Federal Register

Friday,
September 17, 2010

Part III

Department of Labor

Employment and Training Administration

20 CFR Part 606

Federal-State Unemployment Compensation Program; Funding Goals for Interest-Free Advances; Final Rule

DEPARTMENT OF LABOR

Employment and Training Administration

20 CFR Part 606

RIN 1205–AB53

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

AGENCY: Employment and Training Administration, Labor.

ACTION: Final rule.

SUMMARY: The Employment and Training Administration (ETA) of the United States Department of Labor (Department) issues this final 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, established under regulations issued by the Secretary of Labor." This final rule requires that States meet a solvency criterion in one of the 5 calendar years preceding the year in which advances are taken; and to meet two tax effort criteria for each calendar year after the solvency criterion is met up to the year in which an advance is taken.

DATES: *Effective date:* This final rule is effective October 18, 2010.

FOR FURTHER INFORMATION CONTACT: Ron Wilus, Chief, Division of Fiscal and Actuarial Services, Office of Unemployment Insurance, U.S. Department of Labor, 200 Constitution Avenue, NW., Room S–4231, Washington, DC 20210; telephone (202) 693–3029 (this is not a toll-free number).

Individuals with hearing or speech impairments may access the telephone number above via TTY by calling the toll-free Federal Information Relay Service at 1–800–877–8339.

SUPPLEMENTARY INFORMATION:

The preamble to this final rule is organized as follows:

I. Background

UC generally is funded by employer contributions (taxes) paid to a State. The State, in accordance with section 303(a)(4) of the Social Security Act (SSA) (42 U.S.C. 503(a)(4)) and section 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 Unemployment Trust Fund (UTF) maintained by the U.S. Treasury. Section 1202 of the SSA (42 U.S.C. 1322) permits a State to obtain from the Federal Government repayable advances to this account to pay UC when the State account reaches a zero balance. These advances are interest-bearing, except for certain short-term advances, which are called cash flow loans. Under section 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, section 5404) added the third requirement, that is, that the State meet funding goals established under regulations by the Secretary. This statutory requirement is implemented in this final rule.

State UC programs, created in the 1930s, were intended to be self-financing social insurance programs that levied payroll taxes on covered employers and paid benefits to eligible unemployed workers. A primary goal of the program was to act as an automatic stabilizer for the economy, by automatically injecting needed income support during recessionary periods and delaying tax increases. This is accomplished by building trust fund reserves during expansionary periods and using the reserves as a cushion to finance benefit payments during recessions. However, to acquire and maintain levels of reserves that would guarantee all legitimate claims are paid can be prohibitively costly. In the case of the UC program, employers largely pay the taxes (employees may also pay in three States) and paying more in taxes means employers experience increased costs. As a result, employers may have less money available to grow their businesses and add jobs to the economy. Therefore, to satisfy financing needs and fulfill the primary goal of stabilizing the economy in recessions, the UC program is designed to build and maintain State UC reserves at a level that will ensure funds are available to pay benefits during average recessions while not building reserves so high as to impede economic growth. *Report of the Committee on Economic Security: Hearings on S. 1130 Before the Senate Committee on Finance,* 74th Cong., 1st Sess. (1935).

States have wide latitude in determining how to provide for increases in UC benefits. 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 alternative funds to pay UC. Most States use a combination of these methods.

This final rule encourages States to improve their level of forward funding. Forward funding as a method of financing UC began deteriorating in the early 1990s. A steady decline in UC tax rates since then resulted in a measurable deterioration in the level of State UTF account balances. Following a mild recession in 2001, nine States depleted their UC reserves and were forced to take advances to pay UC. At the end of 2007, following more than 6 years of economic expansion, State UTF account balances, on average, stood at approximately 5 months of average recessionary benefits, a historically low level for that period in a cycle.

Forward funding of State UC programs is desirable because taking large advances can result in undesirable State actions. Such actions might include 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. Obtaining advances can also create difficult political decisions for a State. For example, if the advance results in interest coming due, a State must finance the interest payment from a source other than the regular UC tax. Therefore, maintaining solvent State UTF accounts is in the best interest of all involved. This rulemaking will encourage each State to maintain solvent UTF accounts by conditioning interest-free advances upon the State having met funding goals established under section 1202(b)(2)(C) of the SSA.

II. General Discussion of the Rulemaking

On June 25, 2009, the Department published a notice of proposed rulemaking (NPRM, at 74 FR 30402, Jun. 25, 2009) proposing, consistent with the statutory direction to the Department, regulations establishing "funding goals * * * relating to the accounts of the States in the [UTF]," that States must meet as a condition of an interest-free advance. The Department explained in the NPRM that the purpose of the funding goals requirement added by the Balanced Budget Act of 1997 was to provide an incentive for States to build and maintain sufficient reserves in their UTF accounts by restricting an existing Federal subsidy, in the form of an interest-free advance, to only those States that meet a forward funding solvency goal. The NPRM also explained that by restricting the subsidy, Congress hoped to encourage States to build cash reserves in order to adequately prepare for economic downturns. To meet the statutory requirement and its purpose of encouraging States to maintain sufficient balances in their UTF accounts to cover UC benefits in the event of a recession, the NPRM outlined three possible solvency approaches. All three approaches encouraged maintenance of adequate reserves.

