Legislative Analysis

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UNEMPLOYMENT INSURANCE BONDS

Senate Bills 483 & 484
Sponsor: Sen. Mark C. Jansen
House Committee: Commerce
1st Senate Committee: Economic Development
2nd Senate Committee: Finance

Complete to 12-05-11

A SUMMARY OF SENATE BILLS 483 & 484 AS PASSED BY THE SENATE 12-1-11

BRIEF SUMMARY: The bills would create the Employment Security Financing Act and amend the Michigan Employment Security Act, permitting the Michigan Finance Authority (MFA) to issue revenue bonds, if requested by the Director of Licensing and Regulatory Affairs (LARA), to:

- Reduce or avoid the state's need to borrow federal advances for the state's unemployment trust fund
- Repay principal and interest on outstanding federal advances for the state's unemployment trust fund
- Provide for a surplus in the state's unemployment trust fund
- Directly pay unemployment insurance benefits
- Pay for financing costs associated with issuing, securing, and marketing bonds
- Provide sufficient reserves under indenture or federal requirements to minimize impact on unemployment insurance tax rates.

The Director of LARA would collect an Obligation Assessment, as determined by the State Treasurer, from contributing employers to support the payment of bonds issued by the MFA and other financial or administrative expenses.

BRIEF FISCAL IMPACT: The bill could have a positive fiscal impact on the state's unemployment trust fund and could reduce the total amount of interest paid by the state to support unemployment benefits.

Briefly, if the MFA was to issue bonds to immediately pay off all federal advances, full FUTA tax credits would be restored on January 1 of the following year and collection of the state Solvency Tax would cease on June 30, while an Obligation Assessment would be collected from each employer to pay for the bonds. Interest on bonds issued by the MFA would likely be lower than the interest currently paid to the federal government; however, interest to the federal government is paid on the average daily balance of federal advances which will decrease over time, whereas interest paid on bonds will be paid until the bonds mature.

For a detailed discussion, see the ***Detailed Fiscal Impact*** statement later in the document.

DETAILED SUMMARY:

Senate Bill 483

SB 483 (S-1) would create the Employment Security Financing Act to provide a statutory basis for the Michigan Finance Authority (MFA) which was created by EO 2010-2 (MCL 12.194). The MFA is an autonomous agency within the Department of Treasury and the State Treasurer serves as the Chairman of the Board of Directors of the MFA along with six other members appointed by the Governor with consent of the Senate. In addition to the powers conferred to the MFA by EO 2010-2, SB 483 (S-1) would empower the MFA to issue bonds to raise sufficient funds to:

1) Reduce or avoid the state's need to borrow federal advances for the state's unemployment trust fund,
2) Repay principal and interest on outstanding federal advances for the state's unemployment trust fund,
3) Provide for a surplus in the state's unemployment trust fund,
4) Directly pay unemployment insurance benefits,
5) Pay for financing costs associated with issuing, securing, and marketing bonds, and
6) Provide sufficient reserves under indenture or federal requirements to minimize impact on unemployment insurance tax rates.

Bonds issued by the MFA under SB 483 (S-1) are limited to the principal amount necessary to satisfy the state's obligations for federal advances to the unemployment trust fund, including reserves, financing costs, and reimbursement to the state for payments of its federal advance obligations until December 31, 2013. The limitation does not apply to bonds issued to refinance or refund bonds issued under SB 483 (S-1) before December 31, 2013.

The MFA would issue bonds by resolution, stipulating the terms and conditions of the issue, and would not require consent from any state agency or authority or administrative procedures other than those specified by SB 483 (S-1). The MFA would only be permitted to issue special revenue bonds, the obligations of which are payable only from dedicated revenues, eligible funds under the Michigan Employment Security Act (MCL 421.1-421.75), and other MFA assets including bond proceeds and interest income. In addition to the terms and conditions of the issue, the MFA would determine, via resolution, the manner in which it issued bonds (public or private, competitive or negotiated) and the dispersion of the proceeds of the bonds as permitted by SB 483 (S-1). The MFA could issue bonds to refund bonds and could purchase bonds issued by the MFA.

The MFA would be permitted to enter into, amend, or terminate any "ancillary facility" it determines necessary and appropriate. Ancillary facilities are defined by SB 483 (S-1) to include various financial instruments and insurance contracts which could be utilized to:

1) Facilitate the issue and subsequent transactions of bonds or swap contracts;
2) Attempt to hedge risk, lower interest rates, or increase cash flow; or
3) Provide for payments based on specified levels of or changes in interest rates so to guarantee an investment rate for a period of years.

