Senate Fiscal Agency
P. O. Box 30036
Lansing, Michigan 48909-7536

BILL ANALYSIS

Telephone: (517) 373-5383
Fax: (517) 373-1986
TDD: (517) 373-0543

Senate Bills 483 and 484 (as enacted)
Sponsor: Senator Mark C. Jansen
Senate Committee: Finance
House Committee: Commerce

PUBLIC ACTS 267 & 268 of 2011

Date Completed: 1-4-12

CONTENT

Senate Bill 483 created the "Employment Security Financing Act" to permit the Michigan Finance Authority to issue bonds in order to repay Federal advances to State's Unemployment Trust Account, avoid additional advances, pay unemployment benefits before January 1, 2014, and provide reserves to minimize the impact on unemployment insurance tax rates.

The bill also appropriated $1.0 million from the General Fund to the Authority to pay its operating expenses and fund reserve requirements.

Senate Bill 484 amended the Michigan Employment Security Act to:

-- **Permit the Department of Licensing and Regulatory Affairs (LARA) to request the Michigan Finance Authority to issue obligations in order to repay Federal advances and fund unemployment benefits, and for related purposes.**
-- **Create the "Obligation Trust Fund".**
-- **Require employers to pay an unemployment obligation assessment, which will be deposited in the Fund.**
-- **Require LARA to spend money from the Fund for the payment of obligations and expenses, and for the same purposes as proceeds of the obligations.**

The bills took effect on December 19, 2011.

The bills were tie-barred to each other and Senate Bill 806 (Public Act 269 of 2011). (That bill amended the Michigan Employment Security Act with respect to employers' contributions; claimants' eligibility for benefits and disqualifications; penalties; and responsibilities of the Unemployment Insurance Agency.)

Senate Bill 483

Michigan Finance Authority

The exercise of powers by the Michigan Finance Authority under the Employment Security Financing Act is in addition to any other powers conferred on the Authority by law, including Executive Reorganization Order (ERO) 2010-2 (which created the Authority).

The Authority must exercise its duties under the Act through its board of directors, as provided in the ERO.

The property of the Authority and its income and operations are exempt from taxation by the State or any political subdivision of the State.

Unemployment Trust Account Bonds

The Authority may issue bonds in amounts it determines necessary to provide funds for its authorized purposes under the Act, including all of the following:

-- Reducing or avoiding the need for the State to borrow or obtain a Federal advance to Michigan's Unemployment Trust Account within the Federal Unemployment Trust Fund.

-- Repaying principal and interest on unpaid advances to the Unemployment Trust Account.
-- Funding the minimum amount necessary to pay unemployment benefits without advances or loans from the Federal government before January 1, 2014.
-- Paying unemployment benefits before January 1, 2014.
-- Paying or providing for financing costs.
-- Providing sufficient reserves under an indenture or under Federal unemployment insurance laws, rules, regulations, or guidance as necessary to minimize the impact on unemployment insurance tax rates.

("Bond" means a bond, note, financial instrument, or other evidence of indebtedness or obligation issued by the Authority under the Act.)

The board of the Authority may authorize a bond issue by resolution, and without the consent of any department, commission, board, bureau, or agency of the State. The bonds will be payable upon the terms and conditions specified by the Authority. The Authority may sell the bonds in the manner determined by its board at public or private sale and on a competitive or negotiated basis.

As it determines necessary or appropriate, the Authority may enter into, amend, or terminate any ancillary facility for the purpose of facilitating the issue, sale, purchase, or payment of bonds, or the making or performance of swap contracts; or attempting to hedge risk or achieve a desirable effective interest rate or cash flow. (The definition of "ancillary facility" includes various types of agreements, such as a revolving credit agreement, investment agreement, or float agreement; insurance contract; surety bond; or any other contract or agreement or other security agreement approved by the Authority under the Act.)

In the Authority's discretion, any bond and any ancillary facility may be secured by a trust agreement or trust indenture between the Authority and a trustee.

A bond issued under the Act is not subject to the Revised Municipal Finance Act, but is subject to the Agency Financing Reporting Act.

A bond or ancillary facility issued under the Employment Security Financing Act is not a debt or liability of the State or any agency of the State, other than the Authority, and does not constitute a pledge of the faith and credit of the State.

If the Authority intends the interest on its bonds to be exempt from Federal income tax, it must prescribe restrictions on the use of the proceeds of those bonds and related matters as necessary to assure the exemption.

