and 2008, had climbed to an annual average of

[1] The number of seasonally adjusted nonfarm jobs fell 155,000 or 6.5 percent between the May 2008 peak and the January 2010 bottom. By 2013, however, annual nonfarm employment growth had rebounded to 3.1 percent. Colorado has been among the top-ranked states in terms of percentage job gains over the past six years.

$883 million between 2009 and 2011.[2] Over the past three years benefit payments have averaged about $488 million annually.

Colorado Unemployment Compensation Bonds. Several states issued unemployment compensation bonds during the Great Recession as a way of eliminating the federal debt that stemmed from having had to borrow from the Federal Unemployment Account in order to accommodate benefit payments. The Colorado unemployment bonds differed from those issued by other states in that the bond proceeds and principal repayments flowed through the UITF. Structuring the bonds in this way allowed the bond principal repayments 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 bonds, which totaled about $630 million, had a five-year term requiring fixed annual principal repayments of $125 million to be made each May through 2017. The Department made the fifth and final principal payment May 15, 2017. The revenue for the principal repayments was generated from Colorado employers who were billed a bond principal repayment surcharge as part of their annual unemployment insurance premiums. Because the debt has been completely repaid there are no further bond surcharges assessed against Colorado employers.[3]

Interest payments on the bonds were originally scheduled to be due November 15 of each year. There was no penalty for the accelerated repayment of either principal or interest and the Department elected to prepay the entire $12.9 million in interest due on the bonds in 2013 thereby relieving Colorado employers of future interest payments. In June 2014 Fitch's Rating Service reaffirmed their original AA rating on the bonds citing Colorado's strong economic performance and anticipated ample revenue coverage for future principal payments.

Current Trust Fund Outlook. A fundamental recommendation of the 2010 UITF audit by the State Auditor's Office was to increase the taxable wage base to obviate the fund's need to borrow during future recessions. While HB11-1288 made several important improvements to promote long-term solvency of the UITF, the increase to the wage base was likely not adequate to prevent the need to borrow during future recessions. Consequently, in 2016 the CDLE established a UITF Solvency Committee composed of a diverse group of Department stakeholders to discuss what remedial actions, including an increase to the taxable wage base, would be required to substantially bolster long-term fund solvency. The Solvency Committee met several times in late 2016 but was unable to agree upon a set of recommendations for legislative action.

---

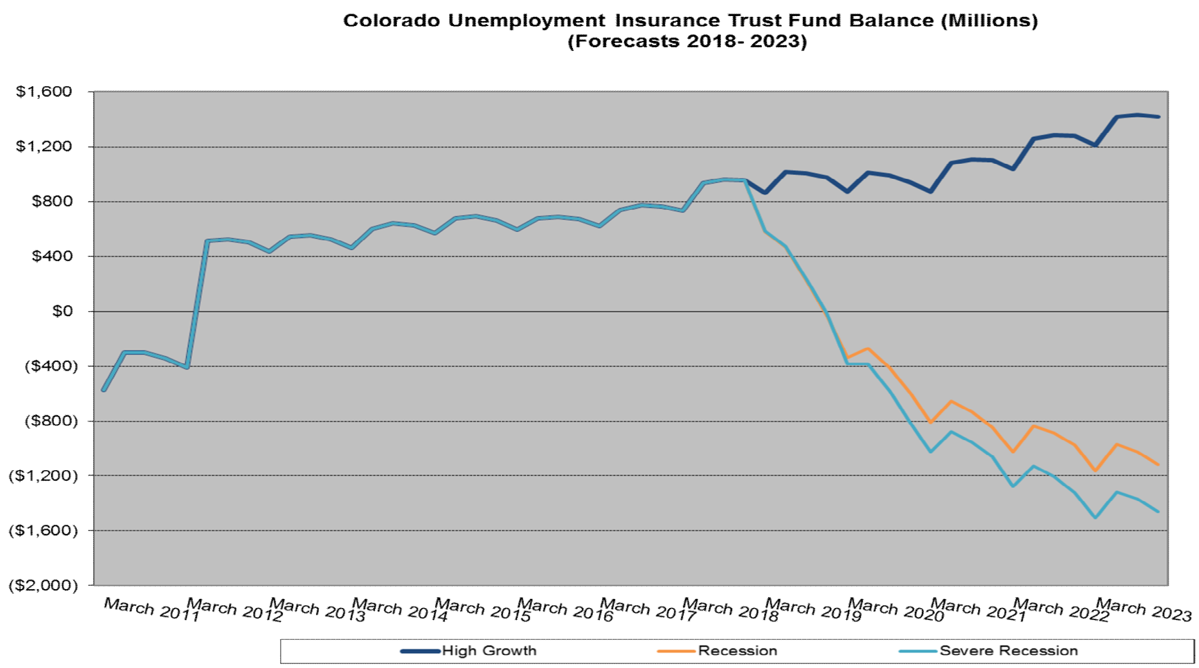
[2]In addition to regular state unemployment benefits, since 2008 $4.0 billion was paid to Colorado claimants under the extended unemployment compensation (EUC) and state extended benefits (SEB) programs. Both EUC and SEB were paid with federal dollars and therefore had no direct financial impact upon Colorado's UITF.

