South Dakota Department of Labor
Unemployment Insurance Advisory Council
2006 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, Bob Riter, Jr., 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. From 2000 through 2006, however, benefits paid 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 2005 Legislature adopted three proposals developed by the Council in 2004. These changes, contained in House Bill 1228 and effective July 1, 2005, eliminated the interest credit to employers and pro-rated 100 percent of non-charged benefits back to the accounts of all employers. HB 1228 also changed the surtax trigger based on a low fund balance from an annual to a quarterly determination. Additional details about these changes can be found in the 2004 report. More importantly, the 2005 changes were the basis for Legislative discussions concerning more significant changes that would be needed in the future. During 2005, the Council continued to focus on the trust fund solvency issue and developed a comprehensive set of proposals to address this problem.

The 2006 Legislature passed House Bill 1027, which implemented the recommendations made by the Council in 2005 to bring long-term solvency to the trust fund and to prevent a surtax from being imposed on all employers because of a low trust fund balance. The Bill was effective July 1, 2006, and contains five sections addressing:

- Wage Base
- Contribution Rate/Reserve Ratio Table
- New Contribution Rate/Reserve Ratio Table
- Interest on Negative Accounts
- Surtax Trigger

Section 1
The wage base is the amount of wages on which the UI contribution rate is paid. Prior law set the wage base at $7,000, where it had been fixed since 1983. This fixed wage base created a structural imbalance in the system because benefits are based on average wages and inflate each year. (The maximum weekly benefit is 50 percent of the average weekly wage.) The result is benefits increase every year as wages rise but contributions to the system are more fixed. Section 1 increased the wage base from $7,000 to $8,500 in 2007, $9,000 in 2008, $9,500 in 2009, and $10,000 in 2010.

Section 2
Section 2 ends the application of the current contribution rate/reserve ratio table after 2006 so the new contribution rate/reserve ratio table in Section 3 of the bill can apply in 2007 and beyond. Delaying the implementation of the new table provided employers with a one-year notice of the changes to allow them time to prepare accordingly.

Section 3
Section 3 establishes the new contribution rate table for 2007 and future years. The reserve ratio requirements for negative accounts are higher than current rates, and the maximum rate moves from the current 7 percent to 8.5 percent.

Section 4
Section 4 establishes a new interest charge penalty for all employer accounts which have been negative for two consecutive years. The first interest charge penalty will be implemented in January 2009 and will apply only if the employer account had a negative balance for the prior two years. Prior negative accounts will be grandfathered and interest will only be charged on the amount the negative balance increased after December 31, 2006.

Section 5
Section 5 lowers the surtax trigger level from $11 million to $2 million for a three-year period. This reduction allows time for the provisions of the bill to be implemented, which will increase the trust fund balance without triggering a surtax on all employers. A surtax would have a major negative impact on all employers in the state. A temporary reduction in the surtax level would limit the possibility of the tax triggering from July 1, 2006, through June 30, 2009, unless the fund balance got below $2 million. Section 5 also adds language to clarify that the contribution rate is 0.1 percent for a trust fund balance from $11 million to $16.5 million when the surtax comes off.

The 2006 Legislature passed two other Bills which affect unemployment insurance. Both were effective July 1, 2006. Senate Bill 108 removed employer contributions to certain pension plans - primarily 401K plans - from the definition of "wages" for unemployment insurance purposes. This makes South Dakota consistent with federal law in this area. The prior situation required that employers calculate one wage figure to use on state unemployment reports. This figure includes their payments to 401K plans for employees. The employer then re-calculated that number by removing the 401K payments to file federal unemployment tax reports. The reason is state law included 401K payments and federal law excluded them. About 40 states have already adopted the change to exclude employer 401K contributions from wages. The prior situation created additional administrative costs for employers because of the double calculation. Some employers reported their payroll software cannot make this adjustment; requiring extensive hand-calculation of the required data. The change will cause a minimal decrease in UI contributions, possibly $30,000 annually out of $18 million in employer payments. It would also have a minimal impact on benefit eligibility.