The MFA could determine the terms and conditions of these various financial instruments and insurance contracts and these determinations would be conclusive.

A bond issued or any ancillary facility entered into by the MFA would not constitute indebtedness or liability of the state and would not entail the full faith and credit of the state. SB 483 (S-1) does not grant the MFA the authority to incur indebtedness or liability on behalf of the state. The state, political subdivisions of the state, pension funds, banks & trusts, savings associations, investment companies, any other fiduciaries, and all persons whatsoever would be able to invest in any bond issued by the MFA. Owners of these bonds would be permitted to deposit bonds with state municipal officers and state agencies for any purpose authorized by law.

The MFA would, at its discretion, be permitted to enter into a trust agreement or trust indenture pertaining to any bond or ancillary facility with any trust company or bank having the powers of a trust company. A trust agreement or trust indenture could contain agreed upon provisions pertaining to the custody, safeguarding, and application of all monies and bonds and protecting and enforcing the rights and remedies under the sale agreement of bond owners and parties to ancillary facilities which are not in violation of law.

The MFA would be permitted to delegate, for a specified period of time, to an officer, employee, or agent of the MFA the power to issue, sell, and deliver bonds within limits prescribed by the MFA. The MFA would continue to exercise its duties independent of the State Treasurer; however, the State Treasurer would supervise the staffing, budgeting, procurement, and administrative functions of the MFA. The MFA retains all the powers of a public body corporate and politic in this state, and its property and income is exempt from any taxation within the state.

Members of the Board, officers, employees, and agents of the MFA would not be subject to personal liability if acting in good faith within the scope of their authority under SB 483 (S-1). The MFA could defend, indemnify, and procure insurance indemnifying Board members, officers, employees, and agents of the MFA. Any legal action against the MFA would be brought in the Court of Appeals, which has exclusive jurisdiction unless a party is seeking money damages, in which case the action would be brought in the Court of Claims. Members of the Board, officers, employees, and agents of the MFA could not have a direct or indirect interest, including property, in any business organization or any contract of any other person engaged in any business with the MFA.

SB 483 (S-1) would pledge the state not to do any of the following until all bonds and ancillary facilities, including interest and secondary expenses, were paid in full and discharged:

1) Limit or alter the rights of the MFA to fulfill the terms of its agreements with bond owners and parties to ancillary facilities,
2) Impair the rights and remedies of bond owners or benefited parties on bond owners or parties to ancillary facilities,
3) Take any action to reduce the amount generated by the applying the then applicable UI contribution rate to the then applicable UI wage base below that required by contract with bond owners or parties to ancillary facilities, and
4) Reduce the "Obligation Assessment" (which would be created by SB 484 (S-1)) to a level below that required by any outstanding bond or ancillary facility.

Each pledge of revenue by the MFA would be valid and binding at the time made. The encumbered revenues, reserves, or earnings pledged in addition to the interest earned on encumbered revenues, reserves, or earnings pledged are immediately subject to the lien created under the pledge. The lien is valid and binding against all parties having claims of any kind against the MFA. Bonds issued by the MFA are fully negotiable for all purposes of the Uniform Commercial Code.

SB 483 (S-1) appropriates $1 million from the General Fund to the MFA for the 2011 fiscal year to pay for operating expenses and reserve requirements and would not lapse to the General Fund if unexpended before September 30, 2011.

The bill declares the following legislative findings:

1) Maintaining sufficient funds to pay unemployment benefits when due is an essential governmental function.
2) At the time SB 483 (S-1) is enacted, unemployment benefit payments are made from the state's unemployment trust fund and supported by employer contributions.
3) At the time SB 483 (S-1) is enacted, borrowing funds via federal advances is the only option to obtain sufficient funds to pay unemployment benefits when the balance in the state's unemployment trust fund is insufficient to support payments.
4) Alternative methods of replenishing the state's unemployment trust fund may reduce the costs of providing unemployment benefits and employers' cost of doing business in the state.
5) It is in the state's best interests to authorize the issuance of bonds to continue the unemployment insurance program at the lowest possible cost to employers in the state and to avoid reductions in the federal unemployment tax credit.
6) The execution of the powers granted by SB 483 (S-1) by the MFA fulfills an essential governmental function and public purpose for the people of the state.