The approach selected in the NPRM had two prongs. The first prong required a State to meet a measure of UTF account adequacy, recommended by the Advisory Council on Unemployment Compensation (Advisory Council) (created by the Emergency Unemployment Compensation Act of 1991), in at least one of the 5 calendar years before the calendar year in which the advance was obtained. This prong assured that the State had made sufficient efforts to obtain solvency before the need for the advance. The second prong required that the State meet two tax effort criteria for each year after the solvency criterion is met up to the year in which the advance was obtained. This prong assured that the State made reasonable efforts through its taxing authority to maintain solvency, even though, despite these efforts, the State needed an advance to pay benefits. In short, a State must achieve fund solvency and have maintained its tax efforts, which satisfies the statutory direction to the Department to establish funding goals for a State's UTF account as a condition of receiving the benefit of an interest-free advance. While not a mandate on the States, these funding goals, consistent with Congressional intent, encourage the States to build and maintain adequate solvency levels during economic expansions, and maintain tax effort, before obtaining an interest-free advance.

The NPRM proposed amending 20 CFR part 606. More specifically, the Department proposed amending § 606.32 by re-designating existing paragraph (b) as paragraph (b)(1) and adding new paragraphs (b)(2) through (b)(5) to establish the funding goals required by the SSA. Paragraph (b)(2)(i) set forth the first prong of the requirement, that the State, as of December 31 of any of the 5 calendar years preceding the calendar year in which the advance was taken, had an average high cost multiple (AHCM) of at least 1.0. Paragraph (b)(2)(ii) set forth the second prong, requiring the State to maintain 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 was taken. Paragraph (b)(3) explained the calculation of the AHCM, based, in part, upon the calculation of the average high cost rate, as provided by paragraph (b)(4).

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)" —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 over whichever period is longer, either the most recent 20 years or the period covering the most recent three recessions.

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.

Paragraph (b)(5) set forth the details of the maintenance of tax effort requirement: A State has maintained tax effort if, for every year between the last calendar year in which it attained an AHCM of 1.0 and the calendar year in which it obtained the advance, the State's unemployment tax rate as defined in § 606.3 for each of the specified years was at least:

1. Eighty percent of the prior year's rate; and,
2. Seventy-five percent of the average benefit-cost ratio over the preceding 5 calendar years, where the benefit-cost ratio for a year is defined as the amount of benefits and interest paid in the year divided by the total covered wages paid in the year.

The first criterion assures that the State maintained its tax effort by not allowing employer contributions, that is, tax revenue, to decline unduly. The second criterion 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 criteria 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.

In the NPRM, the Department also proposed amending the definition of benefit-cost ratio in § 606.3. Previously, this definition applied only for purposes of the cap on tax credit reductions under section 3302(f) of the FUTA (26 U.S.C. 3302(f)). The Department proposed deleting the reference to the cap, thereby making the definition applicable to the funding goals as well. The Department similarly proposed amending the definition of "State 5-year average benefit-cost ratio" at § 606.21(d), so that it also applies to the funding goals as well as the cap. Determining whether a State has met the maintenance of tax effort criteria involves the application of both definitions.

Finally, in the NPRM, the Department also solicited comments on its proposal to apply the funding goals 2 years after publication of the final rule to allow States time to adjust their financing systems. NPRM, at 74 FR 30406, Jun. 25, 2009; *See also http://www.regulations.gov/search/Regs/home.html#docketDetail?R=ETA-2009-0002,* Docket ID: ETA–2009–0002 (analysis of simulations applying solvency approaches discussed in NPRM).

Overview of the Comments Received on the NPRM

The Department received eleven unique comments in response to the NPRM; all but one were from State UC agencies.

The issue most frequently raised in the comments concerned the Department's proposal to apply the funding goals 2 years from publication of the final rule. Most commenters urged the Department to delay applicability due to the recession. In response to these comments, the Department has decided to delay and phase-in the funding goals requirement.

Several commenters also addressed the details of the solvency and maintenance of tax effort criteria. Some commenters offered modest support of the Department's proposed rulemaking objective. In addition, some commenters sought additional stakeholder collaboration before a final approach was determined. A few commenters suggested that the Department avoid "penalizing" States that have demonstrated reasonable efforts to obtain solvency. One commenter challenged the Department's authority to promulgate funding goals regulations. Some commenters requested that the

Department make available waivers from the funding goals requirement.

