South Dakota Department of Labor
Unemployment Insurance Advisory Council
2005 Annual Report

This document serves as the report of meetings, discussions, and recommendations of the Unemployment Insurance Advisory Council, pursuant to SDCL 61-2-7.1. Council members appointed by Governor Rounds include Secretary of Labor Pam Roberts (chair), Carol Hinderaker, Robert Anderson, David Owen, Paul Aylward, Jason Dilges, Jerry Wheeler, Homer Harding, and Mark Merchen. The report is available to any interested person or groups and can be found on the Department of Labor website at www.sdjobs.org.

The South Dakota unemployment insurance trust fund was relatively stable in the decade prior to 2001, with benefit payments to unemployed workers being about equal to revenue from employer taxes and trust fund interest. In the past five years, however, benefits paid have exceeded normal revenue because benefit levels are tied to wage inflation and increase each year, while income to the trust fund and other triggers do not have automatic inflation factors and have remained stagnant.

The current unemployment insurance system was designed with the assumption that adjustments would need to be made periodically. In 2004, the Council adopted financial estimates which projected a continued decline in the Unemployment Insurance Trust Fund. The trust fund balance was estimated to drop to very low levels by the end of 2007 and become insolvent by 2008. Details about historical financial trends can be found in the 2004 report, available online at www.sdjobs.org.

The 2004 Council decided to recommend a combination of short-term and longer-term strategies to address problems with the unemployment insurance system. The longer term strategies and solutions required more analysis and will be reflected in this 2005 Report. The 2004 Council recommended short-term strategies to quickly address specific system inequities and begin the public dialogue on the unemployment insurance trust fund trends and the need for future adjustments. The Council advocated three short-term solutions, which were passed by the 2005 legislature in House Bill 1228 and became law effective July 1, 2005. The specific changes were:

> INTEREST INCOME: The state UI trust fund is held in the US Treasury and earns interest income. Income in 2004 was $1.8 million. This income was pro-rated and added to the accounts of all employers who have money in the fund. HB 1228 eliminated the interest credit to employers and increased revenue to the trust fund by about $700,000 a year.
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> NON-CHARGED BENEFITS: In certain circumstances set in statute, benefits are paid from the trust fund but not charged to the account of the former employer. In 2004, there were $4.5 million in UI benefit payments in this non-charged category. Fifty percent of these non-charged benefits were pro-rated back to the accounts of all employers.

There was no system to pay the other 50 percent, which were deducted from the trust fund as an unfunded expense. HB 1228 directed that 100 percent of non-charged benefits be pro-rated to employer accounts and increased revenue to the trust fund by about $700,000 a year.

TAX SURCHARGE BASED ON FUND BALANCE: South Dakota law has a provision requiring that an additional surtax be added to the tax rate of all employers in certain situations. The tax begins at 0.1 percent when the fund is less than $11 million and increases with lower fund balances. Prior to July 1, 2005, the surtax triggered on or off based only on the fund balance on the last day of the year. The trigger amount had not changed since 1961, and benefit payments had increased to the point that the trust fund could become insolvent during the calendar year even if the surtax were in effect. House Bill 1228 required the surtax trigger amount be determined quarterly, rather than annually, and would remain in effect until the trust fund balance is at least 150 percent of the trigger amount.

Council activity for 2005 began with an organizational meeting on April 14, 2005. Action Issues were identified for the 2005 report which included long term strategies to resolve major system issues over the coming years, as outlined in the 2004 Council Report. A public hearing was noticed and held on June 2, 2005, where the Council received public testimony on the issues under consideration for 2005. A copy of the complete public hearing transcript, as well as minutes from all Council meetings, is available for review on the Department of Labor website. In addition to the public hearing, Department of Labor Unemployment Insurance Division staff and Council members scheduled and participated in numerous meetings across the state with negative account balance employers to share information about problems with the current system and receive their comments and suggestions.

The August 18, 2005, meeting began with a review of current financial estimates. The Council approved the following financial assumptions: that benefit payments would drop slightly to $27.9 million in 2005, and the fund would have an $18 million balance at the end of 2005; that benefit payments would be $28.1 million in 2006, and the trust fund balance be $11 million at the end of 2006; (Attachments A & B) and that if no adjustments are made to the system prior to March 31, 2007, the trust fund balance will drop to $4.7 million on that date, and a surtax on all employers will be implemented. The trust fund balance typically drops to its lowest point during the first quarter of the year because winter layoff benefits are being paid out of the fund during that quarter.

The Council also adopted a long-term target amount of $45 million as the adequate unemployment insurance trust fund balance. The Council requested models of the impact of various changes in the taxable wage base and the maximum tax rate. They also requested estimates of the impact of pro-rating currently unfunded benefits back to the tax accounts of all employers. These are the amounts paid to former employees of firms that have closed and no longer pay taxes, and benefits paid to employees of firms at the maximum tax rate, to the degree that benefits exceed tax payments.

