DEPARTMENT OF LABOR

Employment and Training Administration

20 CFR Part 606

RIN 1205–AB53

Federal-State Unemployment Compensation (UC) Program; Funding Goals for Interest-Free Advances

AGENCY: Employment and Training Administration (ETA), Labor.

ACTION: Notice of proposed rulemaking (NPRM); request for comments.

SUMMARY: The Department of Labor (Department) is proposing a rule to implement Federal requirements conditioning a State's receipt of interest-free advances from the Federal Government for the payment of unemployment compensation (UC) upon the State meeting ''funding goals, as established under regulations issued by the Secretary of Labor.'' The proposed rule would require that States: Meet a solvency criterion in one of the 5 calendar years preceding the year in which advances are taken; and meet two tax effort criteria for each calendar year after the solvency criterion is met up to the year in which an advance is requested.

DATES: To be ensured consideration, comments must be submitted in writing on or before August 24, 2009.

ADDRESSES: You may submit comments, identified by Regulatory Information Number (RIN) 1205–AB53, by only one of the following methods:

- *Federal e-Rulemaking Portal: http://www.regulations.gov.* Follow the instructions for submitting comments.
- *Mail/Hand Delivery/Courier:* Submit comments to Thomas M. Dowd, Administrator, Office of Policy Development and Research (OPDR), U.S. Department of Labor, Employment and Training Administration, 200 Constitution Avenue, NW., Room N–5641, Washington, DC 20210. Because of security-related concerns, there may be a significant delay in the receipt of submissions by United States Mail. You must take this into consideration when preparing to meet the deadline for submitting comments.

The Department will post all comments received on *www.regulations.gov* without making any changes to the comments or redacting any information, including any personal information provided. The *http://www.regulations.gov* Web site is the Federal e-rulemaking portal and all comments posted there are available and accessible to the public. The Department recommends that commenters not include personal information such as Social Security Numbers, personal addresses, telephone numbers, and e-mail addresses in their comments as such submitted information will be available to the public via the *http://www.regulations.gov* Web site. Comments submitted through *http://www.regulations.gov* will not include the e-mail address of the commenter unless the commenter chooses to include that information as part of his or her comment. It is the responsibility of the commenter to safeguard personal information.

Instructions: All submissions received must include the agency name and the RIN for this rulemaking: RIN 1205–AB53. Please submit your comments by only one method.

Docket: All comments will be available for public inspection and copying during normal business hours by contacting OPDR at (202) 693–3700. You may also contact OPDR at the address listed above. As noted above, the Department also will post all comments it receives on *http://www.regulations.gov.*

Copies of the proposed rule are available in alternative formats of large print and electronic file on computer disk, which may be obtained at the above-stated address. The proposed rule is available on the Internet at the Web address *http://www.doleta.gov.*

FOR FURTHER INFORMATION CONTACT: Sherril Hurd, Acting Team Lead for the Regulations Unit, OPDR, Employment and Training Administration, (202) 693–3700 (this is not a toll-free number) or 1–877–889–5627 (TTY). Individuals with hearing or speech impairments may access the telephone number above via TTY by calling the toll-free Federal Information Relay Service at (800) 877–8339.

SUPPLEMENTARY INFORMATION:

I. Background

General

For any insurance program to be successful, revenues generated by the program must, over the long run, exceed the cost of the liabilities against whose risk the program was designed. Complementing that long run objective is the highly desirable feature that the insurance program avoids periods during which reserves are unavailable to pay claims. However, to acquire and maintain levels of reserves that would always guarantee all legitimate claims would be paid can be prohibitively expensive. In the case of the Unemployment Compensation (UC) Program, employers largely pay the premiums (employees can also pay in three states) and paying more in premiums means employers have less to grow their businesses and add jobs to the economy. Hence for the UC Program the objective is to build and maintain reserves at a level that will ensure funds are available to pay benefits during average recessions, which many States have not done, while not building reserves so high as to impede economic growth. For more severe recessions, a back-up is available in the form of advances. However, borrowing can result in undesirable actions, either voluntarily by the State or through the mandate of Federal law, at points in the economic cycle for which the actions are least bearable. Such actions might mean lowering benefits, increasing taxes, or a combination of both at a time when neither employers nor UC beneficiaries are best able to cope with the consequences. Borrowing can also present difficult political decisions for a State. For example, if the advance results in interest coming due, a State must finance the payment from a source other than the regular UC tax. Therefore, maintaining a solvent UC trust fund account is in the best interest of all involved.

UC is generally funded by employer contributions (taxes) paid to a State. The State, in accordance with sec. 303(a)(4) of the Social Security Act (SSA) (42 U.S.C. 503(a)(4)) and sec. 3304(a)(3) of the Federal Unemployment Tax Act (FUTA) (26 U.S.C. 3304(a)(3)), deposits these contributions immediately upon receipt into its account in the Federal Unemployment Trust Fund (UTF). Section 1202 of the SSA (42 U.S.C. 1322) permits a State to obtain repayable advances (commonly called loans) to this account from the Federal Government to pay UC when the account reaches a balance of zero. These advances are interest-bearing, except for certain short-term advances, which are commonly called ''cash flow loans.'' Under sec. 1202(b)(2) of the SSA (42 U.S.C. 1322(b)(2)), these short-term advances are interest free if:

(1) The advances made during a calendar year are repaid in full before the close of September 30 of the same calendar year;

(2) No additional advance is made during the same calendar year and after September 30; and

(3) The State meets funding goals relating to its account in the UTF, established under regulations issued by the Secretary of Labor (Secretary).