[3] The bond principal surcharge ranged from approximately 20 to 25 percent of an employer's base UI premium each year over the life of the bonds. The surcharge was the estimated amount each employer's base premium must increase in order to cover the required annual principal payment of $125 million.

During the first quarter of each calendar year the Department produces a set of UITF five-year forecasts that correspond to low, medium, and high growth economic scenarios. The Department also generates recession forecasts that project the fund balance under stressful economic conditions. These forecasts are continually evaluated and updated throughout the year. The most optimistic growth forecast, which has been closely tracking actual fund movements this year, is summarized below.

The current CDLE fund forecast is predicated upon healthy economic gains continuing through the 2023 forecast horizon. Annual job growth is assumed to average around 2.5 percent 2018 through 2023 with unemployment rates ranging from about 3.0 to 4.0 percent. Average weekly earnings are projected to rise roughly 2.5 to 3.0 percent each year during the forecast period.

Under these conditions fund reserves are anticipated to progressively reach just over $1.4 billion by year-end 2023. The solvency or reserve ratio, a simple measure of the fund's financial soundness, will rise modestly through 2023, increasing from around 0.78 percent this year to about 0.90 percent by 2023.[4] The last time the solvency ratio was at least 1.0 percent was in 2001. The UITF is considered fully solvent for purposes of Colorado's premium rate structure when the adequacy ratio reaches 1.4 percent so that although the fund is expected to remain solvent through 2023, even under relatively high growth conditions it will likely remain below the level of reserves required to attain fully funded status.

