2019 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 an annual report on the fund's financial condition to several committees of the Colorado General Assembly by August 31.

This report provides a brief overview of recent UITF developments including the present financial condition of the UITF; 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. Additionally, this year's report includes an appendix with a brief history of the trust fund and a summary of the long-term solvency challenge facing the fund.

Calendar Year 2018 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, 2018, reserves held in the UITF totaled $932.9 million, an improvement of $166.5 million from twelve months earlier when the fund balance stood at $766.4 million.

As of June 30 this year the fund balance has swelled by $591.0 million since mid-2012. Although the June 30, 2019 fund balance reached a record-high balance of $1.1 billion, just over half of current fund reserves are attributable to organic expansion of the fund due to its current financing structure. In other words, a large share of current fund reserves still originates from the bond proceeds deposited into the UITF in June 2012.

Employer contributions paid into the UITF, including those from reimbursable employers, totaled $522.1 million during 2018, down from $628.8 million the prior year. The decline in employer contributions was due to employers moving to lower premium rates in 2018; consequently, the average tax rate dropped from 0.53 percent in 2017 to 0.41 percent in 2018.[2] Interest earnings on fund reserves totaled $20.7 million in 2018 compared with $16.7 million in 2017.

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[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 3.0 percent. Colorado has been among the top-ranked states in terms of percentage job gains over the past six years.

[2] Employer premium rates are determined by an employer's layoff history, the tax rate schedule in effect for that year, and any additional surcharges that may be in effect. Because layoffs shrink during economic recoveries, most employers see their premium rates drop as the economy expands. Additionally, the bond principal surcharge, which was assessed against employers to repay the principal on the $630 million in unemployment compensation bonds issued in 2012, expired in 2017. This also played a part in reducing the 2018 average tax rate.

At $377.2 million, 2018 regular unemployment insurance benefit payments were down from the $428.0 million paid in 2017. Nearly 84,000 Coloradans received at least one unemployment insurance benefit payment in 2018, compared with almost 97,000 the previous year. In contrast, just over 275,000 persons had at least one payment during the midst of the Great Recession. Reflecting Colorado's continued tight labor market, the number of weeks paid to UI claimants in 2018 slipped about 15 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 $883 million between 2009 and 2011.[3] Over the past three years, benefit payments have averaged about $437 million annually.

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. Therefore, 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. A history of the fund since 1980 as well as a description of the fund's long-term solvency problem is provided in the appendix.

During the first quarter of each calendar year the Department produces a set of five-year UITF 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 2024 forecast horizon. Annual job growth is assumed to average between 2.0 and 2.5 percent through 2024 with unemployment rates ranging from about 3.0 to 4.0 percent. Average weekly earnings are projected to vary from 2.5 to 3.0 percent each year during the forecast period.

Under these conditions fund reserves are anticipated to progressively reach about 1.3 billion by mid-2024. The solvency or reserve ratio, a simple measure of the fund's financial soundness, will remain relatively stable through 2024, increasing from around 0.87 percent this year to just under 1.0 percent by 2021 before declining to about 0.82