The Balanced Budget Act of 1997 (Pub. L. 105–33, sec. 5404) added the third requirement, that is, that the State meet funding goals established under regulations by the Secretary. This notice sets forth these proposed funding goals.

Rationale for Proposed Funding Goals

During periodic economic downturns there is an increase in UC benefit payments made from State trust fund accounts. Changes in insured unemployment reflect the changing economic scene, especially the impact of recessions and long-term unemployment. In economist Saul J. Blaustein's historical review of the unemployment compensation system, in *Unemployment Insurance in the United States, the First Half Century,* he noted that the 1960s concluded with about seven consecutive years of relatively moderate-to-low levels of unemployment compensation claims and benefit outlays, which he reasoned may have encouraged a certain amount of complacency about reserves and financing. The recessions in the early and mid 1970s that were followed by the successive and deep recessions of the early 1980s found many States insolvent by mid-1983. For the first time, the entire Federal-State system was in a net negative balance position with regard to the aggregates of all State and Federal unemployment compensation trust funds accounts. Since advances were available from the Federal Unemployment Account without interest at the time, some States may have been inclined to avoid the more difficult policies required to maintain solvency.

Prior to the 1990–91 recession (December 1989), the aggregate balance of State trust fund accounts stood at 1.9 percent of total covered wages. Seven States used advances under Title XII of the Social Security Act during and following that relatively mild recession. After almost ten years of recovery, the aggregate balance only reached 1.5 percent of total covered wages in December 2000, resulting in nine States borrowing during and following the 2001 recession, again a relatively mild one. Going into the current recession, as of December 2007, State balances were only 0.8 percent of total covered wages. As of June 1, 2009, fourteen States had been forced to borrow.

States have wide latitude in determining how to provide for increases in UC benefits paid from their trust fund accounts. Generally, there are three methods of doing this: (1) Forward funding, whereby the State builds up its fund balance in anticipation of increased outlays, (2) pay-as-you-go financing, whereby taxes are raised as needed to cover benefits, and (3) deficit financing where a State uses borrowed funds to pay UC benefits. Most States use a combination of these methods.

Financing UC benefits by the use of forward funding is the most consistent with the overall UC program goals in that a State can avoid tax increases and/or benefit cuts when the economy is weak and can also avoid large amounts of borrowing. As noted above, the negative consequences of borrowing include interest charges and tax increases as well as potential benefit cuts.

The U.S. Government Accountability Office and the Advisory Council on Unemployment Compensation (1994–1996) raised concern regarding the ongoing financial strain of the unemployment system. These groups documented the increasing trend for States to move away from forward funding of their UC programs. The Advisory Council on Unemployment Compensation, created by the Emergency Unemployment Compensation Act of 1991, reported that during the previous decade many States with low or negative trust fund reserves found themselves in a position of either increasing taxes on employers in the midst of an economic downturn, or restricting eligibility and benefits for the unemployed. The Council reported that it was in the interest of the nation that the Unemployment Compensation System provide for a build-up of reserves during good economic times and drawing down reserves during recessions.

In general, the past reviews of the Unemployment Compensation System concluded that if the forward-funding nature of the Unemployment Compensation System is not restored the shift in financing methods has the potential to dramatically increase borrowing, leading to interest charges and tax credit reductions at points in the business cycle when these additional costs to employers would be difficult to cope with and would also precipitate reductions in UC benefits. Both of these results would reduce the UC program's economic stabilization effect.

It was in light of these reports that the Balanced Budget Act of 1997 included an amendment to Title XII of the Social Security Act (SSA). Under Section 1202(b)(2) of the SSA, advances made from the Federal Unemployment Account during a calendar year are interest free if the following conditions are met:

—The advances are repaid in full before the close of September 30 of the calendar year in which the advances were made, and
—Following this repayment, no other advance is made to the State during the calendar year.

The Balanced Budget Act added a third condition. States were now required to meet ''funding goals, established under regulations issued by the Secretary of Labor, relating to the accounts of the States in the Unemployment Trust Fund.''

According to the House Committee report, this amendment was intended to encourage solvency of State unemployment funds:

> Should a State account become insolvent during an economic downturn, adverse conditions can result for the State and its employers. Borrowing Federal funds imposes a cost on the State at a time when it may face other financial difficulties. The State may react by raising taxes on its employers or cutting benefits, thereby discouraging economic activity during a period when its economy is already in decline. The provision would encourage States to maintain sufficient unemployment trust fund balances to cover the needs of unemployed workers in the event of a recession. (H. Rep. No. 105–149, 104th Cong. 1st Sess. 108 (1997).)

The purpose of the ''funding goals'' requirement established by the Balanced Budget Act was to provide an incentive for States to build and maintain sufficient reserves in their accounts by restricting an existing Federal subsidy, in the form of an interest-free borrowing period, to only those States that meet a forward funding solvency goal. The original adoption of a short interest-free borrowing period (1982), in effect a Federal subsidy to State UC programs, was intended to assist only those States that required a relatively small advance for a short period of time, for cash-flow purposes. By choosing to restrict the current subsidy, Congress hoped to encourage States to be more aware of the need to build cash reserves in order to adequately prepare for economic downturns. Although the current subsidy is a relatively small amount compared to overall borrowing costs, it is used quite often by States during recessionary periods.