Finally, they requested information on the impact of charging interest to employers that have a negative balance in their unemployment accounts.

At their September 9, 2005, meeting the Council received estimates of the impact of the following changes:

- Raising the taxable wage base from $7,000 to $15,000 in increments of $1,000
- Raising the maximum tax rate from seven to 20 percent in one percent increments
- Four combinations of tax rate and wage base increases
- Impact of tax base/tax rate changes on a per employee basis
- Impact of pro-rating unfunded benefits to all employers
- Impact of charging interest to negative account balance employers

After reviewing the information and estimates, the Council voted to recommend adjustments to the unemployment insurance system which would gradually be implemented over the coming months and years to allow employers time to prepare for the changes. Recommendations were made on the following issues:

Issue #1: Wage Base

Summary: The wage base is the amount of wages on which the UI tax is paid. Current law sets the wage base at $7,000, where it has been fixed since 1983. This fixed amount creates a structural imbalance in the system because benefits are based on income which inflates each year because the maximum weekly benefit is 50 percent of the average weekly wage. A review of neighboring states shows that South Dakota wage base is significantly lower. (Attachment C)

Council Action: The Council voted to recommend the wage base be gradually adjusted upward over the coming months and then indexed to wage inflation. The Council recommends the Governor and Legislature adjust the unemployment system during the 2006 Legislative session by increasing the taxable wage base from $7,000 to $8,500 in 2007; increasing the taxable wage base from $8,500 to $10,000 in 2008; and, indexing the wage base to the growth in wages beginning in 2009 to match the growth in benefits each year.

Issue #2: Negative Account Employers

Summary: The state of South Dakota uses an experience rating system to assign tax rates to employers. In general terms, the system compares past tax payments to wages paid by the employer, and a tax rate is assigned which can range from zero to seven percent. A major problem is an inequity in the system because certain employers and industries pay significantly less in taxes than their workers receive in benefits. Even though an average worker receives about $2,600 on a claim for benefits, the maximum tax an employer is asked to pay on that worker is $490. Some employers have negative accounts because benefits paid to former employees consistently exceed the employer tax payments.

This imbalance reduces assets in the State trust fund which, in turn, reduces interest income earned by the fund.

Council Action: The Council voted to recommend the maximum tax rate be gradually adjusted upward over the coming months so the largest users of the system pay more of the costs of the system. The Council recommends the Governor and Legislature adjust the unemployment system during the 2006 Legislative session by increasing the maximum tax rate from 7 percent to 8.5 percent in 2007 and the maximum rate from 8.5 percent to 10 percent in 2008.

The Council further voted to recommend an additional interest charge be levied against employer accounts which have been negative for more than two years. The two year period would start on January 1, 2007. Any negative balance accrued before January 1, 2007, would be disregarded, for purposes of charging interest, to allow employers time to prepare for the change. Beginning January 1, 2009, an interest penalty would be charged annually against any account which has been negative for 24 consecutive months. The interest rate charged would be the same rate the US Department of Labor pays on trust fund assets. (4^{th} Quarter 2004 rate was 5.4 percent.)

Issue #3: Surtax on all employers

Summary: Current law contains a provision whereby an additional surtax be added to the tax rate for all employers in certain situations. The current surtax begins at 0.1 percent when the fund is less than $11 million at the end of any quarter and increases with lower fund balances. Once triggered on, the surtax remains in effect until the trust fund reaches a $16.5 million balance at the end of any quarter.

Council Action: The Council voted to recommend the surtax trigger amount be reduced downward over the coming months to eliminate a surtax becoming effective while 2006 legislation is allowed to address system problems. The Council recommends the Governor and Legislature adjust the unemployment system during the 2006 Legislative session by temporarily reducing the surtax trigger amount from $11 million to $2 million for 2006, 2007, and 2008 because a clear mechanism to rebuild the trust fund would be in place. The trigger amount would return to $11 million in 2009 and beyond.

Issue # 4: Reserve Ratios

Summary: Reserve ratios are the mechanism used in the experience rating system to assign tax rates to individual employers. An account balance is maintained for each employer and tax payments credited to that account are used to fund benefits for their workers. The reserve ratio measures the balance (reserve) in each employer's account compared to their taxable payroll for the prior three years. State law contains a schedule of 26 reserve ratios and associated tax rates. The reserve ratios have not changed since 1993, even though potential benefits have increased significantly through growth in wage levels.