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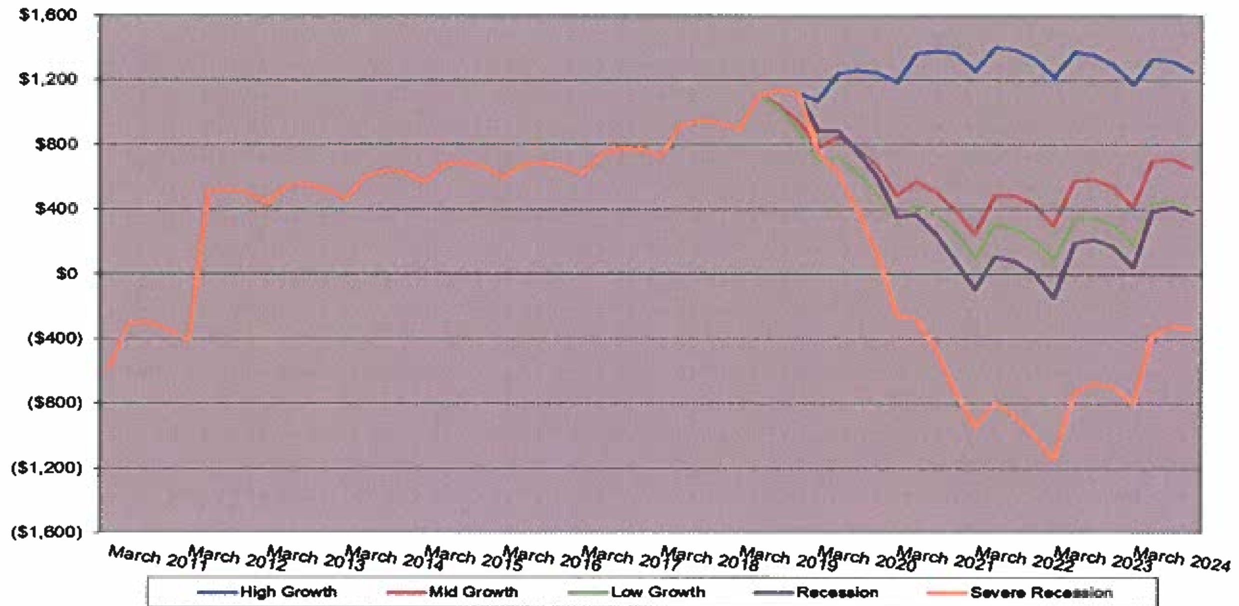
[3]In addition to regular state unemployment benefits, since 2008 $4.0 billion was paid to Colorado claimants under the extended unemployment compensation (EUC) and state extended benefits (SEB) programs. Both EUC and SEB were paid with federal dollars and therefore had no direct financial impact upon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

percent by 2024.[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 would remain solvent through 2024, even under relatively high growth conditions it is likely remain below the level of reserves required to attain fully funded status.



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 ignoring all employer contributions that flow into the UITF. In other words, the AHCM expresses the burn rate of the fund's current reserves; however, because it excludes revenues that continue to flow into the fund it is not an estimate of how long the fund will remain solvent. The AHCM is expressed in years so that an AHCM of 1.0 means the trust fund has enough current 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 2019 AHCM for Colorado is estimated to be

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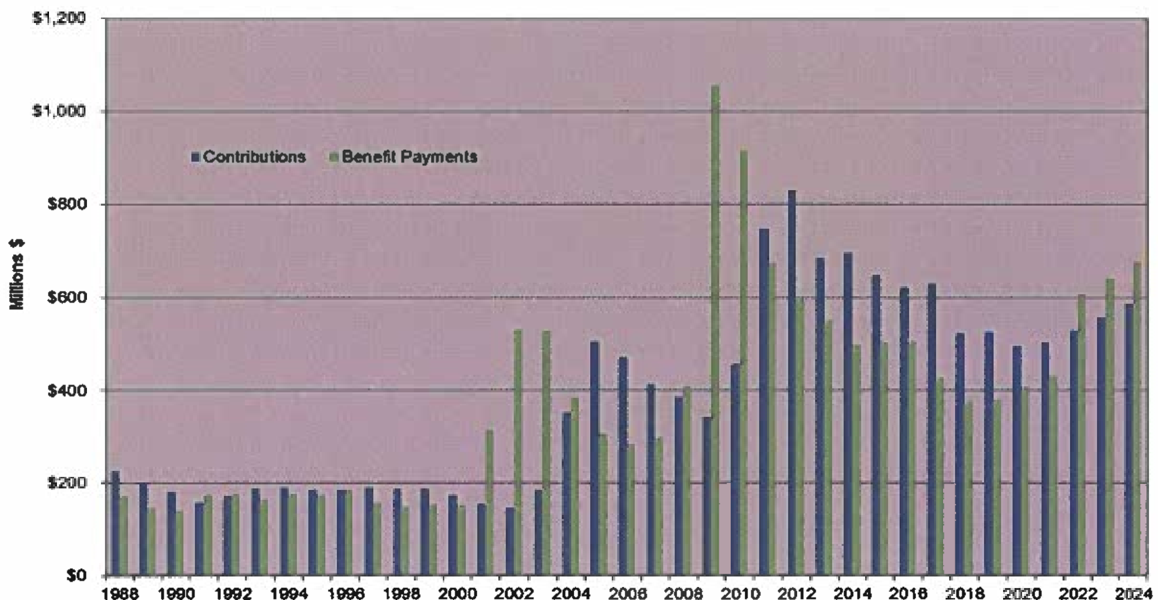
[4] The reserve ratio is the trust fund balance divided by annual total private wages. During past several recessions, a solvency ratio of about 1.4 percent measured from the start date of the recession would have been large enough to allow the fund to pay benefits without borrowing over the course of 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 2024 would require a fund balance of around $2.2 billion.