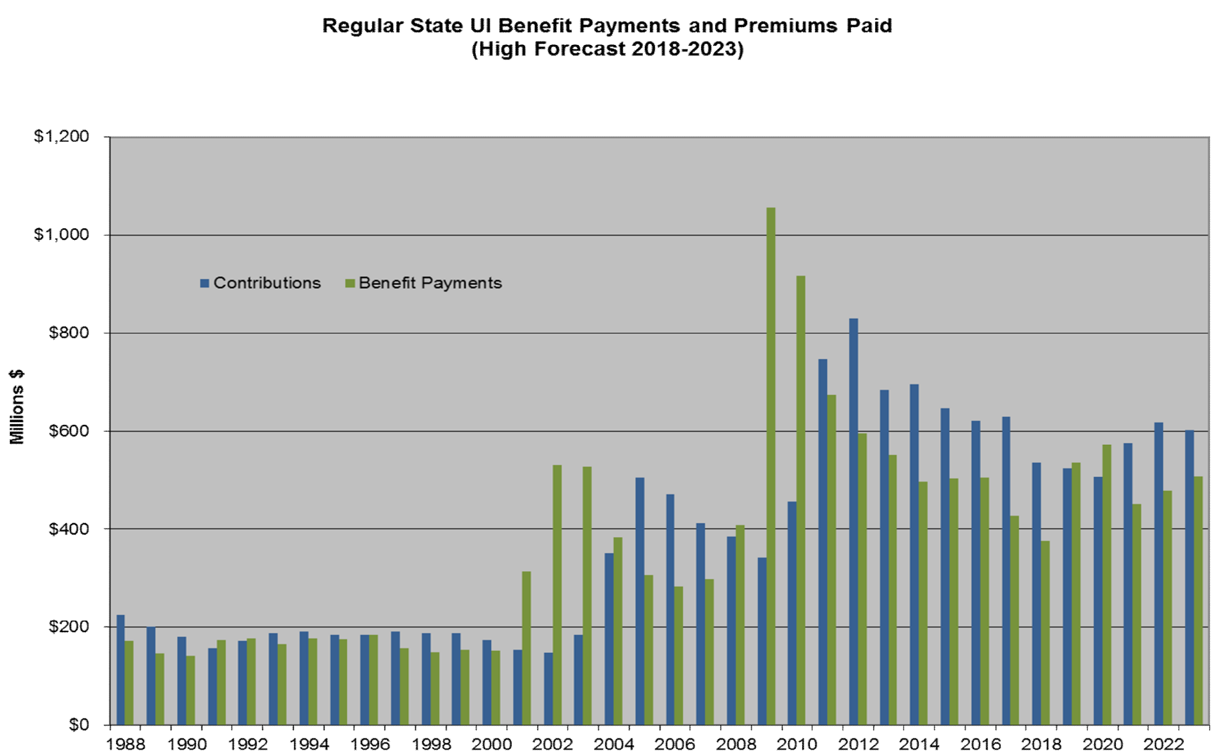


[4] The reserve ratio is the trust fund balance divided by annual total private wages. During past several recessions, a solvency ratio of about 1.4 percent measured from the start date of the recession would have been large enough to allow the fund to pay benefits without borrowing over the course of the recession. The premium rate schedules adopted in HB11-1288 set employer premium rates at their minimum when fund reserves reach the desired 1.4 percent threshold. To reach the 1.4 percent solvency ratio by 2023 would require a fund balance of nearly $2.1 billion.

The U.S. Department of Labor uses a measure called the average high cost multiple (AHCM) to assess fund solvency. The AHCM estimates how long trust fund reserves can pay benefits at historically high payout rates if one ignores employer premiums that flow into the UITF. The AHCM is expressed in years so that an AHCM of 1.0 means the trust fund has enough reserves to pay benefits for a year at recession levels while an AHCM of 0.5 would mean the fund could pay benefits for six months.

The USDOL recommends that all state trust funds reach an average high cost multiple of at least 1.0 by 2020—states that meet this standard will be eligible for interest-free short-term loans from the Federal Unemployment Account should it become necessary to borrow to continue to pay UI benefits. The 2018 AHCM for Colorado is estimated to be 0.71 and is expected to rise to about 0.80 by 2023—short of the recommended federal level.

Under persistent growth conditions fund revenues are forecast to rise from $524 million in 2018 to $602 million by 2023. The taxable wage base, which is $12,600 in 2017, will increase to $13,100 in 2019 and $14,500 by 2023. The average employer premium rate is anticipated to drop from 0.43 percent this year to 0.36 by the end of the forecast period. Annual interest earnings on fund reserves are expected to increase from $26.5 million this year to $46.1 million by 2023.



Benefits, meanwhile, are projected to remain relatively stable through 2023 as labor markets remain tight and unemployment low. Benefit payments are expected to increase from about $375 million this year to $509 million by 2023. The annual benefit cost rate, which is expected to be 0.30 this year, will change little over the forecast period.[5] The solvency surcharge, which had been assessed against Colorado employers since 2004, was turned off in 2013 due to UI bonding and will remain off under high growth conditions.

Fund Stress Tests. Since 2013, Colorado's economy has outperformed that of most other states, consistently ranking among the leaders in both job growth and unemployment. However, while the fund will remain solvent under continuing conditions of economic growth, even robust economic growth may not allow it to reach desired solvency levels as measured by either the solvency ratio or the average high-cost multiple. Because the current economic expansion is now entering its tenth year, much longer than the average post-war expansion, it is important to consider what would happen to the fund when the economy slumps. To this end, the Department models various recession scenarios that essentially serve as stress tests of the fund and show the extent of its vulnerability to economic downturns.