Council Action: The Council voted to recommend that reserve ratios be changed to require a higher reserve for the tax rates assigned to positive balance employers. This would increase employer account balances and provide additional resources to fund benefits to workers. Building a bigger reserve in employer accounts would reduce the risk that claim payments would deplete the employer account balance, resulting in the significantly higher rates assigned to negative account employers. A zero percent tax rate would still be available if the employer paid sufficiently more into the system than they have cost the system. The Council also voted to increase the tax rates for the reserve ratios that apply to employers that have negative balances in their accounts.

Issue # 5: Social Security and Unemployment Offset

Summary: Current law requires that pension income be deducted from UI payments if the employer paying the claim also paid into the pension. The amount of the pension deducted is the share funded by the employer. Fifty percent of the Social Security benefit is also deducted from all claims because employers pay 50 percent of the premium. Eliminating the current deduction would increase benefit payments by about $500,000.

Council Action: In 2004 a Council motion to support 2006 legislation to eliminate the current deduction of Social Security benefits failed on a 1 yea to 7 nay roll call vote because members did not want to drain further assets from the trust fund until a long-term solution could be enacted and implemented. No further action on this issue was recommended or taken in 2005.

Issue # 6: DOL Administrative Rules

Summary: The Department of Labor has administrative rules which provide the detailed procedures to implement laws covering unemployment insurance benefits. These rules need periodic review to insure the program meets the needs of employers and workers, adapts to changes in the economy and the labor market, and maintains the integrity of the unemployment insurance system.

Council Action: The Council recommends Department of Labor administrative rules concerning the requirement that unemployed workers seek other employment as a condition of receiving benefits be reviewed and revised.

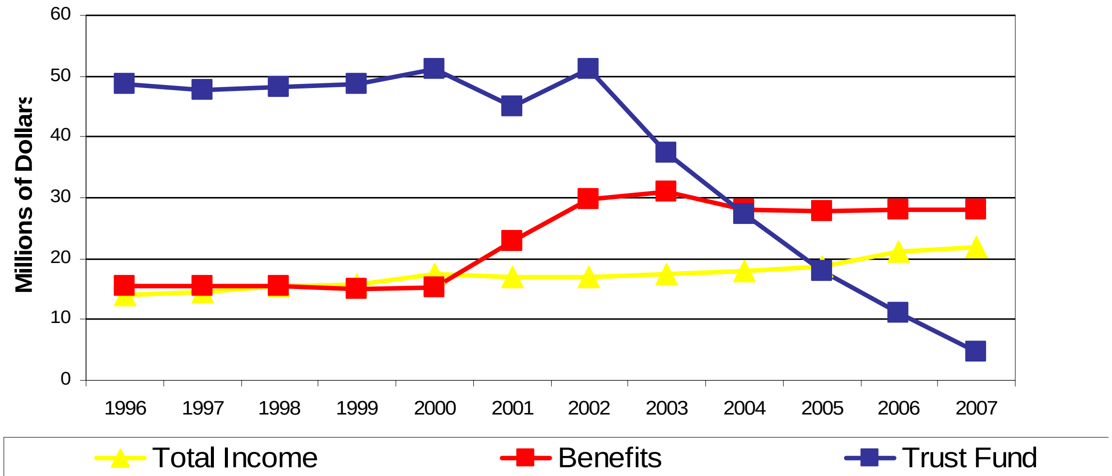
Attachments D, E, and F show the projected financial trends of the unemployment insurance trust fund if Council recommendations are fully implemented during the 2006 legislative session.

Respectfully submitted on October 5, 2005, by the Unemployment Advisory Council Members:

Pamela S. Roberts	Carol Hinderaker
Robert Anderson	David Owen
Paul Aylward	Jason Dilges
Jerry Wheeler	G. Homer Harding
Mark Merchen	

Attachment A

Unemployment Insurance Projections
Level Benefits



Attachment B

Unemployment Insurance Projections
Level Benefits (In Millions)

YEAR	Total Income	Benefits	Trust Fund
1996	14.0	15.6	48.6
1997	14.5	15.5	47.7
1998	15.5	15.4	48.1
1999	15.8	15.1	48.7
2000	17.5	15.2	51.1
2001	16.9	22.8	45.1
2002	17.0	29.8	51.2
2003	17.5	31.0	37.4
2004	18.0	28.1	27.3
2005	18.6	27.9	18.0
2006	21.1	28.1	11.0
2007	21.8	28.1	4.7