The original bill (H.R. 2015, 105th Cong. sec. 9404 (1997)) specified a solvency standard that a State's UTF account had to meet in a specified past time period to obtain an interest-free advance. However, the bill ultimately enacted as the Balanced Budget Act, as explained by the legislative history (H.R. Conf. Rpt. 105–217, at 571, reprinted at 1997 U.S.C.C.A.N. 176, 950 (Jul. 30, 1997)), dropped the solvency standard and timeframe, leaving it to the Secretary ''to establish appropriate funding goals for States.''

To meet the statutory requirement and Congress's goal of encouraging States to provide for sufficient unemployment trust fund balances to cover the needs of unemployed workers in the event of a recession, the Department proposes funding goals which would encourage States to: (1) Build and maintain adequate solvency levels during economic expansions; and (2) avoid substantial reductions of tax effort prior to obtaining an advance. These proposed funding goals provide an incentive for States to increase their level of forward funding, but are not a mandate on States.

The Department adhered to several principles in developing the proposed funding goals. These principles required that the funding goals should:

- Be based on currently collected data from reports approved by the Office of Management and Budget (OMB), specifically tax rates calculated from contributions and wage data reported in the Quarterly Census of Employment and Wages (QCEW) report (OMB No. 1220–0012); State trust fund account balances and benefits paid data from the ETA–2112 report (OMB No. 1205–0456)) which can be used to measure adequacy of trust fund account solvency and tax effort. These data are used to establish criteria for the funding goals discussed below;
- Be based on established concepts and measures such as the reserve ratio and average high cost multiple that are commonly used by DOL, State offices, and researchers to assess trust fund account adequacy. See below for the definitions of ''reserve ratio'' and ''average high cost multiple'';
- Consider Trust Fund account balances over a reasonable period of time rather than at a single recent point-in-time in order to recognize that economic dynamics, such as a changing industrial mix, and a growing labor force could be responsible for an erosion in fund balances; and
- Take into account State behavior in terms of an intentional reduction in revenues.

Funding Goals Considered

The Department considered three approaches to establishing funding goals as required by sec. 1202(b)(2)(C) of the SSA. Each is discussed in turn.

Approach I

Under this approach States would have to satisfy two criteria in order to qualify for an interest-free advance:

(1) A solvency goal (described below) which requires a State to have met a specified solvency level in one of the 5 years prior to borrowing; and

(2) The maintenance of a specified level of tax effort (mechanics described below) in the years between reaching the solvency goal and borrowing.

The two criteria are complementary in terms of proper trust fund management and together support the intent of the Balanced Budget Act. The solvency goal is a measure of trust fund account adequacy at a point in time and reflects past efforts to ensure availability of funds to pay UC in an economic downturn. Legislative history shows Congressional interest in such a concept. The maintenance of tax effort requirement reflects State behavior over a period of time, i.e., the period between attaining the solvency goal and needing an advance to pay UC, and is designed to avoid giving an interest-free advance to a State whose need for an advance was precipitated by a deliberate State action such as a legislated tax cut that adversely impacted trust fund account solvency. As described below, the maintenance of tax effort requirement allows for reductions that might typically occur as a result of an automatic shift in tax schedules.

Solvency Goal

The solvency goal would require that a State have an Average High Cost Multiple (AHCM), as calculated below, of at least 1.0 in one of the 5 years prior to the year in which a State seeks to obtain an interest-free advance. The AHCM is a measure of solvency that was refined and recommended by the Advisory Council on Unemployment Compensation (ACUC) in 1995. This measure is similar, but not identical to, the measure described in the legislative history (as outlined below). The ACUC, established by the Emergency Unemployment Compensation Act of 1991 (sec. 908, SSA; 42 U.S.C. 1108), recommended that States accumulate reserves sufficient to pay at least one year of benefits using the AHCM formula, that is, an AHCM of 1.0. The legislative history also recommended a level equal to one year of benefits.

For any year, the AHCM consists of two ratios:

(1) The ''reserve ratio''—The balance in a State's UTF account on December 31 divided by total wages paid to UC-covered employees during the 12 months ending on December 31; and

(2) The ''average high cost rate (AHCR)''—Over whichever period is longer, either the most recent 20 years or the period covering the most recent three recessions, the average of the three highest values of: Benefits paid during a calendar year divided by total wages paid to UC- covered employees during the same calendar year.

The AHCM is computed by dividing the reserve ratio by the AHCR. The resulting AHCM represents the number of years a State could pay UC benefits at a rate equal to the AHCR, without collecting any additional UC taxes.

Based upon the Department's review of historical data, going back to 1967, States having an AHCM of at least 1.0 going into a moderate recession are not likely to borrow during or after the recession. None of the States borrowing during the current recession (as of June 9, 2009) had an AHCM exceeding 0.4 at its beginning, December 2007. For the solvency goal under Approach I, the Department would require a State to have an AHCM of 1.0 as of the end of one of the 5 calendar years prior to the year in which it has taken the advance that could potentially qualify as an interest-free advance. Requiring that a State had met the solvency goal in one of the 5 years prior to borrowing demonstrates that the State had acted responsibly by achieving the goal in the recent past. The use of the five-year requirement also recognizes that economic dynamics may be such that a State may slide toward insolvency over a period of time. The time requirement suggested by the legislative history was much shorter, but was rejected as unworkable. The requirement also might enable a State to qualify for an interest-free advance in consecutive years, but no more than five, as a result of needing an AHCM of at least 1.0 in one of the 5 years preceding the advance. Because a State may qualify for interest-free advances over a 5-year period, there is ample time for it to fix its inability to adequately finance its UC program before losing access to interest-free advances.