The Department read and carefully considered all of the comments in the process of developing this final rule. The substantive issues raised by the comments that are germane to the rule are responded to below. Other than the changes related to the phase-in of the funding goals, the Department makes no substantive change from what it proposed in the NPRM.

Timing of Rule Applicability

The most significant change to the rulemaking relates to the Department's intention to make the funding goals effective two years after publication of the final rule. In general, commenters argued that since the United States has experienced an economic downturn of historic proportion, now is not the time to require States to build and maintain sufficient reserves in their UTF accounts. Some of these commenters noted that the proposed 2-year timeframe for applicability was not sufficient for the States that have gone into debt due to the current recession. As one commenter stated, "[t]he majority of [S]tates are dealing with record high benefit levels and immediate or near-future insolvency * * *. Implementing this new requirement will seriously hamper [their recovery] process." Another commenter contended that the solvency goal "is not reasonably attainable to a large number of [S]tates that currently have negative balances in their funds."

Several commenters requested that the Department delay implementation of the funding goals requirements, with one commenter suggesting that the new funding goal requirements be delayed indefinitely in light of the length and severity of the current recession. One commenter suggested a delay of 5 years after the end of the current recession in the rule implementation, while another commenter suggested the funding goals should be implemented in 2017. Commenters also noted that section 2004 of the American Recovery and Reinvestment Act of 2009 (Pub. L. 111–5) (Recovery Act) waived all interest on advances during the period February 17, 2009, through December 31, 2010, and provided that no interest accrues on any advance during this period. They argued that this Act recognizes the need for a delay in the timing of the funding goal requirement. One commenter urged an extension of the existing waiver of interest on UTF account advances until 2011. Commenters also recommended that the solvency criterion, in particular, be phase-in over a period of time.

The Department has carefully considered these comments and recognizes that the current recessionary environment has greatly stressed States' ability to meet their UC funding obligations. While the Recovery Act's interest provisions will help the States, the Department also recognizes that States needing access to interest-free advances after this statutory provision expires may not meet the measure of UTF account adequacy established by this rulemaking within the proposed 2-year timeframe. Therefore, the Department has decided to delay and phase-in implementation of the funding goals requirement.

The Department has decided to delay application of the funding goals requirement until 2014, and to phase-in the solvency criterion thereafter. No funding goals requirement for an interest-free advance will apply through calendar year 2013. Starting in 2014, the maintenance of tax effort criteria will apply, as will a solvency criterion of 0.50 AHCM. The AHCM requirement will then increase by one-tenth each year until it reaches the 1.00 requirement in 2019. (As explained below, the NPRM proposed an AHCM of 1.0, but the final rule adopts an AHCM of 1.00. The distinction is relevant for rounding.)

In response to these comments, the Department chose to begin phasing in the funding goals requirement in 2014. Commencing application of the funding goals requirement in 2014 will give States more than a year of additional time to prepare for the requirement beyond what they would have under the 2-year application timeframe proposed in the NPRM. The Department decided to delay the application of the funding goals requirement in recognition that there will be a continued period when States will attempt to recover from a recession in the midst of unusually high unemployment. The Department's approach provides States additional time to repay advances and to build sufficient reserves to meet the requirement for an interest-free advance.

Phasing in the solvency requirement will also make this goal reasonably attainable, thus addressing one commenter's concern. Although the Department remains committed to the eventual application of the 1.00 AHCM solvency criterion, it recognizes that the effects of the current recession remain and so it will allow access to interest-free advances in 2014 to States with an AHCM of only 0.50 in at least one of the preceding 5 years. By then, the economy should be well into an expansionary period. Phasing in the AHCM also will provide States more severely impacted by the recession additional time to repay advances and build sufficient reserves to meet the requirement for an interest-free advance. Further, by increasing the solvency criterion by 0.10 a year, the Department intends to continue to provide the benefit of interest-free advances to those States that are actively pursuing forward funding their UTF accounts but which cannot yet attain an AHCM of 1.00. By 2019, the lingering effects of the current recession will have abated sufficiently to make it reasonable for the Department to apply the full solvency criterion.

While the Department's decision to delay implementation of the funding goals requirement provides States time to restore their finances, it also should encourage States to be more aware of the need to build cash reserves in order to adequately prepare for future economic downturns. Financing UC by the use of forward funding is a basic UC program goal. Forward funding allows a State to avoid the need to obtain advances as well the need to increase taxes or cut benefits when the economy is weak. Notably, several commenters supported the concept of a funding goal that builds UTF account solvency and tax effort maintenance goals into the UC system, with the caveat that sufficient time be provided for States to implement the proposed goals after the end of this current recession.

While the UTF account solvency measure will be phased-in over a 5-year period, the maintenance of tax effort goal begins in 2014. As the Department explained in the NPRM, it is important to maintain an adequate UTF account balance over the length of a business cycle rather than at just one point in time, in order to reduce the need for States to obtain advances. If the maintenance of tax effort criteria were not included, a State might reduce taxes too sharply during a period of economic expansion, which would likely leave the State to rely on advances from the Federal government during a recessionary period.