0.79 and is expected to decrease to about 0.68 by 2024—short of the recommended federal standard.

Under persistent growth conditions fund revenues are forecast to rise from $529 million in 2019 to $586 million by 2024. The taxable wage base, which is $13,100 in 2019, will increase to $13,600 in 2020 and $15,000 by 2024. The average employer premium rate is anticipated to drop from 0.40 percent this year to 0.34 by the end of the forecast period. Annual interest earnings on fund reserves are expected to increase from $30.5 million this year to $45.0 million by 2024.



Benefits, meanwhile, are projected to increase steadily through 2024 despite tight labor markets and relatively low unemployment rates. Because weekly benefit payments are a function of wage levels, higher wages will result in higher average benefit payments. Higher benefit payments, combined with an increased number of UI covered workers and somewhat higher claims levels are expected to cause total benefit payments to climb from $394 million to $675 million between 2019 and 2024. The annual benefit cost rate, which is expected to be 0.28 percent this year, will grow to 0.40 percent by 2024.[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.

[5] The average premium rate is total premiums divided by total private wages while the average benefit cost rate is benefit payments divided by total private wages. For comparison purposes, the average premium rate 2001-2010 was 0.45 percent and the average benefit cost rate was 0.66 percent. The highest annual benefit cost rate was 1.3 percent and occurred in 2009 when over a billion dollars in benefits was paid from the trust fund. When the annual premium rate exceeds the annual benefit cost rate the fund balance grows; when the benefit cost rate is greater than the average premium rate the balance declines.

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 has now exceeded ten years, much longer than the average post-war expansion, it is important to consider what may happen to the fund when the economy slumps. To this end, the Department models various recession scenarios that 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 2020. 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 the moderate 2020 recession scenario, the fund becomes insolvent in early 2022 and remains intermittently insolvent until about mid-2023, with the peak insolvency level reaching about $150 million. The severe recession forecast has the fund becoming insolvent in early 2021 and remaining so through 2024. The peak insolvency level under severe recession conditions reaches around $1.1 billion. The recession forecasts show the employer solvency surcharge going into effect in 2021 and remaining on through at least 2025.

Colorado's UITF became insolvent 1982-85, narrowly averted insolvency in the wake of the 2001 recession, and became insolvent again 2010-12 (see Appendix). 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 recommend 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 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.

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[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 94.5 percent of Colorado improper payments in 2018 were overpayments.

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 2018, the most recent calendar year with complete data, the gross improper payment rate was 11.726 percent while the net improper payment rate was 9.42 percent. The net improper payment rate is calculated by subtracting recovered overpayments from the estimated gross improper payment rate. For the latest relevant data, the first eight months of the current Improper Information Act (IPIA) Year (July 2018 through June 2019) should be considered. In that period to date, the gross improper payment rate is 9.95 percent and the net improper payment rate is 7.67 percent.

Most improper payments are the result of claimants not meeting their eligibility requirements, failing to provide information as required, providing incomplete or inaccurate information, and/or employers failing to provide information as required or providing incomplete or inaccurate information. As a result, efforts to reduce improper payments are focused on communication and education of requirements and responsibilities as well as technology upgrades designed to gather more complete and accurate information needed to make a proper determination to pay benefits.

