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 Bill 483 (Substitute S-2 as passed by the Senate)
Senate Bill 484 (Substitute S-1 as passed by the Senate)
Sponsor: Senator Mark C. Jansen
Committee: Finance

Date Completed: 12-5-11

CONTENT

Senate Bill 483 (S-2) would create 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, fund a surplus in the Account, and provide reserves to minimize the impact on unemployment insurance tax rates.

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

Senate Bill 484 (S-1) would amend 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 would 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 are tie-barred to each other and Senate Bill 806. (That bill would amend 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 (S-2)

Michigan Finance Authority

The exercise of powers by the Michigan Finance Authority under the proposed Act would be 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 would have to 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 would be exempt from taxation by the State or any political subdivision of the State.

Unemployment Trust Account Bonds

The Authority could issue bonds in amounts it determined necessary to provide funds for its authorized purposes under the proposed 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 (UTF).
-- Repaying principal and interest on unpaid advances to the Unemployment Trust Account.

-- Funding a surplus in the Unemployment Trust Account.
-- Paying unemployment benefits.
-- 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" would mean a bond, note, financial instrument, or other evidence of indebtedness or obligation issued by the Authority under the Act.)

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

As it determined necessary or appropriate, the Authority could 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 proposed 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 proposed Act.)

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

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

A bond or ancillary facility issued under the proposed Act would not be a debt or liability of the State or any agency of the State, other than the Authority, and would not constitute a pledge of the faith and credit of the State.

If the Authority intended the interest on its bonds to be exempt from Federal income tax, it would have to 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 proposed Act would be 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, and to fund a surplus in the State's account within the Federal UTF, including 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 would 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 would not be subject to personal liability when acting in good faith within the scope of his or her authority under the proposed Act or on account of any liability of the Authority.

A member, officer, employee, or agent of the Authority could 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 bill would appropriate $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 would not revert to the General Fund, and the Authority could 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, could legally invest funds in any bond issued by the Authority.

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

Legislative Findings & Declarations

The bill 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 (S-1)

Financing; Employer Assessments

The bill would add 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 could 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 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.

"Obligation" would mean 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 would require an employer, in 2011 and each subsequent year in which an obligation was outstanding, to pay an unemployment obligation assessment. The assessment would have to be collected quarterly and be deposited to the credit of the Obligation Trust Fund. The assessment would be in addition to the employer's required contributions, would not be subject to the limiting provisions for contributions required under the Act, and would be in addition to and separate from the solvency tax imposed on employers.

The State Treasurer would have to determine the assessment rate after consulting with the LARA Director. The rate would have to 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 were 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 could take into account an employer's experience rating from the previous year. The rate would have to be applied against the taxable wage limit and be assessed against all contributing employers.

The assessment would 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 would have to administer and cause the obligation assessments to be collected.

Obligation Trust Fund

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

The State Treasurer could receive money or other assets from any source for deposit into the Fund. The following would have to be deposited into the Fund:

-- All obligation assessments on employers collected under proposed 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 would have to direct investment of the Fund, and credit to it interest and earnings from Fund investments. For auditing purposes, LARA would be the administrator of the Fund.

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

The Department could 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 could be used).

The LARA Director could 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 421.2 et al. (S.B. 484)

Legislative Analyst: Suzanne Lowe

FISCAL IMPACT

The bills would have an indeterminate fiscal impact on the State's finances. The bills would 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 could issue bonds to pay for future unemployment insurance liabilities that the Unemployment Compensation Fund could not cover. Any principal and interest costs from these bonds would be paid by an unemployment obligation assessment levied by the State Treasurer on Michigan employers on the first $9,000 of wages paid to employees. The level of this assessment would be determined by the State Treasurer, and would be set to raise revenue sufficient for servicing any bonds issued under the bills.

While the bills would allow the MFA and the Department of Licensing and Regulatory Affairs to bond to pay for the expenses described above, the bills would not require them to do so. The current system of borrowing from the Federal government and using Federal Unemployment Tax Act (FUTA) taxes to pay the principal of these loans and the solvency tax to pay the interest would still be possible if bonding turned out to be a more expensive option. This flexibility would apply only to the initial decision to finance Michigan's current Title XII balance and future potential Title XII borrowing. If the MFA and LARA decided to finance Michigan's current Title XII balance, those bonds would have to be serviced until they were paid in full or refinanced; no mechanism would exist to move a bond balance back to a Title XII advance, even if such a move were financially advantageous.

Currently, Michigan owes about $3.2 billion in Title XII balances. This debt is being repaid by 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 is expected for FY 2011-12.

The bills would allow the MFA to issue bonds to pay for this shortfall, or to repay the Title XII balance in its entirety. Table 1 shows Michigan's current 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. Tables 2 and 3 show two of the potential bonding scenarios compared with UIA projections under current law. The assumptions made in assembling the tables are as follows: a 5- or 10- year repayment window, a $3.161 million Title XII balance, and bonds that are fully amortized.

Table 1
Current 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
5-year Bond to Repay Title XII Loans (in millions)[1]

Calendar Year	2012	2013	2014	2015	2016	Totals
Debt Payment	661	661	661	661	661	3,305
FUTA Collections[2]	200	186	186	186	186	944
Est. Interest Due	0	0	0	0	0	0
Est. Solvency	0	0	0	0	0	0

[1]A 1.5 % interest rate was used in these calculations; this rate was obtained using average current yield on 5-year AA-rated municipal bond.
[2]Assumes FUTA credit will remain reduced for tax year 2011 (payable in 2012) and then will be restored.

Table 3
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	356	356	356	356	356	356	356	356	356	356	3,560
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 2.2% 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 the three scenarios above is somewhat difficult. One of the primary reasons is that the current repayment scheme uses net SUTA tax revenue to assist with repaying Title XII loans. Net SUTA tax revenue is the SUTA revenue left over after paying UI benefit obligations for the year. Because bonds are used to fully repay the Title XII advances in the scenarios from Tables 2 and 3, it is not necessary to use net SUTA revenue for this purpose, and at the end of repayment in the bonding scenarios, the Unemployment Compensation Fund (UCF) would be left with a substantial balance. Under the current repayment milieu, a relatively small UCF balance will be left when repayment is finished. Having a larger UCF balance reduces the likelihood of future borrowing to pay unemployment insurance benefit obligations.

Another difficulty in comparing the three 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 (S-2) would appropriate $1.0 million in GF/GP revenue to the MFA for the administration of the Act, and any unused appropriations would not lapse at the end of the fiscal year and would be available for administrative expenses in future years.

Fiscal Analyst: Josh Sefton

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