As States move away from a pay-as-you-go funding goal approach and toward forward funding their UC programs, the Department encourages States not to freeze, restrict eligibility, or precipitously lower UC benefits. These actions would reduce the UC program's economic stabilization effect during recessionary periods and clearly would have a negative impact on the ability of unemployed workers to support themselves and their families.

Many commenters acknowledged the need to maintain and restore solvency in their accounts to adequately prepare for the next economic downturn; to avoid the negative consequences of obtaining advances; and to restore the UC program to its forward funding nature. The funding goals requirement will help satisfy the legislative goal (as described in House Report No. 105–149, June 24, 1997, on the original House bill) to "encourage States to maintain sufficient unemployment trust fund balances to cover the needs of unemployed workers in the event of a recession."

In reviewing these comments, the Department realized that denoting a solvency goal that is rounded to the nearest tenth (0.1) does not reflect the established procedures for rounding the Department has adhered to when measuring the AHCM to assess trust fund adequacy. The Department has historically adhered to an established policy that carries out final calculations for the AHCM to the nearest hundredth (0.01) as demonstrated in the simulation analysis discussed in the NPRM and included in the rulemaking docket. This policy and changes made to the definitions in § 606.3 to reflect the Department's rounding procedures are explained in detail below. Accordingly, in this final rule and as appropriate in this preamble and as explained more fully below, references to the AHCM will be expressed in hundredths to reflect the Department's established rounding procedures. In addition, the Department modified § 606.32(b) to reflect the delay and phase-in of the funding goals requirement. The Department added a sentence to what is now the permanent funding goals requirement at paragraph (b)(2), stating that the paragraph is effective January 1, 2019. The Department also added a new paragraph (b)(3) to address the phase-in of the funding goals requirement. Paragraph (b)(3) states what AHCM will be required for each calendar year between 2014 and 2018. Paragraph (b)(3)(i) provides the phase-in of the solvency criterion. Paragraph (b)(3)(ii) covers the tax maintenance criteria, which become effective in 2014. The historical simulation analysis cited in the NPRM is still applicable for estimating the impact of the funding goals once the program is fully implemented. The phase-in of the solvency criterion does not change that analysis.

Solvency and Maintenance of Tax Effort Criteria

The Department received several comments about the solvency and tax maintenance criteria.

Some commenters addressed the proposed solvency criterion of a 1.0 AHCM; a few commenters suggested that this level was too high. One commenter suggested that, "as a practical matter, the requirement would foreclose the possibility of cash flow loans for many, if not all, of the largest [S]tates." This commenter further contended that a 1.0 AHCM is a "luxury" that many States will not be able to afford given the "virtually unlimited demands" facing State governments. Another commenter argued that a 1.0 AHCM would result in unnecessarily high reserves; maintaining that much money in the UTF account would be bad for local economies by diverting funds from those economies into a Federal account where the money is "not needed and not used, for decades."

The Advisory Council recommended using a 1.0 AHCM as a measure of solvency in its report to Congress in 1996. The Advisory Council's recommendation was made to encourage States to avoid obtaining large advances and incurring the risk of having to reduce benefits and raise taxes during the early years of a recovery. The Department conducted simulations to determine the effects of applying the funding goals on a State's eligibility for an interest-free advance. The simulations were discussed in the NPRM. The analysis revealed that a 1.00 AHCM (using the Department's established rounding procedures) as a measure of trust fund adequacy best satisfied the legislative goal of encouraging States to maintain adequate reserves to pay benefits during recessionary time while being a realistic and obtainable measure for States.

In the analysis discussed in the NPRM (NPRM, at 74 FR 30406, Jun. 25, 2009), the Department created a set of annual State data from 1967 through 2007, and then examined borrowing over the period 1972 through 2007. (*http://www.regulations.gov/search/Regs/home.html#docketDetail?R=ETA-2009-0002,* Docket ID: ETA–2009–0002). The results from the Department's simulation analysis determined that any of the three funding goal approaches proposed in the NPRM would make it more difficult for States with problematic financing systems to receive an interest-free advance. Going into a recession with an AHCM of at least 1.00 does not guarantee that a state will not need advances at some point. However, the analysis concluded that States that achieved an AHCM of 1.00 going into a moderate recession are less likely to need to obtain an advance during or after the recession than other States. For example, entering the 2001 recession, 28 States had achieved an AHCM of 1.00 and only one of those States received an advance during or after the recession. Additionally, during the recessionary periods from 1974–2001, only 14 percent of States that entered the recession with an AHCM of 1.00 received an advance during or after the recession whereas 60 percent of the States that entered those recessionary periods with an AHCM below 1.00 received an advance.