The Legislature determines that the creation of the MFA by EO 2010-2 and the execution of its authorize purposes under SB 483 (S-1) are public and governmental purposes for the benefit of the people of the state and the for improvement of their health, safety, welfare, comfort, and security and that the MFA will be performing these public purposes as an essential governmental function in the excise of powers conferred to it under SB 483 (S-1).

Senate Bill 484

SB 484 (S-1) would amend the Michigan Employment Security Act (1936 (Ex Sess) PA 1, MCL 421.1-421.75) by altering Section 2 and adding Sections 10(a) and 26(a).

SB 484 (S-1) would declare the following legislative findings:

1) High levels of unemployment have exhausted the state's unemployment trust fund, required federal advances to the unemployment trust fund, and caused the imposition of penalty and solvency taxes on employers.
2) The funding of unemployment benefits and the unemployment trust fund and financing of federal advances are an essential governmental function and public purpose of the state.
3) The issuance of bonds by the Michigan Finance Authority (MFA) to finance federal advances and reduce penalty and solvency taxes furthers an essential governmental function and public purpose and will encourage economic development and public welfare.

The Obligation Trust Fund (Fund) would be created by SB 484 (S-1) as a separate fund in the state Treasury not to be considered part of the General Fund and money in the Fund would remain at the close of the fiscal year and would not lapse into the General Fund. The State Treasurer could receive and deposit money or other assets into the Fund and would direct the investment of money within the Fund, crediting to the Fund earnings from investments of money from the Fund.

All Obligation Assessments (Assessments) collected under SB 484 (S-1) would be deposited into the Fund. All interest, penalties, and damages derived from the Assessments along with portions of the proceeds from any obligations specified by the MFA would be deposited into the Fund.

The Department of Licensing and Regulatory Affairs (LARA) would administer the Fund for auditing purposes and would be able to expend money from the Fund only to:

1) Pay obligations, including administrative and associated expenses,
2) Refund erroneously collected Assessments, and
3) Any other purpose for which the MFA could issue obligations (see following list).

The Director of LARA (Director) could request the MFA to issue notes, bonds, financial instruments, or other evidences of indebtedness; these issues are collectively referred to as "obligations." These obligations would not constitute state indebtedness. The proceeds of these obligations could be used to:

1) Finance, refinance, and refund any payments or other obligations issued under SB 484 (S-1) or federal advances,
2) Repay principal and interest on federal advances,
3) Reimburse:
a. The state for loans to the unemployment trust fund for required payments, and
b. The unemployment trust fund for loans to the Obligation Trust Fund to pay obligations of the MFA,
4) To support unemployment benefits and the unemployment trust fund, and
5) To support capitalized interest, debt services reserves, and payments of costs and administrative expenses derived from issuing obligations.

SB 484 (S-1) stipulates that in each year in which any obligation is outstanding, employers would be subject to an Obligation Assessment. The Assessment would be collected in addition to, at the same time and in the same manner as, subject to the same penalties and interest as, and not subject to the limiting provisions of, employers' required unemployment contributions and Solvency Taxes. The Assessment would be collected quarterly and deposited within the Fund by the Director. The Director could request the State Treasurer to establish subaccounts within the Fund to precisely identify the sources of payments into and disbursements from the Fund or as required by MFA resolution or indenture of an obligation. The Director could enter into agreements with the MFA or third parties as necessary to issue obligations.

The rate of the Assessment would be determined by the State Treasurer in consultation with the Director. The Assessment rate would be applied to all contributing employers on the taxable wage base limit and could take into account employers' experience rating from the previous year. The Assessment would be sufficient to ensure timely payment of:

1) The principal, interest, and redemption premiums on obligations;
2) Administrative expenses, credit enhancement and termination fees, and any other fees derived from issuing obligations;
3) All other amounts required to be maintained and paid under the terms of a MFA resolution, indenture, or authorizing statute under which obligations are issued; and
4) Amounts necessary to maintain ratings assigned by nationally recognized rating services on obligations at a level determined by the State Treasurer.

The revenue generated by the Assessment is irrevocably pledged to the payment of obligations and administrative expenses and are subject to the pledge and lien described in the MFA resolution, indenture, and authorizing statue under which obligations are issued.