Limitation on Bonds

Bonds issued under the Act are limited to the principal amount necessary to satisfy the State's obligations to the Federal government for advances or loans from the Federal account of the Unemployment Trust Fund, to pay unemployment benefits before January 1, 2014, and to pay financing costs, reserves, coverage required for financing, and reimbursement for advances made by the State to pay a portion of its obligations on or before December 31, 2013.

This limitation does not apply to or preclude issuing bonds to refinance or refund bonds issued under the Act on or before that date.

Board Members, Officers, & Employees

A member of the board or an officer, appointee, or employee of the Authority is not subject to personal liability when acting in good faith within the scope of his or her authority under the Act or on account of any liability of the Authority.

A member, officer, employee, or agent of the Authority may not have an interest in any business organization engaged in any business, contract, or transaction with the Authority or in any contract of any other person engaged in any business with the Authority, or in the purchase, sale, lease, or transfer of any property to or from the Authority.

Appropriation

In addition to any other appropriations provided by law, the Act appropriated $1.0 million from the State's General Fund to the Authority for the 2011-12 fiscal year for the following purposes:

-- Payment of operating expenses of the Authority.
-- Funding any reserve requirements.

Money not spent before the end of the 2011-12 fiscal year will not revert to the General Fund, and the Authority may retain and use the money for these purposes.

Other Provisions

The State, all political subdivisions of the State, governmental pension funds, financial institutions, fiduciaries, and anyone authorized to invest in bonds or other obligations of the State, may legally invest funds in any bond issued by the Authority.

Any legal action against the Authority seeking money damages must be brought in the Court of Claims for the State. Any other legal action against the Authority must be brought in the Michigan Court of Appeals.

Legislative Findings & Declarations

The Act states the following:

-- "It is an essential governmental function to maintain funds in an amount sufficient to pay unemployment benefits when due."
-- "At the time of the enactment of this act, unemployment benefits are made from Michigan's account in the unemployment trust fund of the United States treasury and are funded by employer contributions."
-- "At the time of the enactment of this act, borrowing from the federal government through loans from the federal unemployment trust fund is the only option available to obtain sufficient funds to pay benefits when the balance in Michigan's account…is insufficient to make necessary payments."
-- "Alternative methods of replenishing this state's account…may reduce the costs of providing unemployment benefits and employers' cost of doing business in the state."
-- "It is in this state's best interests to authorize the issuance of bonds when appropriate for the purpose of continuing the unemployment insurance program at the lowest possible cost to this state and employers in this state and to avoid reductions in the employer unemployment tax credit."
-- "Execution by the authority of its powers granted under this act fulfill[s] in all respects an essential governmental function and public purpose…".

Senate Bill 484

Financing; Employer Assessments

The bill added Section 26a to the Michigan Employment Security Act to allow the LARA Director to request the Michigan Finance Authority to issue notes, bonds, financial instruments, or other evidences of indebtedness, whose proceeds may be used for any of the following purposes:

-- To finance, refinance, refund, or advance refund any payment required or obligation arising under Section 26a or under 42 USC 1321 and 1322 (described below).
-- To repay amounts owed or to be owed to the U.S. Treasury resulting from advances made to the State by the Federal government under Federal law, including 42 USC 1321, plus interest.
-- To reimburse funds advanced or loaned by the State to the Unemployment Trust Fund (UTF) and used to make any payment required or obligation described in Section 26a or 42 USC 1321.
-- To reimburse funds advanced or loaned by the UTF to the Obligation Trust Fund and used to pay obligations of the Michigan Finance Authority.
-- To fund unemployment compensation benefits and the State's account within the Federal UTF, including balances in that account.
-- To fund capitalized interest, debt service reserve funds, and payment of costs of, and administrative expenses connected with, issuing obligations.

The bill defines "obligation" as a note, bond, financial instrument, or other evidence of indebtedness issued as provided in Section 26a.

(Sections 1321 and 1322 of Title 42 of the United States Code pertain to advances to states from the Federal Unemployment Trust Fund. Section 1321 contains eligibility criteria, application requirements, and limits on the amount that may be transferred. Section 1322 provides for repayment by a state from its account, and requires interest on advances, subject to certain exceptions.)

Section 26a also requires an employer, in 2011 and each subsequent year in which an obligation is outstanding, to pay an unemployment obligation assessment. The assessment must be collected quarterly and be deposited to the credit of the Obligation Trust Fund. The assessment is in addition to the employer's required contributions, is not subject to the limiting provisions for contributions required under the Act, and is in addition to and separate from the solvency tax imposed on employers.