Before the current recession, nineteen States had already met the 1.00 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.

Therefore, the Department will implement an AHCM solvency criterion of 1.00.

Raising a related issue, one commenter suggested a "pay-as-you go" approach that would include a measure of solvency of 50 percent of a State's average high cost of benefits. Using a solvency level of 50 percent of the average high cost of benefits would be similar to using a 0.50 AHCM. However, forward funding of State benefits is needed in order for the UC program to act as a stabilizer for the economy. The funding goals requirement was enacted by Congress in the Balanced Budget Act of 1997 to encourage States to adequately forward fund their UC program and not rely on a "pay-as-you-go" system. The Department does not consider a solvency criterion of a 0.50 AHCM an adequate level of forward funding because, at this level of reserves, there is a high probability that the State will need to take advances during a recession. Historical data shows that on average 63 percent of the States that entered the last five recessions with an AHCM of 0.50 had to take advances to pay UC. However, of the States that entered those recessions with a 1.00 AHCM, only 25 percent on average have taken advances. For these reasons, the Department will not adopt the commenter's suggestion.

The Department disagrees with the comment that it is difficult for large States to achieve the AHCM solvency goal; larger States will have the same relative degree of difficulty in meeting this goal as smaller States. Many large States do have smaller balances when considered in relation to the wages subject to UC taxes, but that is primarily due to deteriorating tax structures in those States rather than a result of the State's size. While large States should obviously have higher dollar amounts in their UTF accounts than smaller States, when viewed in relation to the wages being taxed there is no correlation between the size of a UTF account balance and the size of a State. That is, the measure of an adequate UTF balance is based on the average level of past high payouts in the State. A larger State will have paid out more benefits, but will also have collected taxes on more wages.

In a related point, a commenter suggested that rather than promulgating one solvency goal for all States, the Department should "set goals for individual [S]tates based on their existing status and showing improved solvency over a period of time." The Department declines to adopt this suggestion, for several reasons. First, both the solvency and the maintenance of tax effort goals are structured and intended to prepare States to be able to pay the expected UC outlays required by a moderate recession. The Department wants every State to achieve that level of preparedness, and so it makes sense to uniformly apply the criteria to all States. Further, the solvency criterion is defined as a rate, so its very design accounts for variances among States. This is a balanced and fair approach and means that the goal is equally reasonable for any State to achieve. Finally, there are advantages to applying a uniform goal to every State. One advantage is administrative ease, but another is transparency; the factors that enable a State to obtain an interest-free advance will be known and uniform for all States and thus a State's progress in meeting the funding goals can be easily tracked.

In the NPRM, the Department proposed December 31 as the date on which to measure a State's AHCM. One commenter recommended changing to a date after the collection of the first quarter tax revenues (May) because States have higher UTF balances at that time. However, selecting such a date would provide a false reading on the State's financial health; States generally do not sustain that balance over the course of the year. End-of-calendar-year UTF account balances are neither a seasonal high nor low. Accordingly, the Department retains December 31 as the AHCM measuring point.

In the NPRM, the Department proposed a solvency requirement based upon whether a State had an AHCM of 1.0 on December 31 of any of the 5 calendar years preceding the calendar year in which the advance was taken. The same commenter recommended using the last 7 years before the advance instead of the last 5 years for the time period used to determine achievement of the solvency criterion. The Department selected a period of 5 years because it is a reasonable balance between a lengthy period for deterioration in a State's solvency level and allowing insufficient time for the unpredictable arrival of the next recession. Specifically, choosing a period longer than 5 years would allow a prolonged period of possible tax reductions, which might keep the State above the tax maintenance effort limits but would still contribute to a slowly diminishing trust fund solvency level that is inadequate for the next recession. Choosing a period of less than 5 years means less allowance for the normal swings between unexpected benefit payment levels and revenue flows that a state may experience.

Other commenters addressed the maintenance of tax effort criteria. One commenter raised concerns about the second criterion for the maintenance of tax effort goal, which requires the average tax rate in each year after attaining the AHCM of at least 1.00 but before the year in which an advance is taken to be at least 75 percent of the average benefit-cost rate over the preceding 5 years. This commenter objected to this requirement, arguing that the methodology in the criterion is flawed because it is impossible to know in advance when benefit payments are going to spike. In other words, following a large increase in total benefits (due to an economic downturn), even if a State meets the solvency criterion, its average tax rate may still not meet the 75 percent threshold compared to the State's 5-year average benefit-cost ratio because of the increased benefit payout, or spike, during the downturn.

In fact, the Department chose a 5-year period and a 75 percent rate to provide States a generous limit to account for unexpected changes in benefit levels. Using a 5-year average for the benefit-cost ratio will mitigate any 1- or 2-year large increase, or spike, in benefits, making it much easier for the State's tax system to respond. The last several recessions lasted on average about a year, and although unemployment may continue to rise for a short time following a recession, a 5-year average of benefits is still an exceptionally low level for a State's average tax rate to meet.