House Bill 1197 will end the current deduction of one-half of the social security benefit from unemployment payments when the balance in the Unemployment Trust Fund reaches $30 million. The Department initially opposed HB 1197 because the Trust Fund balance was down to $19 million and further declines were predicted. A comprehensive solution to structural problems in the trust fund had been proposed, but not passed. The original version of HB 1197 would have made the change effective July 1, 2006, and would have increased benefits by about $500,000 per year, despite the low trust fund balance. The Bill was amended so that a trust fund balance of $30 million was required before the Bill would be effective. By this time, the long-term trust fund problems had also been addressed through the passage of HB 1027. These changes addressed the concerns about the Bill and the Department supported it as amended. This legislation passed and became effective July 1, 2006.

The 2006 legislature also passed House Bill 1177 which will limit the amount contributed by employers to the “Employer's Investment in South Dakota's Future Fund.” The Department of Labor worked with the sponsors of HB 1177 to change and amend the Bill to achieve the Governor's goals. Employers pay Investment Fees and Unemployment Insurance contributions on the same wage base. HB 1027 increased the wage base as part of a solution to structural problems in the Unemployment Insurance Trust Fund. HB 1177 as amended eliminates an unintended increase to the Future Fund resulting from an increase in the wage base authorized in HB 1027.

The maximum investment fee rate is now 0.7 percent and the wage base is now $7,000. HB 1177 amends SDCL 61-5-24.1 to reduce the fee rate for new employers to 0.55 percent in 2007 and thereafter. It also amends the maximum fee rate by reducing it to 0.6 percent in 2007 and further reducing it by small annual increments to 0.55 percent by 2010. The amended version of HB 1177 allows orderly growth in the Future Fund based on normal growth in wages.

The legislature also added Section 2 to House Bill 1177 which states: “The Department of Labor and the Department of Tourism and State Development shall study and make recommendations regarding the broadening of the base of payers into the employer's investment in South Dakota's future fund. A report shall be made to the Governor and the Legislature by November 15, 2006.”

In the summer of 2006, the Department of Labor and the Department of Tourism and State Development engaged Dr. Ralph Brown, Emeritus Professor of Economics at USD, to study the future fund issue as required by Section 2 of House Bill 1177.

Council action for 2006 began with a meeting on August 29, 2006. The Council received a summary of 2006 Legislative actions and updated financial projections based on the changes contained in House Bill 1027. (Attachment A). The changes are projected to stop the decline in trust fund reserves in 2006 and gradually build the fund back to a solvent position beginning in 2007.

Dr. Brown gave a presentation on the current Future Fee system and on four alternatives. The current system parallels the UI contribution rates. Future fee rates range from 0.0 percent to 0.7 percent. Alternative 1 uses a flat rate future fee rate applied to the UI wages. UI wages are the amount subject to the UI contribution. Alternative 2 also uses a flat future fee rate but with total wages instead of UI wages. Alternative 3 uses a flat rate with total employment as a base instead of wages. Alternative 4 uses a flat rate with taxable sales as a base. Dr. Brown followed his presentation with a synopsis of the stability, equity and fairness of the Future Fee program. The independent study by Dr. Brown is available online at www.sdjobs.org .

The Council voted to recommend that the current system, as well as all four of Dr. Brown's alternatives, be considered but that Alternative 4 would be a low priority and would be used for discussion only.

The October 10, 2006, meeting began with a discussion on a proposal by the Department of Labor regarding penalties for late filing.

Issue #1: Penalties for Late Filing

Background: Twenty-five thousand employers are covered by the unemployment insurance (UI) program. Each quarter every employer is required to pay any UI contributions and Future Fees due and file a report listing all their employees and wages paid to them. The payment and report are due 30 days after the end of the quarter. Even though some employers have a "0" rate and no payment is required, it is still critical that the report be received on a timely basis. The employee wage data is used for many labor market information purposes, for UI claim eligibility and by other state government departments to verify eligibility for public benefits.

Problem: Each quarter about 1,500 employers fail to make the required payment and/or do not file the report on time. The Department first sends the employer a "late" notice. If the payment/report is still not submitted, it is assigned to one of ten out-stationed field representatives. It is estimated that each quarter:

1,000 phone calls are made to collect late reports
250 in-person employer visits are made
5,000 miles are driven in state vehicles

75 subpoenas are issued to employers that refuse to comply voluntarily

This collection activity uses the equivalent of approximately one full-time position.