The State Treasurer must determine the assessment rate after consulting with the LARA Director. The rate must be an amount sufficient to ensure timely payment of all of the following:

-- Principal, interest, and any redemption premium on the obligations.
-- Administrative expenses, credit enhancement and termination fees, and other fees, if any, in connection with issuing the obligations.
-- All other amounts required to be maintained and paid under the terms of a resolution, indenture, or authorizing statute under which the obligations are issued.
-- Amounts necessary to maintain the ratings on the obligations assigned by a nationally recognized rating service at a level determined by the State Treasurer.

The obligation assessment rate may take into account an employer's experience rating from the previous year. The rate must be applied against the taxable wage limit and be assessed against all contributing employers.

The assessment will be due at the same time, collected in the same manner, and subject to the same penalties and interest as contributions assessed under the Act.

The LARA Director must administer and cause the obligation assessments to be collected.

Obligation Trust Fund

The bill creates the Obligation Trust Fund as a separate fund in the State Treasury. The assets of the Fund may not be commingled with any other fund or considered part of the State's General Fund.

The State Treasurer may receive money or other assets from any source for deposit into the Fund. The following must be deposited into the Fund:

-- All obligation assessments on employers collected under Section 26a.
-- All interest on payments, penalties, and damages collected in connection with the obligation assessments.
-- A portion of the proceeds of any obligations, as described in Section 26a, in amounts specified by the issuer.

The State Treasurer must direct investment of the Fund, and credit to it interest and earnings from Fund investments. For auditing purposes, LARA must be the administrator of the Fund.

Money in the Fund at the close of the fiscal year must remain in the Fund and not lapse to the General Fund. Money in the Fund is continuously appropriated for the purposes specified in Section 26a.

The Department may spend money from the Fund only for the following purposes:

-- To pay obligations, administrative assessments, and associated expenses described in Section 26a.
-- To refund erroneously collected assessments under that section.
-- For any other purpose described in Section 26a(1) (which lists the purposes for which proceeds of obligations may be used).

The LARA Director may request the State Treasurer to establish additional special subaccounts within the Obligation Trust Fund for the purpose of identifying more precisely the sources of payments into and disbursements from the Fund, or as required under the resolution or indenture authorizing the obligations.

Legislative Findings

The bill states the following:

"The legislature finds that from time to time high levels of unemployment have resulted in the exhaustion of the funds in this state's account of the unemployment trust fund, has [sic] required advances or loans to the state from the federal account of the unemployment trust fund, and has [sic] caused the imposition of lawful penalty taxes and solvency taxes to repay those advances and the interest on those advances. The financing and payment of the outstanding principal amount…advanced or loaned to the state from the federal account of the unemployment trust fund and the interest on those loans, if any, the funding of unemployment compensation benefits, and the financing and funding of this state's account in the unemployment trust fund…, are an essential governmental function and public purpose of this state. The legislature further finds that the issuance of bonds by the Michigan finance authority or other issuer to finance the foregoing payments and to avoid or reduce the imposition of penalty taxes and solvency taxes will further and facilitate an essential governmental function and public purpose of this state that will encourage the development of industry and commerce, foster economic growth, provide employment opportunities…and further other economic development activities in this state..."

MCL 12.271-12.294 (S.B. 483)
421.2 et al. (S.B. 484)

Legislative Analyst: Suzanne Lowe

FISCAL IMPACT

The bills will have an overall positive fiscal impact on the State's finances. The bills allow the Michigan Finance Authority (MFA) to issue bonds to pay for Title XII, Social Security Administration advances used for paying unemployment insurance benefits. The MFA also may issue bonds to pay for future unemployment insurance liabilities that the Unemployment Compensation Fund cannot cover. Any principal and interest costs from these bonds will be paid by an unemployment obligation assessment levied by the State Treasurer on Michigan employers on the first $9,500 of wages paid to employees. The level of this assessment will be determined by the State Treasurer, and will be set to raise revenue sufficient for servicing any bonds issued under the bills.

Before bonds were issued under the authority provided in these bills, Michigan owed about $3.2 billion in Title XII balances. This debt was being repaid by Federal Unemployment Tax Act (FUTA) tax collections. The FUTA tax is levied on employers by the Federal government on the first $7,000 in annual wages. The nominal rate of this tax is 6.2% with a 5.4% credit, yielding a net tax rate of 0.8%. However, the FUTA tax credit for Michigan employers has been reduced in recent years due to Michigan's Title XII balance. For each fiscal year a state carries a Title XII advance forward, its FUTA credit is reduced by 0.3%. For tax year 2011 (payable by employers in 2012), Michigan's FUTA credit will be reduced by 0.9%, yielding a net tax rate of 1.7% or about $119 per employee. Additionally, Title XII advances accrue interest at a rate of approximately 4.1% per year. The funding mechanism for these interest costs is the solvency tax, which is paid by employers with a negative unemployment insurance experience account balance (meaning their former employees have received more unemployment insurance benefits than the employers have paid in State Unemployment Tax Act (SUTA) taxes). In FY 2010-11, the solvency tax raised approximately $47.3 million, while the total amount of Title XII interest owed was approximately $106.0 million, leaving a shortfall of $58.7 million. An even larger shortfall of $69.4 million was expected for FY 2011-12.