Attachment C

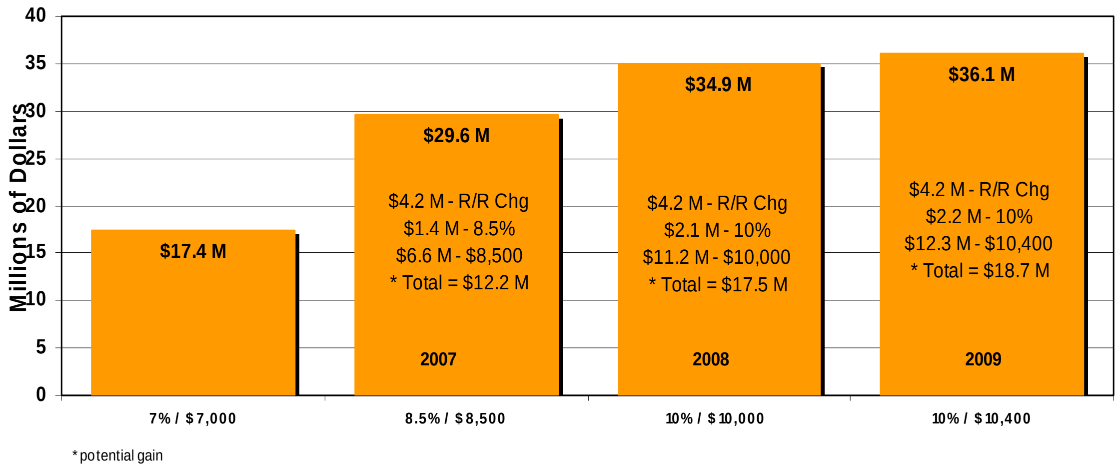
Bordering States' Wage Base

	Wage Base *
IOWA	$20,400
MINNESOTA	$23,000
MONTANA	$21,000
NEBRASKA	$7,000
NORTH DAKOTA	$19,400
WYOMING	$16,400
SOUTH DAKOTA	**$7,000**

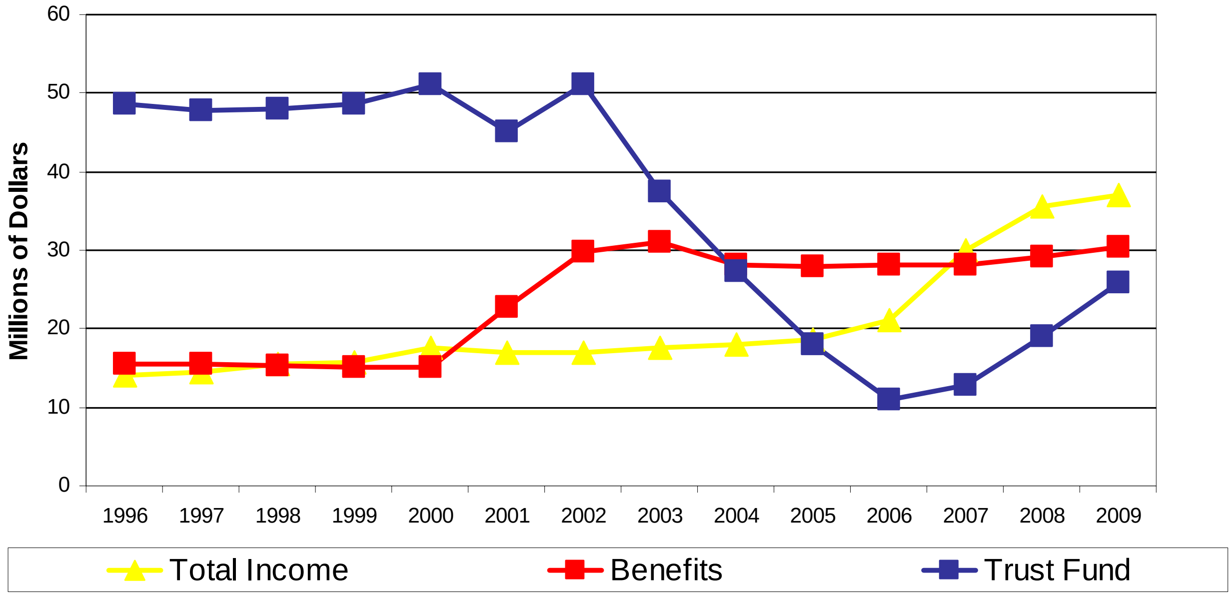
* As of 7/2005

Attachment D

Unemployment Insurance Revenue Estimates – Changes to Maximum Rate / Wage Base / Reserve Ratios



Unemployment Insurance Projections
Level Benefits



Attachment F

Unemployment Insurance Projections
Level Benefits (In Millions)

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1996	14.0	15.6	48.6
1997	14.5	15.5	47.7
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1999	15.8	15.1	48.7
2000	17.5	15.2	51.1
2001	16.9	22.8	45.1
2002	17.0	29.8	51.2
2003	17.5	31.0	37.4
2004	18.0	28.1	27.3
2005	18.6	27.9	18.0
2006	21.1	28.1	11.0
2007	29.9	28.1	12.8
2008	35.5	29.2	19.1
2009	37.1	30.4	25.8