To gauge the fund's response to economic recessions the CDLE looked at two scenarios in which the economy contracts beginning 2019. These forecasts provide a general idea of how the fund would react to a slump similar to the 2001 recession as well as a deeper and more protracted event like the Great Recession.

Under both 2019 recession scenarios the fund becomes insolvent during the first quarter of 2020 and, assuming a moderate economic recovery, remains insolvent through the end of the forecast period. Peak insolvency levels would potentially range from $1 billion to $1.4 billion. The recession forecasts show the employer solvency surcharge going into effect in 2020 and remaining on through at least 2026.

Colorado's UITF became insolvent 1982-85, narrowly averted insolvency in the wake of the 2001 recession, and became insolvent again 2010-12. Insolvency imposes substantial financial burdens upon Colorado businesses in the form of high base premium rates, a solvency surcharge, interest payments and administrative expenses. Moreover, the federal unemployment tax paid by employers may increase should the insolvency period exceed two years. Because the fund is vulnerable to insolvency during recessions or lengthy periods of economic stagnation, these costs are felt at the very time when it is most difficult for employers to bear them. The Department will continue to evaluate and pursue corrective steps necessary to move the fund toward a position of long-term solvency.

Improper Payments. Federal benefit entitlement programs with improper payment rates greater than 10 percent are considered to be out of compliance with federal performance

[5] 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 from the trust fund. The annual premium rate is expected to generally exceed the annual benefit cost rate through 2023 which means fund inflows (employer premiums received) are projected to exceed fund outflows (benefit payments).

standards.[6] The Department's Integrity Task Force (ITF) is charged with analyzing the issues, root causes, and trends related to improper payments. Based on analysis and input, ITF recommends strategies to detect, prevent, and deter payment errors. Between 2008 and 2011, prior to the establishment of the ITF, Colorado's gross improper payment rate was estimated to be 17 percent for an extrapolated gross total of $305.4 million. Improper payment data are provided to the USDOL, which tracks the improper payment rate annually based on a small sample size of paid claims within that year. For calendar year 2017, the most recent year with complete data, the gross improper payment rate was 11.38 percent while the net improper payment rate was 8.87 percent. The net improper payment rate is calculated by subtracting recovered overpayments from the estimated gross improper payment rate.

Recent and ongoing steps to reduce the improper payment rate include the following:

- established a core team dedicated to developing and implementing actions and strategies designed to reduce improper payments;
- established a messaging campaign, including enhanced email and letter communications to educate claimants on eligibility requirements, including reporting new employment, earnings, job separations, other-pay received, and work-search efforts;
- established an additional, targeted education-centered messaging campaign to claimants who, based on analysis of data, have a higher likelihood of misreporting earnings and/or not conducting valid searches for work;
- established a campaign, including messaging and in-person outreach, to educate employers on the importance of providing timely and accurate information when so requested in order to protect employer accounts and program integrity;
- updated the online application used by claimants to file unemployment insurance claims to improve claimants understanding and the gathering of complete and accurate facts;
- updated the online and telephone continued-claim applications used to request payments to improve the clarity of the questions being asked as well as the accuracy and completeness of the responses by introducing behavioral economic strategies such as positive reinforcement and nudging;
- updated the existing automated workload management system used to increase efficiencies and timeliness of unreported and misreported earnings audits;
- expanded the definition of a work-search activity to include actions beyond making formal job contacts (e.g., participation in reemployment services or job-related skills development workshops); and
- implemented focused wage-benefit crossmatch audits for those most likely to have overpayments (i.e., specific employers and industries) based on analysis of the data.

[6] 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). Approximately 95.8 percent of Colorado improper payments in 2017 were overpayments.

In addition to lessening the rate of improper payments the CDLE has made significant progress toward improving the overpayment collection rate. Currently, over $69 million in overpayments on the regular State UI program has been recovered from claimants since July 2012.