The Department ran historical simulations (available at *http://www.regulations.gov/search/Regs/home.html#documentDetail?R=09000064809ff0d2*) going back to 1967 assuming the funding goal requirements had been in effect, and found that in the vast majority of cases, the only States unable to meet the 75 percent criterion were those that had implemented large tax cuts, not those that had experienced significantly increased benefit outlays.

The same commenter also proposed amending the 80 percent and 75 percent tax rate thresholds in the maintenance of tax effort criteria so that a State would fail to achieve the criteria only if it failed to meet each requirement for 3 consecutive years rather than every year between the last year for which the solvency goal was met and the year in which a potentially interest-free advance is taken, as proposed in the NPRM. The tax maintenance criteria were included in the funding goals requirement specifically to discourage States from implementing large tax cuts after achieving an adequate level of solvency. Historically, a number of States have implemented significant tax cuts for short periods of time, for example 1 or 2 years, which have resulted in significant reductions in their trust fund solvency level. In some instances, States assigned a zero-percent tax rate to a large majority of their employers for the entire year. The 80 percent and 75 percent criteria would allow the States some latitude to reduce their tax effort, but allowing States to avoid the tax effort criteria altogether for 1 or 2 years would undermine the funding goals because of the potential loss of solvency from large, temporary tax cuts. As a result, the Department has determined that it is appropriate to apply the tax effort criteria to every year, as originally proposed.

In the NPRM, the Department described three possible approaches to funding goals. The first approach, the one selected, included the solvency criterion of a 1.0 AHCM and the two maintenance of tax effort criteria. The second possible approach eliminated the maintenance of tax effort criteria from Approach I. The third possible approach included a solvency criterion of a 1.7 reserve ratio and the two maintenance of tax effort criteria. One commenter suggested that the Department chose the most burdensome of the possible approaches. While Approach I imposes obligations that the commenter considers burdensome, it is the best approach to funding goals. As explained in the NPRM, Approach III would have been roughly as stringent as Approach I. Simulations revealed that approximately the same number of States, though not necessarily the same States, would have qualified for an interest-free advance under Approach III during the period 1972–2007 as qualified using Approach I. The Department selected Approach I over Approach III because the AHCM is a better indicator of a State's ability to pay UC benefits in an economic downturn than the reserve ratio. The Department selected Approach I over Approach II because Approach I included incentives for States to achieve an adequately financed system via the maintenance of tax effort criteria.

Other Issues

The comments raised a variety of other issues.

One commenter suggested that the Department encourage States to amend their laws to achieve solvency in their UTF accounts by linking the FUTA tax credit employers receive to criteria designed to achieve solvency in their UTF accounts, noting that this approach would provide a strong incentive for State legislatures to enact responsible UC tax reforms. The Department cannot adopt this suggestion as it does not have the legal authority to link the FUTA tax credit to a solvency requirement for a State's account in the UTF. Section 3304(a) of the FUTA (26 U.S.C. 3304(a)) sets forth the requirements for approval of State UC laws, which are conditions for the tax credit under section 3302(a)(1) of the FUTA (26 U.S.C. 3302(a)(1)). No requirement in section 3304(a) provides a basis for conditioning employer tax credits upon a State's meeting a solvency requirement.

That being said, the Department does have the authority to condition a State's UC administrative grant upon the State meeting a solvency standard. Section 303(a)(1) of the SSA (42 U.S.C. 503(a)(1)) conditions a State's grant upon its law including provision for "[s]uch methods of administration * * * as are found by the Secretary of Labor to be reasonably calculated to insure full payment of unemployment compensation when due * * *." Since an insolvent UTF account could jeopardize the "full payment of unemployment compensation when due," the SSA certainly authorizes the Secretary to prescribe "methods of administration" for maintaining the solvency of that account. Nevertheless, since section 1202(b)(2)(C) of the SSA (42 U.S.C. 1322(b)(2)(C)) explicitly directs the Secretary to promulgate funding goals, that is the proper vehicle for addressing this matter. Accordingly, the Department makes no change in the final rule.

One commenter took the position that mandating solvency goals as a requirement to obtain an interest-free advance may not be an effective mechanism to promote fund solvency. This commenter contended that States that do meet the solvency criterion will not need an advance, while some States cannot even meet the basic requirements for an interest-free advance (the advance is repaid in full by September 30 and no additional advance is made after that date) and so the funding goals requirement provides no real incentive to forward fund their UTF account because those States cannot get an interest-free advance anyway.

The Department disagrees with these comments. Section 1202(b)(2)(C) of the SSA explicitly directs the Secretary to promulgate funding goals regulations as a condition for an interest-free advance, even though the commenter believes that this is not an effective mechanism for promoting solvency. The Department also disagrees with the commenter's contention that this rule will provide insufficient incentive to affect the behavior of many States. During the 2001 recession, all nine of the States that obtained advances took interest-free cash flow loans. The Department is confident that many States will continue to seek these interest-free advances and will be consequently motivated to meet the funding goal.