SB 483 (S-1) (S-1) & 484 (S-1) are tie-barred to each other and to SB 806, which reforms several provisions of the Michigan Employment Security Act.

BACKGROUND INFORMATION:

Unemployment benefit payments have significantly increased since the national economic constriction began and, beginning in FY 2008, the amount within the state unemployment trust fund has not been sufficient to support unemployment benefit payments. The state accepted advances from the federal government authorized by Title XII of the federal Social Security Act (42 USC 1321 et seq.), which permits states to receive federal advances to pay unemployment benefits when the state unemployment trust fund does not have sufficient resources. Since FY 2008, the state has sustained outstanding balances of federal advances. Federal advances outstanding at the end of the fiscal year accrue interest (currently 4.0869%) which is due no later than September 30. Interest cannot be paid, directly or indirectly, from money within the states' unemployment trust fund.

The *interest* on federal advances is paid with funds from the state's Unemployment Contingent Fund, Penalty and Interest account which consist of revenue from penalties and damages, interest on contributions, and revenue generated from the Solvency Tax. The Solvency Tax is levied on employers with negative balances (i.e. those who have paid less in unemployment taxes than their former employees have received in unemployment benefits) when the state's unemployment trust fund balance is insufficient to pay outstanding federal advances on June 30. As of June 30, 2010, 29% of employers have negative balances and the maximum Solvency Tax rate is $67.50 per employee. If the amounts generated by the Solvency Tax and within the Contingent Fund are not sufficient to pay the annual interest on federal advances, the state may have to appropriate from the General Fund to support the interest payment.

Payments of the *principal* of federal advances can be made either voluntarily when states have sufficient resources in their unemployment trust funds to repay all or a portion of the outstanding principal or are paid via reductions of federal tax credits under the Federal Unemployment Tax Act (FUTA). As of July 1, 2011, the Federal Unemployment Tax is 6.0% on the first $7,000 earned per employee; compliant employers receive 5.4% in FUTA credits, resulting in an effective FUTA tax rate of 0.6%. However, if a state has outstanding federal advances on January 1 for two consecutive years that have not been paid off by November 10 of the second year, the FUTA credit is reduced 0.3% ($21 per employee) for that second year, payable on the fourth quarter of the following year, and additional 0.3% each year thereafter until the third consecutive year when more substantial credit reductions take effect. These reductions are effective until the outstanding federal advances are paid. In CY 2011, the FUTA credit was reduced by 0.6% for employers in the state. In CY 2012 the FUTA credit reduction will be 0.9% or $63 per employee.

In September, 2011, the Legislature appropriated $38,250,000 from the General Fund to supplement $47,800,000 in Solvency Tax revenue and $20,000,000 in additional Contingent Fund monies to pay $106,000,000 in annual interest on the state's federal advances. As of November 30, 2011, the total outstanding balance of federal advances was $ 3,144,740,063. According to the Treasury Department, interest on federal advances in 2012 will approach $136,000,000 and revenue from the Solvency Tax will fall $79,400,000 short of the required interest payment. This shortfall will have to be made up, and all appropriation from the General Fund for interest must be repaid under the Michigan Employment Security Act (1936 (Ex Sess) PA 1, MCL 421.1-421.75). Between 2012 and 2017, the Treasury estimates, at a 4% rate, approximately $250,000,000 in unfunded interest on federal advances. Each year the federal advances remain outstanding, FUTA credits will be further reduced; the Treasury estimates that between 2012 and 2018, when federal advances are expected to be paid off, total Federal Unemployment Tax collections will total $2,915,000,000.

DETAILED FISCAL IMPACT:

SB 483 (S-1) & 484 (S-1) could have a positive fiscal impact on the state's unemployment trust fund and could reduce the total amount of interest paid by the state. Since SB 483 (S-1) & 484 (S-1) only authorize and do not require the Director to request the MFA to issue bonds to support the unemployment issuance program, it could be assumed that the Director would only request the issuance of bonds if such an issuance engendered a cost savings to the state. SB 483 (S-1) would appropriate $1,000,000 from the General Fund to the MFA for operating expenses and reserve requirements.

Table #1 presents the Treasury Department's projections, updated with outstanding balances of federal advances as of 11/30/11, of the repayment schedule of estimated principal and interest of federal advances. Under this scenario, the state pays off the federal advances sometime in CY 2018 primarily from reductions in the FUTA tax credits on employers, totaling nearly $3,000,000,000. Additionally, in this scenario the state pays approximately $600,000,000 in interest, with an approximate shortfall of $200,000,000 that may have to be supported from the General Fund.