Important steps taken since 2011 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 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;
- provided training to existing staff on the top three root causes of improper payments and common misunderstandings claimants and employers have that caused the errors;
- updated telephone hold messages claimants listen to when contacting the division with information on how to avoid improper payments;
- updated the online application used by claimants to file unemployment insurance claims to improve claimants understanding and the gathering of complete and accurate facts

More recent steps taken to drive down improper payments include:

- 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 online continued-claim application to include examples of acceptable work-search activities, which should help to avoid unnecessary errors based on claimant misunderstanding or confusion;
- updated the online continued-claim application to include examples of how to correctly report hours and earnings, which should help to avoid unnecessary errors based on claimant misunderstanding or confusion;
- 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), focusing on activities suited to any economic condition that may assist individuals return to work rather than the quantity of activities;
- 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;
- leveraged knowledge, expertise, and resources of the National Association of State Workforce Agencies (NASWA) and National and Regional USDOL Offices on improper-payment strategies

On the horizon in the coming year the Division is planning the following which should have a direct bearing on improving improper payments:

- implementing new system wherein benefit recipients will request benefit payments on a weekly basis rather than biweekly, which will improve the accuracy of information received;
- implementing new system requiring that benefit recipients provide a listing of work-search activities completed for the week of benefits being requested; and
- exploring statutory changes related to other remuneration as it impacts benefit claims.

In addition to lessening the rate of improper payments the CDLE has made significant progress toward improving the overpayment collection rate. Currently, over $84 million in overpayments on the regular State UI program has been recovered from claimants since January 2012.

Appendix to 2019 Colorado Unemployment Insurance Trust Fund Summary Report

Trust Fund Solvency 1980- Present. In the aftermath of the back-to-back recessions of the early 1980s, Colorado's UITF became insolvent in 1982 and remained so until 1985. Over this period the fund borrowed $221 million from the Federal Unemployment Account and repaid $15 million in interest. Colorado's economy saw little growth throughout the 1980s as national recessions, an oil shale bust, and the S&L crisis kept jobless rates elevated and job gains depressed. Still, in an effort to make the UITF sustainably solvent, the Colorado General Assembly raised the taxable wage base (the amount of each worker's earnings subject to UI tax) in several steps from $6,000 to $10,000 between 1982 and 1988. However, after the passage of the TABOR amendment in 1992, future attempts to remediate UI financing problems via legislative action were frozen until 2011 when the UI Program began operating as an Enterprise Program under state budget rules.

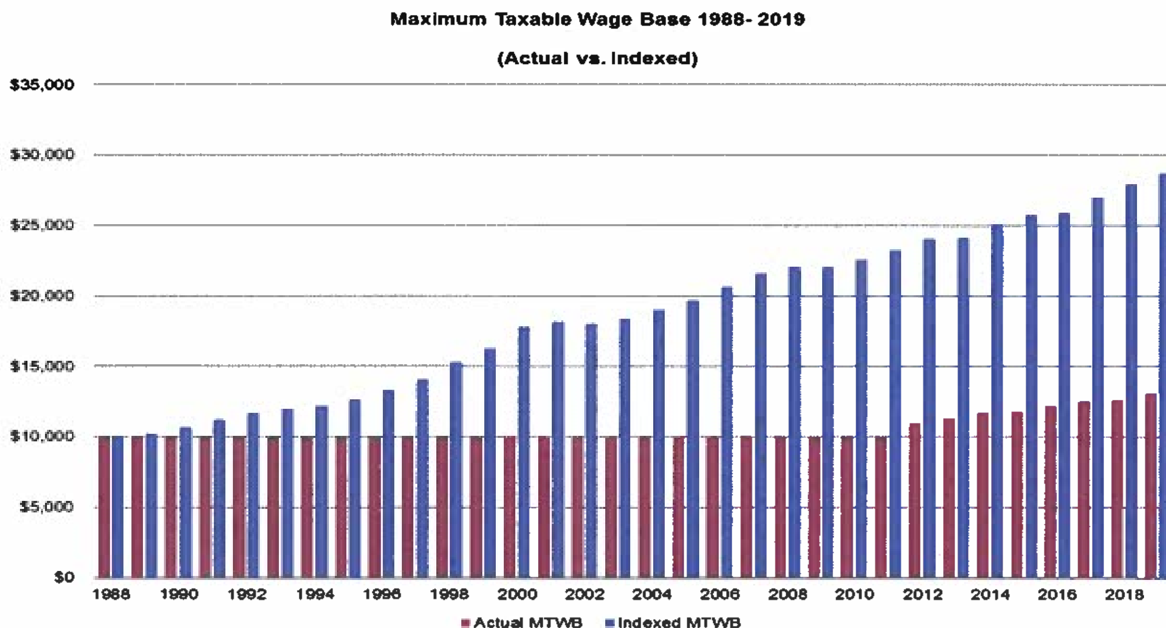
After the 2001 recession, the UITF narrowly escaped insolvency in late 2003 and would have become insolvent absent the injection of $142 million into the UITF from a special one-time distribution from USDOL of federal Reed Act funds. However, the depletion of fund reserves (which reached a low of $8 million in April 2004) caused the employer solvency surcharge to trigger on in 2004. Although fund reserves slowly began replenishing after 2004, the surcharge, which had been designed to provide a short-lived boost to fund revenues, became a semi-permanent feature of the financing system and remained in effect through 2012.