Proposed Maintenance of Tax Effort Goal

The maintenance of tax effort goal is based upon two measures. The first is the ''unemployment tax rate'' (UTR), defined at 20 CFR 606.3(j) as, for any taxable year, the percentage obtained by dividing the total amount of State UC taxes paid into the State unemployment fund by ''total wages.'' (''Total wages,'' as defined in 20 CFR 606.3(l), is the sum of all remuneration covered by a State law, disregarding any dollar limitation on the amount of remuneration which is subject to contributions under the State's law. Since State UC laws tax only a portion of wages paid, disregarding this dollar limitation means that ''total wages'' includes all the wages paid.) The UTR, also known as the Average Tax Rate, is published in the quarterly UI Data Summary. The second is the ''benefit-cost ratio'' (BCR), defined at 20 CFR 606.3(c) as the percentage obtained by dividing all UC paid under State law during a calendar year by ''total wages.'' (UC paid to former employees of reimbursing employers, that is, employers not subject to UC taxes, but who instead ''reimburse'' the costs of benefits, is excluded.)

For a State to meet the maintenance of tax effort goal, it must satisfy two requirements demonstrating that it attempted to maintain the solvency of its UTF account through its tax system. First, for each year between the last year in which the solvency goal was met and the year of the potential interest-free advance, the State's UTR must be at least 80 percent of the prior year's rate. Since the UTR is a measure of revenue generating capacity, this requirement would prohibit a State from receiving an interest-free advance if it allowed its revenue generating capacity to decline by more than 20 percent annually for any year between the last year the solvency goal was met and the year of the potential interest-free advance. A reduction in the UTR of 20 percent or less from one year to the next is considered an acceptable variation as historical data show UTR drops of this magnitude are common and largely attributable to tax schedule shifts. If the State's UTR were lower than 80 percent of the prior year's UTR for any year at issue, the State would be considered to be making insufficient efforts to fund UC.

Second, for each year between the last year in which the solvency goal was met and the year of the potential interest-free advance, the UTR must be at least 75 percent of the average of the State's BCRs, as determined under 20 CFR 606.21(d), over the previous 5 years. This requirement supplements the first by assessing whether a State has contributed to its benefit financing problems. The first requirement assures that the State maintained its tax effort by not allowing employer contributions, that is, tax revenue, to decline unduly. The second requirement assures that the State maintained its tax efforts by keeping employer contributions at a reasonable proportion of UC paid, which assures that the State's tax structure is sufficiently functional to generate adequate revenue to cover a reasonable percentage of the 5-year average costs. Thus, the two requirements together assure that the State meets the maintenance of tax effort goal by both maintaining revenue and assuring that that revenue is reasonably adequate to finance benefits.

Approach II

Approach II eliminates the tax effort requirement from Approach I. This approach focuses on attainment of adequate trust fund account solvency at a point in time relatively close to the time borrowing begins. Attaining an adequate trust fund account shows a State did act responsibly to build reserves to guard against the risks of high unemployment. This approach dilutes the incentive for achieving and maintaining trust fund account solvency, while making it easier for States to qualify for interest-free advances.

Approach III

This approach is modeled on Approach I, but instead of having an AHCM of 1.0, the State would have to have a reserve ratio of 1.7 percent. (As explained above, the ''reserve ratio'' is the balance in a State's UTF account on December 31 divided by total wages paid to UC-covered employees during the 12 months ending on December 31.) The reserve ratio is a widely used measure of trust fund levels, making it attractive. But it does not contain any measure of previous State payouts which makes it less powerful as a solvency measure than the AHCM. Setting the threshold at 1.7 percent makes the approach roughly as stringent as Approach I, which is based on the ACUC recommendation. Simulations revealed that approximately the same number of States, but not necessarily the same States, would qualify for an interest-free advance over the period 1972 through 2007 using the reserve ratio as a measure of trust fund account adequacy with a threshold of 1.7 percent as using an AHCM with a threshold of 1.0.

Including the maintenance of tax effort criterion would guard against a State's taking deliberate action resulting in reduced revenue, thereby precipitating the need for an advance. The provision would encourage States to act responsibly to avoid the need to borrow funds.

Impact on Federal State Unemployment Compensation (UC) Program

The overall impact of the funding goals will be the potential reduction in the amount of Federal subsidies going to States in the form of increased interest payments from States that no longer qualify for the interest-free borrowing period. Although a high proportion of States that borrow Federal funds to pay UC benefits receive this subsidy, it is actually small compared to overall borrowing costs. For example, following the 1991 recession, seven states borrowed Federal funds to pay UC benefits. All seven used the interest-free borrowing period at some point in their borrowing. Following the 2001 recession (2002–2007), nine States borrowed approximately $5 billion to pay UC benefits. All nine States that borrowed Federal funds during this period at some point received an interest-free borrowing period. Their foregone interest payments totaled an estimated $17 million. However, this was only about 9% of the total of $184 million in interest payments that these States made.

When the proposed criteria for each approach of the funding goals was applied to these two recessions, only two of the seven States that qualified for an interest-free advance following the 1990–1991 recession would have qualified under any of the proposed approaches. Only one of the nine States that qualified following the 2001 recession would have qualified under the proposed approaches. That one state, Massachusetts, avoided only approximately $1 million in interest payments, which represented less than one percent of all borrowing costs following this recession.