General Fund revenue and an available balance in the Contingent Fund – Penalty and Interest Account were used to pay the $58.7 million solvency tax shortfall in FY 2010-11. Of this, $38.25 million was from the General Fund. Without legislative action, the General Fund would have likely been used in subsequent fiscal years to pay these shortfalls, as shown in Table 1. The bonds issued under the bills will prevent General Fund revenue from being needed to pay future interest payment shortfalls, and the General Fund money used in FY 2010-11 was repaid as well.

Table 1 shows Michigan's prior progress in repaying its Title XII advances, using projections from the Unemployment Insurance Agency (UIA). Title XII balance figures from these projections were updated to account for newer Title XII balance information. The bonds that were issued on December 28, 2011, were short-term bonds bearing 0.24% interest. A press release from the Michigan Finance Authority indicates that these bonds will be refinanced in January 2012 as 10-year bonds. It is likely that when the bonds are refinanced the interest rate will increase by an unknown amount. As of January 4, 2012, the AA-rated 10-year composite municipal bond rate was about 2.0%, so it is likely that the interest rate on these bonds will be around 2.0% when they are refinanced. The figures in Table 2 assume a 2.0% interest rate and bonds that are fully amortized.

Table 1

Title XII repayment projections (in millions)

Calendar Year	2012[a]	2013	2014	2015	2016	2017	2018	Totals
Beg. Title XII Bal.	$3,161	$2,962	$2,503	$2,074	$1,547	$875	$115	$N/A
Net SUTA	(1)	188	84	111	184	199	272	1,037
FUTA Collections	200	271	345	416	488	561	634	2,915
End Title XII Bal.	2,962	2,503	2,074	1,547	875	115	0	N/A
Est. Interest Due	126.4	118.5	100.1	83.0	61.9	35.0	4.6	529.5
Est. Solvency	57.0	57.0	57.0	57.0	57.0	57.0	57.0	399.0
Interest Shortfall	69.4	61.5	43.1	26.0	4.9	(22.0)	(52.4)	130.5

[a]Michigan's Title XII balance as of November 4, 2011, was $3,161,437,019. This was used as the beginning balance for calendar year 2012. The actual balance could be higher or lower.

Table 2

10-year Bond to Repay Title XII Loans (in millions)[1]

Calendar Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Totals
Debt Payment	$352	$352	$352	$352	$352	$352	$352	$352	$352	$352	$3,520
FUTA Collections	200	186	186	186	186	186	186	186	186	186	1,874
Est. Interest Due	0	0	0	0	0	0	0	0	0	0	0
Est. Solvency	0	0	0	0	0	0	0	0	0	0	0

[1]A 2.0% interest rate was used in these calculations; this rate was obtained using average current yield on 10-year AA-rated municipal bond.

Making a comparison of these repayment schemes is somewhat difficult. One of the primary reasons is that the former (non-bonding) repayment scheme used net SUTA tax revenue to assist with repaying Title XII loans. Net SUTA tax revenue is the SUTA revenue left over after UI benefit obligations are paid for the year. Because bonds are now being used to fully repay the Title XII advances in the scenarios from Table 2, it is not necessary to use net SUTA revenue for this purpose, and at the end of repayment of the bonds, the Unemployment Compensation Fund (UCF) should be left with a substantial balance. Under the former repayment milieu, a relatively small UCF balance would have been left when repayment was finished. Having a larger UCF balance reduces the likelihood of future borrowing to pay unemployment insurance benefit obligations.

Another difficulty in comparing the two scenarios is the treatment of FUTA tax collections. Regardless of what happens to Michigan's Title XII balance, there will always be some level of FUTA collections; therefore, to do a marginal analysis of these repayment schemes, a baseline amount of FUTA collections must be subtracted from each scenario's assumed FUTA collections.

Finally, Senate Bill 483 appropriated $1.0 million in GF/GP revenue to the MFA for the administration of the Act. Any unused appropriations will not lapse at the end of the fiscal year and will be available for administrative expenses in future years.

Fiscal Analyst: Josh Sefton

S1112\s483es