Despite another special one-time distribution from USDOL of $127 million in UI Modernization funds in late 2009, Colorado's UITF again became insolvent in January 2010. The trust fund remained insolvent until June 2012 when the outstanding federal debt was effectively replaced with bond proceeds financed through the sale of special unemployment compensation bonds placed in the private market. Overall, Colorado borrowed more than $1.1 billion from the Federal Unemployment Account and issued more than $600 million in unemployment compensation bonds, bringing the total amount borrowed to about $1.7 billion. Although the bond proceeds restored the fund to solvency and turned off the solvency surcharge assessed against Colorado employers (turning off the solvency surcharge was a primary reason for issuing bonds), debt issuance did not solve the long-term financing problem facing the UITF. Indeed, current CDLE forecasts indicate that, despite Colorado's impressive economic gains since 2012, the fund may become insolvent again during the next recession thereby requiring a future round of borrowing that will lead to additional surcharges borne by Colorado employers.

Significance of the Taxable Wage Base. Not all wages paid by UI covered employers are subject to UI taxes. Currently, in Colorado the first $13,100 earned during a year by a worker for a UI covered employer is subject to UI tax. The $13,100 subject to UI tax is the taxable wage base and is used to calculate the amount of UI premiums due. The average weekly wage for all Colorado private sector UI covered workers is presently

around $1,170. An employer with five workers earning the average wage and working for the employer for the entire year would pay wages to those workers totaling 5 x $1,170 x 52 weeks or $304,200 over the course of the year. However, the amount of wages subject to UI tax, referred to as the employer's taxable wages, would be $13,100 x 5 or $65,500 since only the first $13,100 are subject to tax. If the employer had a UI premium rate of 1.5 percent then the amount of UI premiums due during the year would be $65,500 x 0.015 or $982.

With annual earnings of Colorado UI covered workers now equal to about $1,170 x 52 or $60,840 the current wage base of $13,100 is about 22 percent of annual wages. When the wage base was raised to $10,000 in 1988 it represented 47 percent of annual earnings, which were at that time around $21,000. Colorado's wage base had been fixed at $10,000 from 1988 to 2011 so that by 2011 the wage base made up only 20 percent of an average worker's annual earnings. ***Had the taxable wage base been maintained at parity with the 1988 base (i.e., 47 percent of average annual earnings) the wage base would now be over $28,000.*** In other words, the wage base has failed to keep up with the growth in average earnings over this period, severely hampering the UITF's revenue generating capacity. The erosion of the wage base relative to annual earnings has made the fund increasingly vulnerable to economic downturns and, by depressing the fund balance, has kept employer premium rates relatively high even during economic expansions.