Besides these measurable impacts, the proposed funding goals will also have significant impacts that are difficult to quantify. One unquantifiable benefit is that by establishing a solvency goal, an inadequately funded State could no longer misuse the interest-free borrowing period by taking an interest-free advance in one year and repaying it with funds from other sources, and then possibly repeating that process in consecutive years—thereby avoiding the payment of interest on the use of Federal funds. The adoption of an interest-free borrowing period was intended to assist those States that required only a relatively small advance for a short period of time, not to encourage States to maintain small trust fund account balances and misuse the interest-free mechanisms, which has occurred on several occasions.

Another unquantifiable benefit will be the publication in Federal regulations, for the first time, a reference to the importance of the level of trust fund solvency. Since no solvency standards currently exist in Federal statutes or regulations, this would be the first guideline that States could refer to when considering the adequacy of their UC trust fund accounts.

Finally, State reaction to the funding goals will determine the extent to which solvency is improved and future borrowing reduced. To the extent States do react and interest-free borrowing is reduced, the policy goal of reducing the subsidy provided by interest-free advances will be achieved.

Impact on Eligibility for Interest-Free Advances

The Department conducted simulations using historical data to examine the effects of applying the three solvency approaches on the eligibility for an interest-free advance. To do these simulations, the Department created a set of annual State data from 1967 through 2007, and then examined borrowing over the period 1972 through 2007. (The earlier data were used to satisfy the proposed five-year look-back criterion.) Between 1972 and 2007, States borrowed in a total of 246 years. These individual borrowing years were then aggregated into 67 borrowing episodes (defined as periods of consecutive years in which a State borrowed). Only the first year of each episode was tested for eligibility under the three approaches, assuming that the first year of borrowing is when a State would most likely seek an interest-free advance. These episodes may have lasted for a single year or multiple years and may have required interest payments. The episodes lasted 3.3 years on average, with 17 of them being less than one year long. They have tended to become shorter with milder recessions. Information was not available to determine how many States would have qualified for interest-free advances under the existing criteria, and the States' borrowing practices may well have changed after 1982, when interest was imposed on borrowing. As a result, the analysis based on these historical data is only able to show the number of episodes for which the new funding goals would have been met in the first year, not whether States had met the other criteria for interest-free cash-flow advances that year.

The results, based on the 67 borrowing episodes, are summarized below.

Approach I

- In 23 instances (34 percent of the time) the State would have met the funding goals for an interest-free advance in the first year of borrowing under the proposed approach.
- In 19 instances (28 percent of the time) the State would not have met the 1.0 AHCM solvency goal.
- In 9 instances (13 percent of the time) the State would have met the solvency goal, but not the maintenance of tax effort goal.
- In 16 instances (24 percent of the time) the State would have met neither the solvency goal nor the maintenance of tax effort goal. (Percentages do not add to 100 due to rounding.)

Approach II

- In 32 instances (48 percent of the time) the State would have met the funding goals for an interest-free advance in the first year of borrowing under the proposed approach.
- In 35 instances (52 percent of the time) the State would not have met the 1.0 AHCM solvency goal

Approach III

- In 22 instances (33 percent of the time) the State would have met the funding goals for an interest-free advance in the first year of borrowing under the proposed approach.
- In 19 instances (28 percent of the time) the State would not have met the 1.7 percent reserve ratio solvency goal.
- In 9 instances (13 percent of the time) the State would have met the solvency goal, but not the maintenance of tax effort goal.
- In 17 instances (25 percent of the time) the State would have met neither the solvency goal nor the maintenance of tax effort goal. (Percentages do not add to 100 due to rounding.)

An examination of the simulation results reveals that imposing any of the three approaches will make it more difficult for States with problematic financing systems to receive an interest-free advance. Of the 67 borrowing episodes studied, States would have met the funding goals for interest-free borrowing under the three funding goal approaches 34 percent, 48 percent, and 33 percent of the time respectively. Thus, while imposition of any of the three approaches as additional qualifying criteria for an interest-free advance restricts such advances, they are not so restrictive that interest-free advances would be eliminated. A detailed break-out of the data used for the simulations and results is available by contacting the Department through the contact information provided above as well as on www.regulations.gov as part of the supplemental information provided with this NPRM.

Impacts on Employers and Claimants

The impact of implementation of the funding goals depends on what choices States make. If a State chooses to take no action, the State will pay more interest in the event it has a cash-flow loan, which will ultimately impact taxes and/or benefits. If a State chooses to increase its trust fund level to meet the funding goals, there are also potential impacts on taxes and benefits. Either way, the ultimate impacts fall on employers or claimants, although some of the costs for one group are benefits for the other group and vice-versa.

There are identifiable benefits and costs to employers and claimants. Identifying and quantifying the distribution of the impacts to these groups is done to provide a breakdown. However, the impacts between groups are not exclusive of one another. The table below summarizes these identifiable annual impacts of the three approaches. The estimates were made by simulating the adoption of each approach during the 1999–2006 period. This period contained a relatively high frequency of State borrowing with extensive use of the existing interest-free advance provision, and a relatively large number of States responding to that recession by increasing tax revenue and/or reducing benefits. Each State's situation was examined and assumptions made about how the State would react to the implementation of each of the three approaches compared to what actually occurred. Estimated impacts were then calculated for employers and for claimants.