Table #1: Treasury's UTF Projections (in millions)
Assumptions: $9,000 wage base, 20 week benefits, low growth

Calander Year	2012	2013	2014	2015	2016	2017	2018
Beg. Fed Advance Bal.	**-$3,145**	**-$2,946**	**-$2,487**	**-$2,058**	**-$1,531**	**-$859**	**-$99**
State UTF Balance	-$1	$188	$84	$111	$184	$199	$272
FUTA Collections	$200	$271	$345	$416	$488	$561	$634
End Fed Advance Bal.	**-$2,946**	**-$2,487**	**-$2,058**	**-$1,531**	**-$859**	**-$99**	**$807**
Est. Interest Due	$136	$128	$110	$93	$72	$45	$15
Less Solvancy Tax Coll.	$57	$57	$57	$57	$57	$57	$57
Interest Shortfall	**$79**	**$71**	**$53**	**$36**	**$15**	**-$12**	**-$42**

SOURCE: Unemployment Insurance Agency

SB 483 (S-1) & 484 (S-1) authorize the Director to request the MFA to issue bonds to support the unemployment insurance program. Following a request from the Director to issue bonds, the MFA would structure these bonds so to acquire the highest possible credit rating; realistically, an AA-rating. The structuring of bonds by the MFA (the number of bonds to issue, their nominal value, whether sold at or below par, their coupon rate, whether fixed or floating, their maturity date, and various other features) is influenced by numerous economic and financial issues and the objectives of the Director so to maximize proceeds and benefits to the state.

At this point in time, it would be premature to project any of myriad possible bonding scenarios, and financial transactions, that the MFA may pursue given the continuously changing conditions of financial markets. However, any comprehensive analysis would consider how the following implications of issuing bonds to repay federal advances would affect state and federal unemployment taxes and the unemployment trust fund:

1) Effective on January 1 of the year following the year the state pays off its federal advances, the FUTA tax credits would be restored, reducing the FUTA tax to 0.6% (i.e. if the state paid off all of its federal advances in March 2012, the restoration of FUTA tax credits would become effective on January 1, 2014). In 2012 the FUTA tax credit reductions will cost employers $63 per employee.

2) Effective the June 30 following the payoff of its federal advances, the state would cease collecting the Solvency Tax from negative balance employers. In 2012, the Solvency Tax will cost negative balance employers a maximum of $67.50 per employee.

3) In order to pay outstanding bond obligations, the state Treasurer would determine an Obligation Assessment which the Director would collect from employers. The Obligation Assessment would be in addition to required unemployment contributions and sufficient to maintain and afford bond obligations, including administrative and associated costs.

4) Currently, the state pays interest at an annual rate of 4.0869% to the federal government on its federal advances. Varying estimates from the MFA and the UIA place the interest rate (coupon) for bonds issued to support the unemployment insurance program approximately in the range of 2.5% to 3.5%, lower than the rate paid to the federal government. However, it should be noted that:

a. The interest rate paid to the federal government is calculated on the average daily balance of the state's federal advances. That is, interest is only paid on the average amount of federal advances on any given day. As the state pays off its federal advances, the average daily balance decreases, and thus the interest payment is reduced.

b. The interest rate on bonds issued to support the unemployment insurance program would either be fixed or float (i.e. contingent to a benchmark interest rate) and would be paid on the entire principal until the bond matured.

5) Currently, state unemployment contributions collected in excess of benefits disbursed are directed towards repayment of federal advances; if federal advances were paid off with bond proceeds, excess unemployment contributions would constitute substantial reserves within the state's unemployment trust fund.

6) The issuance of bonds by the MFA engenders indeterminate administrative, underwriting, and legal costs.

In summary, if the MFA was to issue bonds to immediately pay off all federal advances, full FUTA tax credits would be restored on January 1 of the following year and collection of the state Solvency Tax would cease on June 30, while an Obligation Assessment would be collected from each employer to pay for the bonds. Interest on bonds issued by the MFA would likely be lower than the interest currently paid to the federal government; however, interest to the federal government is paid on the average daily balance of federal advances which will decrease over time, whereas interest paid on bonds will be paid until the bonds mature.

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