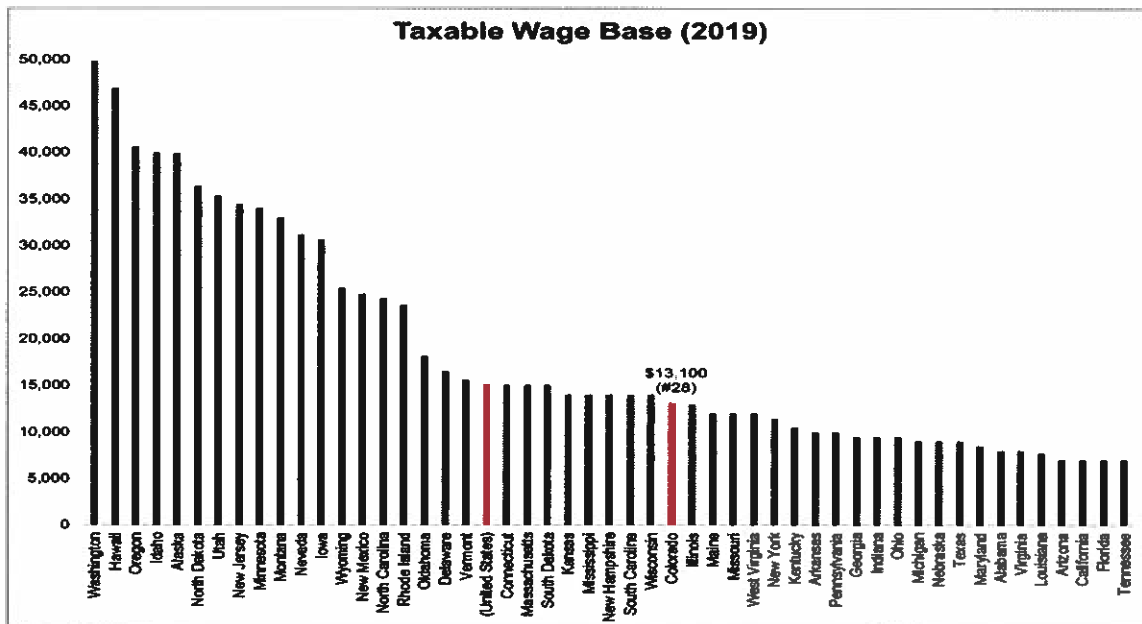
A 2010 audit of the Colorado UITF by the Office of the State Auditor recognized the problem with the wage base:

> Raising the wage base to an amount that promotes the long-term solvency of the UI Trust Fund could cause financial hardships for some employers,

particularly if the wage base is increased during the recession. However, failing to adjust this fundamental component of the UI financing system could further weaken the financial condition of the Trust Fund and, as we discuss later in the chapter, could result in additional fees and federal taxes charged to employers due to the Department's need to borrow funds from the federal government to pay UI Benefits. (Evaluation of the Unemployment Insurance Trust Fund- June 2010, Report of the Colorado State Auditor)