ESTIMATED POTENTIAL IMPACTS ON EMPLOYERS AND CLAIMANTS (1999–2006)

[Annualized amounts in $millions]

	Approach I	Approach II	Approach III
Employers:			
A. Decreased Taxes	0.6	0.6	0.5
B. Increased Contributions	–4.2	–2.1	–2.9
Claimants:			
C. Smaller UC Benefit Reductions	1.8	2.5	2.0

ESTIMATED POTENTIAL IMPACTS ON EMPLOYERS AND CLAIMANTS (1999–2006)—Continued

[Annualized amounts in $millions]

	Approach I	Approach II	Approach III
D Reduced UC Benefits	−1.2	−0.8	−1.1

The estimated impacts on employers and claimants are within the total estimated State impact and depend on how the State would react to the implementation of each of the three approaches as described below.

The funding goals would provide a benefit to employers in the form of a reduced risk of higher taxes that could occur when most detrimental—during a recession or its aftermath (line A in the table). For States that increase account balances to meet the solvency goal, higher interest earnings will be realized on those balances. The resulting higher account balances will put some downward pressure on tax rates once the higher balances are achieved, to the benefit of employers. In addition, the higher balances will reduce the likelihood of borrowing and the possibility of having to pay interest. The payment of interest can be a problem since States cannot use funds from their UTF accounts to pay it (sec. 1202(b)(5), SSA), raising the possibility of a separate tax on employers to pay the interest. Further, if advances are taken from the UTF and not repaid within a specified period of time, a State's employers could pay higher taxes through a reduction in the FUTA credit to help repay the advance (sec. 3302(c)(2), FUTA). With higher balances in a State's trust fund account at the beginning of a recession, the period during which an advance is needed would be shorter, thus reducing interest charges and reducing the risk of FUTA credit reduction.

One identifiable cost to employers is the possible higher unemployment compensation taxes in States that may lose their current ability to receive interest-free borrowing privileges or in those States that choose to meet the funding goal requirements (line B in the table). In the first case, States would need to find a way to make interest payments as those payments may not, under sec. 1202(b)(5), SSA, be made from revenues collected to pay unemployment compensation. That might mean a separate tax on employers, or using other State money. In the second case, in States that choose to meet the funding goal criteria but currently do not, higher UC taxes (resulting from either tax increases or smaller tax reductions than might otherwise be the case) would need to be implemented.

There is also a benefit to workers. Some States whose trust fund accounts become depleted may choose to limit scheduled benefit amount increases or to reduce benefits. States adopting the funding goal are more likely to avoid the need to borrow as well as the need to negatively impact the benefits of unemployed workers (line C in the table).

The funding goal could also impose a cost on workers by cutting benefits (line D in the table). States that respond to insolvency by cutting benefits may be induced to cut further because of the increased interest cost. Also, States that try to achieve the solvency criterion may cut benefits to do so (although this seems unlikely), in addition to increasing taxes.

These estimates, as can be seen, are relatively small given that they fall within the limits of the interest foregone from attaining an interest-free borrowing period. Interested parties can obtain the backup information from the Department through the contact information provided above or on *www.regulations.gov* as part of the supplemental information provided with this NPRM.

Selected Approach and Justification

Upon careful review of the three approaches, the Department selected Approach I to best satisfy the legislative goal of encouraging States to maintain adequate reserves to pay benefits during recessionary periods. All three approaches encourage maintenance of adequate reserves but vary in terms of complexity and impact, and these factors were also weighed in the decision process as well as the fact that there was relatively little difference in the quantitative impact analysis among the three approaches, given the size of the UC program (in fiscal year 2008, $32 billion in State revenues and $38 billion paid in State benefits).

Approach I uses as a measure of trust fund account adequacy, the AHCM, which was recommended by the ACUC. Benefit costs are a key determinant of trust fund account solvency and the AHCM includes benefits as a component to help measure the risk of insolvency, while the reserve ratio does not include benefits. As a result, the AHCM is believed to be a better indicator of a State's ability to pay UC in an economic downturn. Hence that consideration supported Approach I over Approach III which had the same tax maintenance effort requirement as Approach I.

Approach II dropped from Approach I the maintenance of tax effort criterion in order to create a simpler, more easily understood funding goal that still reflected Congressional intent. The simulations show that, compared to Approach I, eight more borrowing episodes could have qualified as interest-free advances without the maintenance of tax effort requirement. So, absent the tax effort requirement, a State might reduce taxes too sharply, causing it to borrow, but nevertheless qualify for an interest-free advance despite its poor tax management. This simulation result reinforces the concept that it is important to maintain an adequate trust fund over the length of the business cycle rather than at just one point in time in order to reduce the need to borrow. Thus, the incentive to achieve an adequately financed system is reduced under Approach II compared to Approach I. Therefore, Approach I is superior to Approach II in light of the objective.

On the above analysis, Approach I was selected.

II. Proposed Amendments

The proposed rule would amend paragraph (b) of § 606.32 to add the funding goal described in Approach I to the existing requirements for an interest-free advance. More specifically, the amendments would require that a State have had an AHCM of at least 1.0 in one of the 5 years prior to the year in which that State seeks to obtain an interest-free advance. Also, the State must have maintained tax effort between the last year the State had an AHCM of at least 1.0 and the year in which the advance or advances were made. The amendments would then specify the calculation of the AHCM as well as how to determine whether a significant tax cut was made.