Also, it is not true that States that do meet the solvency criterion will not need an advance, since a severe recession occurring after a State meets this criterion may result in the State's UTF account becoming insolvent. Nevertheless, the solvency criterion will make it less likely that a State will need an advance, which, of course, is the purpose of this rule.

One commenter recommended a "waiver of the solvency goal when during a downturn or recession in which the benefits cost rates during the downturn are substantially higher than the AHCM standard." The Department interprets this comment to refer to a situation in which benefit costs in the current recession are higher than the historical benefit costs used in calculating the AHCM. The Department believes that no waiver is necessary in this situation. Under the proposed funding goals, a State that builds up a fund balance sufficient to cover a recession equal to the average of past recessions, but then experiences a worse recession and is forced to take advances, would meet the solvency criterion.

Another commenter suggested that "[S]tates that continue to be the hardest hit by recessions" should be eligible for interest-free advances. First, to the extent that this comment is related to the current recession and the 2-year implementation date proposed in the NPRM, the delay and phase-in of the rule should mitigate the commenter's concern. To the extent the commenter is considering future recessions, the funding goals requirement promulgated in this rule is intended to encourage States to prepare for economic downturns. The solvency and tax maintenance effort criteria are designed so that States that meet those criteria are adequately prepared for an average recession.

Another commenter suggested providing a waiver for States that demonstrate reasonable efforts to obtain solvency through changes in State law. As this commenter, a State, detailed its recent actions to obtain solvency, this comment may also relate to the current recession and the 2-year implementation date proposed in the NPRM. To that extent, again, the delay and phase-in of the rule should mitigate the commenter's concern. To the extent this comment relates to potential future efforts by States, such actions would be consistent with, and reflected in, the maintenance of tax effort criteria. This rule is intended to encourage States to make reasonable efforts toward solvency by forward funding their UTF accounts. The reward for doing so is access to interest-free terms for short-term advances, just as the commenter desires.

One commenter argued that the Department's proposed funding goals "go well beyond the authority" of the 'Balanced Budget Act' by prescribing "standards that were never codified in statute" and "[i]n fact, the Congress by deciding in 1997 to drop the solvency standard and timeframe expressly rejected the idea of standards or sanctions." This comment apparently refers to the fact that the original House bill (H.R. 2015, 105th Cong, section 9404 (1997)) specified a solvency standard that was dropped from the enacted law. The commenter also maintained that this rulemaking overvalues the notion of building reserves as a solvency goal. The Department disagrees with both contentions. The Balanced Budget Act of 1997 added section 1202(b)(2)(C) to the SSA, explicitly requiring the Secretary to issue regulations governing "funding goals * * * relating to the accounts of the States in the [UTF]." Further, the SSA explicitly conditions an interest-free advance upon a State meeting these funding goals. That is exactly what this regulation does. It establishes funding goals that a State account in the UTF must meet as a condition of an interest-free advance.

The original House bill required, for an interest-free advance, that the average daily balance of a State's account "for each of 4 of the 5 calendar quarters preceding the calendar quarter in which such advances were made exceeds the funding goal of such State (as defined in subsection (d))." Subsection (d) defined "funding goal" as meaning "for any State for any calendar quarter, the average of the unemployment insurance benefits paid by such State during each of the 3 years, in the 20-year period ending with the calendar year containing such calendar quarter, during which the State paid the greatest amount of unemployment benefits." The report (H.R. Rep. No. 105–149 (1997)) accompanying the original House bill made clear that the funding goal requirement was a "provision [that] would encourage States to maintain sufficient unemployment trust fund balances to cover the needs of unemployed workers in the event of a recession." Thus, that "funding goal" was clearly a "solvency" standard which a State's account had to meet over a specified period in order for the State to qualify for an interest-free advance.

The enacted legislation deleted the specified "funding goal," but nevertheless required that a State meet "funding goals, established under regulations issued by the Secretary of Labor * * *." Accordingly, the final bill only deleted the particular "funding goal" specified in the House bill, which was a "solvency" requirement, and instead directed the Secretary of Labor to establish "funding goals," that is, a solvency requirement. There is no indication that the House/Senate conference decided that a "funding goal" in the form of a solvency requirement was inappropriate, only that it should be the Secretary, rather than Congress, that determined the "funding goals." As the House Conference Report (H.R. Rep. No. 105–217, at 950 (1997) (Conf. Rep.)) stated, "[t]he conference agreement follows the House bill, with the modification that the Secretary is to establish appropriate funding goals for States." Thus, although the original House bill would have established the funding goal, Congress ultimately decided that the Secretary should select the specific level of reserves necessary. Congress, therefore, did not turn away from a "solvency" requirement; it only turned away from selecting the particular "solvency" requirement itself, and, instead, delegated to the Secretary the determination of the solvency standard. This is precisely what the NPRM proposed.