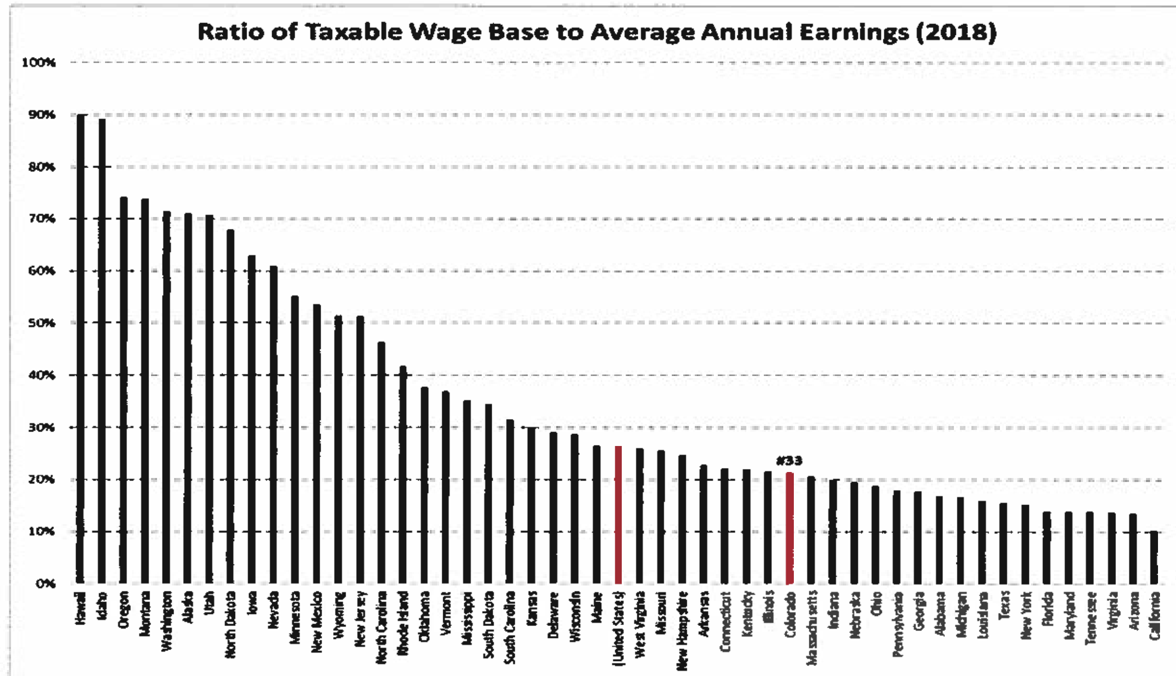
In an effort to address the problem, HB11-1288 made several important enhancements to the fund's financing structure such as increasing the wage base to $11,000 in 2012 and thereafter indexing the base to the yearly change in average wages. The increases in the base following HB11-1288, however, may not be adequate to maintain fund solvency during future recessions.

The wage base differs among states and ranges from over $40,000 to as low as $7,000 (this is effectively the minimum base permitted under federal law). Since the onset of the 2007 recession, many states took action to strengthen their trust funds by increasing their taxable wage bases. Colorado's wage base, which is adjusted annually to changes in average weekly earnings, currently ranks among the lower half of all states. Sixteen states now have a wage base of at least $20,000—Colorado's 2019 wage base of $13,100 places it 28th among all states.



While a comparison of state wage bases is useful, it is more meaningful to consider the wage base relative to average state earnings. A state with a wage base of $7,000 and where the average yearly earnings of a UI covered worker is $50,000 is assessing UI premiums against 14 percent of wages whereas one with a $20,000 wage base but an identical average wage would be using 40 percent of earnings to fund their UI system. In general, high-wage states, such as Colorado, require higher wage bases to support their

trust funds while low-wage states need lower wage bases. Colorado currently ranks 33rd among states when the wage base is measured as percentage of average annual earnings.



Improving UITF Solvency over the Long-Term. At $1.1 billion, the June 30, 2019 fund balance is nearly $400 million below the level necessary to meet USDOL's current solvency recommendation by year-end 2019. Because the present economic recovery is now over 10 years old and the average postwar expansion lasts around five years, it is unreasonable to expect growth to continue unchecked for the next five years. CDLE forecasts through 2024 indicate that even in the unlikely scenario of moderate to high uninterrupted economic growth, trust fund reserves will not reach the $1.8 billion that will be necessary to meet the federal solvency standard in 2024.

Colorado's economic performance over the past five years has been among the strongest in the nation. Dependent upon the timing, severity, and duration of the next recession, the trust fund may again become insolvent and borrowing will be required to make legally obligated benefit payments. This will inflict substantial costs to employers in the form of various surcharges, administrative costs, and interest expenses. *These will take effect at the same time the premium rate schedules shift to their highest levels thereby compounding the financial stress upon employers.*

CLDE recommends increasing the taxable wage base beginning 2021. The appropriate taxable wage level is essential to maintaining UITF solvency during economic slumps and is considered a best practice of fund management by the General Accounting Office, USDOL, and many other groups that study UI financing systems. By strengthening the UITF in this way employers will see smaller premium increases when the economy weakens. The most favorable time to raise the wage base is when business activity is healthy, the economy is growing, and employer premium rates are declining.