The proposed rule would also amend the definition of ''BCR'' at § 606.3(c). Currently, this definition applies only for purposes of the cap on tax credit reductions under sec. 3302(f) of the Federal Unemployment Tax Act (26

U.S.C. 3302(f)). The proposed rule would delete the definition's reference to the cap, thereby making it applicable to the funding goal as well. Paragraph (d) of § 606.21, which defines the ''State 5-year average benefit cost ratio,'' would similarly be amended so as to apply to the funding goal as well as the cap.

The Department intends that the final rule establishing funding goals would apply 2 years after its date of publication to allow States time to adjust their financing systems if they choose to do so. The Department also invites comments about the possibility of phasing in the funding goals and related mechanics.

Request for Comments

The Department proposes in this NPRM to amend part 606 to establish the funding goals required by sec. 1202(b)(2)(C) of the SSA. The Department is interested in receiving comments on the three approaches to funding goals considered here, as well as in receiving other suggestions for funding goals.

III. Administrative Provisions

Executive Order 12866

This proposed rule is not an economically significant rule. Under Executive Order 12866, a rule is economically significant if it materially alters the budgetary impact of entitlements, grants, user fees, or loan programs; has an annual effect on the economy of $100 million or more; or adversely affects the economy, a sector of the economy, productivity, competition, jobs, the environment, public health or safety, or State, local, or tribal governments or communities in a material way. This proposed rule is not economically significant under the Executive Order because it will not have an economic impact of $100 million or more on the State agencies or the economy as explained above. However, the proposed rule is a significant regulatory action under Executive Order 12866 at sec. 3(f) because it raises novel legal or policy issues arising out of legal mandates, the President's priorities, or the principles set forth in the Executive Order. This proposed rule updates existing regulations in accordance with Congressional mandates. Therefore, the Department has submitted this proposed rule to the Office of Management and Budget (OMB) for review.

Paperwork Reduction Act

Under the Paperwork Reduction Act (PRA), the Department is required to submit any information collection requirements to the Office of Management and Budget (OMB) for review and approval. 44 U.S.C. 3501 *et seq.* This proposed rule does not impose any new requirements on the States that have not already been approved by OMB for collection. Therefore, the Department has determined that this proposed rule does not contain a new information collection requiring it to submit a paperwork package to OMB. Data to be used is covered by the following OMB approvals: OMB No. 1220–0012 for the Quarterly Census of Employment and Wages report and OMB No. 1205–0456 for the ETA–2112 report containing State trust fund account balances and benefits paid data.

Executive Order 13132: Federalism

Section 6 of Executive Order 13132 requires Federal agencies to consult with State entities when a regulation or policy may have a substantial direct effect on the States or the relationship between the National Government and the States, or the distribution of power and responsibilities among the various levels of government, within the meaning of the Executive Order. Section 3(b) of the Executive Order further provides that Federal agencies must implement regulations that have a substantial direct effect only if statutory authority permits the regulation and it is of national significance. The proposed rule does not have a substantial direct effect on the States or the relationship between the National Government and the States, or the distribution of power and responsibilities among the various levels of Government, within the meaning of the Executive Order. Any action taken by a State as a result of the rule would be at its own discretion as the rule imposes no requirements. In addition, the primary estimate on an annualized basis for the difference of costs over benefits is $4.2 million. That $4.2 million would be added to State unemployment trust fund accounts.

Unfunded Mandates Reform Act of 1995

This regulatory action has been reviewed in accordance with the Unfunded Mandates Reform Act of 1995. Under the Act, a Federal agency must determine whether a regulation proposes a Federal mandate that would result in the increased expenditures by State, local, or tribal governments, in the aggregate, or by the private sector, of $100 million or more in any single year. The Department has determined that this proposed rule does not create any unfunded mandates as it will not significantly increase aggregate costs of the UC program. The main effect of this proposal is to encourage States to build and maintain adequate balances in their UC accounts. Accordingly, it is unnecessary for the Department to prepare a budgetary impact statement. Further, as noted above, the impact is positive for State trust fund accounts.

Plain Language

The Department drafted this proposed rule in plain language.

Effect on Family Life

The Department certifies that this proposed rule has been assessed according to sec. 654 of Public Law 105–277 for its effect on family well-being. This provision protects the stability of family life, including marital relationships, financial status of families, and parental rights by encouraging the States to maintain adequate funding of their UTF accounts. It will not adversely affect the well-being of the nation's families. Therefore, the Department certifies that this proposed rule does not adversely impact family well-being.

Regulatory Flexibility Act/SBREFA

We have notified the Chief Counsel for Advocacy, Small Business Administration, and made the certification according to the Regulatory Flexibility Act (RFA) at 5 U.S.C. 605(b), that this proposed rule will not have a significant economic impact on a substantial number of small entities. Under the RFA, no regulatory flexibility analysis is required where the rule ''will not * * * have a significant economic impact on a substantial number of small entities.'' 5 U.S.C. 605(b). A small entity is defined as a small business, small not-for-profit organization, or small governmental jurisdiction. 5 U.S.C. 601(3)–(5). This proposed rule would directly impact States. The definition of small entity does not include States. Therefore, no RFA analysis is required.