This problem exists in part because of minimal penalties for late filing. Current law requires only a $5 per month penalty for a late report and/or late payment. (Interest of 1 ½ percent/month is also charged on unpaid amounts.) The maximum total penalty for any quarter is $60. Many employers comment that they ignore the due date for reporting because the penalty is only $5.

Council Action: The UI advisory Council recommended that the penalty be increased from $5 to $25 per month. The higher penalties are expected to decrease delinquent payments and reports and free staff for more productive work.

A public hearing was held to receive public input on the current Future Fee system and on four alternatives. A copy of the public hearing transcript can be found online at www.state.sdjobs.org under the Unemployment Insurance program link.

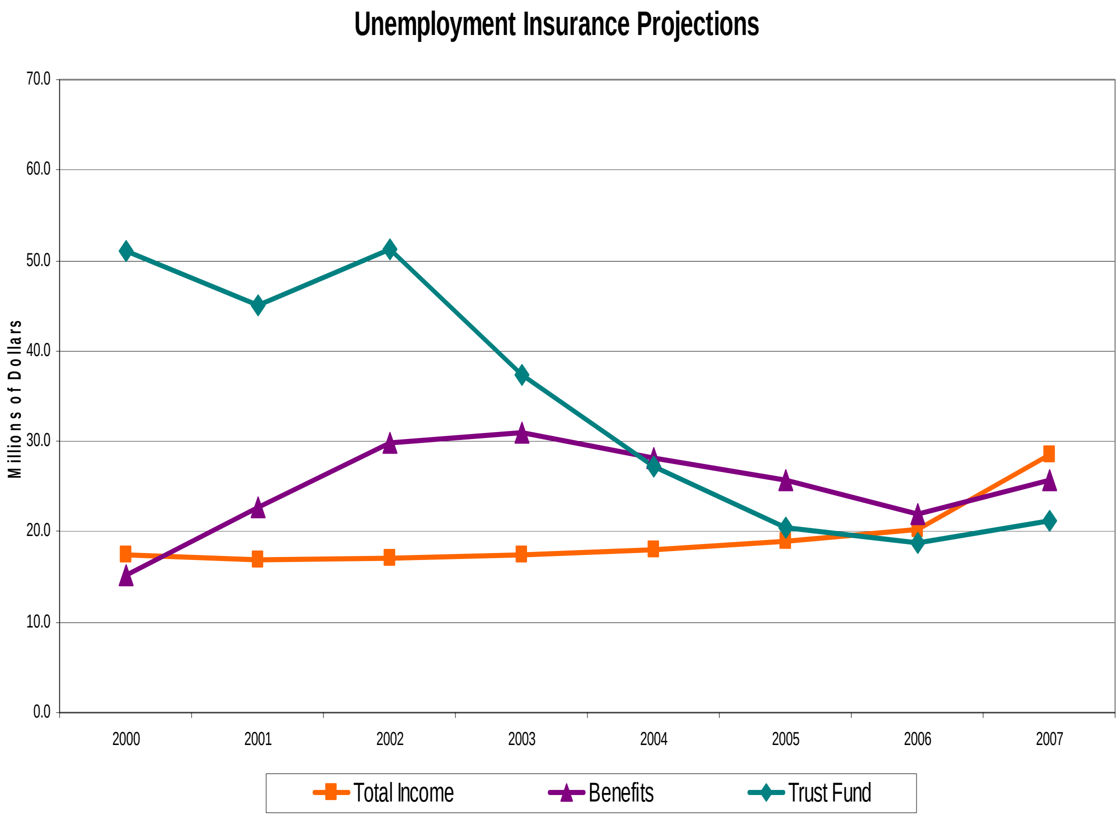
Any recommendations of the Council concerning the Future Fee study will be included in the final report submitted to the Governor and Legislature by the Departments of Labor and Tourism and State Development.

Respectfully submitted on October 10, 2006, by the Unemployment Insurance Advisory Council.

Members:

Pamela S. Roberts	Carol Hinderaker
Robert Anderson	David Owen
Paul Aylward	Jason Dilges
Bob Riter, Jr.	G. Homer Harding
Mark Merchen	

Attachment A



Unemployment Insurance Projections

(in millions)

YEAR	Total Income	Benefits	Trust Fund
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	18.9	25.8	20.4
2006	20.3	22.0	18.7
2007	28.3	25.8	21.2