In addition, this proposed rule encourages States to build and maintain adequate balances in their UC accounts but does not require that they do so. Before the current recession, nineteen States had already met the 1.0 AHCM criterion with an additional two States having AHCMs above 0.95 for which little or no action would have been necessary to meet the criterion. Some States with lower AHCMs perceive a low risk of borrowing either because they have responsive tax systems or low unemployment projections, while other States prefer keeping their UC taxes low to spur further economic growth and such States are not likely to take action to meet the solvency criterion. For the States that might take action, achieving the solvency criterion would involve varying degrees of tax changes depending on how quickly achievement of the criterion is desired. With proper adjustment to their funding mechanisms, tax increases would only be in place until appropriate UTF account balances reflecting the solvency criterion are met. Only a few States are likely to take action to achieve the solvency criterion and any action is likely to involve temporary, modest increases to a tax that is relatively low. Under any of the alternatives, only a few States would take action which would translate to a minimal impact on all entities given the impact estimates and size of the UC tax. Therefore, the Department certifies that this proposed rule will not have a significant impact on a substantial number of small entities and, as a result, no regulatory flexibility analysis is required.

In addition, consistent with the impact analysis discussed above, this proposed rule is not a major rule as defined by sec. 804 of the Small Business Regulatory Enforcement Act of 1996 (SBREFA).

List of Subjects in 20 CFR Part 606

Employment and Training Administration, Labor, and Unemployment compensation.

Words of Issuance

For the reasons stated in the preamble, the Department proposes to amend 20 CFR part 606 as set forth below:

Signed at Washington DC, this 16th day of June 2009.

Douglas F. Small,

Deputy Assistant Secretary, Employment and Training Administration.

PART 606—TAX CREDITS UNDER THE FEDERAL UNEMPLOYMENT TAX ACT; ADVANCES UNDER TITLE XII OF THE SOCIAL SECURITY ACT

1. The authority citation for 20 CFR part 606 is revised to read as follows:

Authority: 42 U.S.C. 1102; 42 U.S.C. 1322(b)(2)(C); 26 U.S.C. 7805(a); Secretary's Order No. 3–2007, April 3, 2007 (72 FR 15907).

2. Section 606.3(c) introductory text is revised to read as follows:

§ 606.3 Definitions.

* * * * *

(c) *Benefit-cost ratio* for a calendar year is the percentage obtained by dividing—

* * * * *

3. Section 606.21(d) is amended by revising the first sentence to read as follows:

§ 606.21 Criteria for cap.

* * * * *

(d) *State five-year benefit-cost ratio.* The average benefit cost ratio for the five preceding calendar years is the percentage determined by dividing the sum of the benefit cost ratio for the 5 years by five. * * *

4. Section 606.32 is amended by revising paragraph (b) to read as follows:

§ 606.32 Types of advances subject to interest.

* * * * *

(b)(1)(i) *Cash flow loans.* Advances repaid in full prior to October 1 of the calendar year in which made are deemed cash flow loans and shall be free of interest; provided, that:

(A) The State has met the funding goals described in paragraph (b)(2) of this section; and

(B) The State does not receive an additional advance after September 30 of the same calendar year.

(ii) If such additional advance is received by the State, interest on the completely repaid earlier advance(s) shall be due and payable not later than the day following the date of the first such additional advance. The administrator of the State agency shall notify the Secretary of Labor no later than September 10 of those loans deemed to be cash flow loans and not subject to interest. This notification shall include the date and amount of each loan made in January through September and a copy of documentation sent to the Secretary of the Treasury requesting loan repayment transfer(s) from the State's account in the Unemployment Trust Fund to the Federal unemployment account in such Fund.

(2) *Funding goals.* A State has met the funding goals if:

(i) As of December 31 of any of the 5 calendar years preceding the calendar year in which such advances are made, the State had an average high cost multiple (AHCM) of at least 1.0, as determined under paragraphs (b)(3) and (b)(4) of this section; and

(ii) The State maintained tax effort with respect to the years between the last year the State had an AHCM of at least 1.0 and the year in which the advance or advances are made, as determined under paragraph (b)(5) of this section.

(3) *Calculation of AHCM.* The State's AHCM as of December 31 of a calendar year is calculated by:

(i) Dividing the balance in the State's account in the Unemployment Trust Fund as of December 31 of such year by the total wages paid to UC covered workers during such year; and

(ii) Dividing the amount so obtained by the State's average high cost rate (AHCR) for the same year.

(4) *Calculation of the AHCR.* A State's AHCR is calculated as follows:

(i) Determine the time period over which calculations are to be made by selecting the longer of:

(A) The 20-calendar year period that ends with the year for which the AHCR calculation is made; or

(B) The number of years beginning with the calendar year in which the first of the last three completed national recessions began, as determined by the National Bureau of Economic Research, and ending with the calendar year for which the AHCR is being calculated.

(ii) For each calendar year during the selected time period, calculate the benefit-cost ratio, as defined at § 606.3(c); and

(iii) Calculate the mean of the three highest ratios from paragraph (b)(4)(ii) of this section and round to the nearest multiple of 0.01 percent.

(5) *Maintenance of Tax Effort.* A State has maintained tax effort for any year between the last calendar year in which the funding goals in paragraph (b)(1)(i) of this section were met and the calendar year in which an interest-free advance is sought, if the State's unemployment tax rate as defined in § 606.3(j) for the calendar year is not at least—

(i) 80 percent of the prior year's unemployment tax rate, and

(ii) 75 percent of the State 5-year average benefit cost ratio, as determined under § 606.21(d).

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