Further, section 1202(b)(2)(C) of the SSA clearly makes the funding goal a condition of obtaining an interest free advance. The NPRM simply proposed incorporating this condition into the existing regulations setting forth the requirements for an interest-free advance. Accordingly, no change is made to the final rule.

This same commenter also argued that there was no statutory basis for a requirement that a state maintain a specified level of tax effort in order to receive an interest-free advance. The Department again disagrees. Because the maintenance of tax effort criteria are essential components of sound funding goals, the statutory basis for these criteria is the statutory direction to the Secretary to "establish[] under regulations" funding goals "relating to the accounts of the States in the [UTF]." Merely requiring a State to achieve solvency at some point in time before receiving an advance would serve no purpose if the State could thereafter "squander" that solvency by significantly reducing its tax effort. Thus, the maintenance of tax effort and solvency criteria work in tandem to encourage proper management of the State's UTF account.

In the NPRM, the Department stated that, "[t]o 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." 74 FR 30406, Jun. 25, 2009. One commenter argued that no such policy goal exists because Congress did not mention it in the Balanced Budget Act of 1997. Regardless of whether a reduction in the subsidy provided by interest-free advances was considered by Congress to be a policy goal, the Department is required to promulgate these funding goals regulations which encourage States to forward fund their UTF accounts. A reduction in advances is a likely consequence of improved forward funding.

One commenter argued that the maintenance of tax effort criteria are effectively at odds with the experience rating aspect of the UC system. The Department disagrees. The tax maintenance criteria do not restrict a State's ability to award reductions in tax rates based on an individual employer's experience with layoffs. The criteria place a limit on the State's overall tax rate reduction once a State has achieved an adequate trust fund balance. A State may still individually assign any distribution of rates it desires. In fact, the tax maintenance limits were made intentionally low to avoid the possibility that in any one year the movement of employers within the existing range of rates of any State's effective tax schedule would affect the level of tax effort and cause a State to fall below the limit.

A commenter also contended that, if States do not satisfy the criteria, they will be subject to sanctions without recourse. As an initial matter, the Department disagrees with characterizing the requirement that a State pay interest on an advance as a "sanction," when, in fact, paying interest is the norm. The SSA requires that interest be paid on all advances and then provides incentives for States to obtain interest-free advances, which is a significant benefit. Failure to meet the conditions under which this benefit is offered is not a sanction. Additionally, the SSA does not provide a process for a State to challenge the denial of an interest-free advance, which is why the Department did not create such a process through regulations. A State seeking recourse could challenge funding goals determinations through other legal processes.

The same commenter suggested measuring each State's solvency effort against its own history. The AHCM is calculated using State data to determine the adequacy of its UTF account. This measure takes the current balance of a State's account in the UTF and compares it to its own benefit payout history in order to derive the length of time the current account balance would last under an average recession in that State. Thus, the rule accords with the suggestion, and the Department makes no change in the final rule.

This commenter also suggested that the Department reward States that have made meaningful progress toward solvency with additional administrative grant funding. Congress thought that the way to promote solvency is to establish funding goals, as required by section 1202(b)(2)(C) of the SSA, which established the mechanism for encouraging States to achieve funding goals. Accordingly, the Department does not adopt this suggestion.

A commenter argued that placing any further conditions on obtaining interest-free advances might result in a State not qualifying for one, which would impose interest costs on the State. The commenter further argued that meeting those costs might reduce the amount of money available for the payment of benefits. In fact, the funds in a State's trust fund account may only, with exceptions not relevant here, be used to pay for UC (section 3304(a)(4) of the FUTA; section 303(a)(5) of the SSA), and may not, therefore, be used to pay interest costs, so the payment of interest would not, at least directly, reduce funds available for the payment of benefits. Nevertheless, the Department may not decline to impose funding goals because they might result in interest costs, since section 1202(b)(2)(C) of the SSA requires that the Secretary establish them by regulation.

Some commenters sought more involvement in the development of a funding goal approach. The Department believes that it provided stakeholders ample opportunity through the rulemaking process to provide reasonable alternatives to the funding goal approach selected by the Department. These commenters did not provide an alternative solvency goal for the Department to consider; therefore, the Department will not further delay this rulemaking.

A few commenters suggested that the Department's proposed funding goals requirement failed to adequately account for or appreciate the action(s) that some States have taken to maintain solvency. To the extent that this comment relates to the effects of the current recession, the delay and phase-in of this rule should mitigate the commenters' concern. Viewed more globally, the Department agrees that the funding goals ought to take into account what actions a State has undertaken to achieve and/or maintain solvency; this rule has been designed to do exactly that. The solvency criterion indicates whether a State has put sufficient funds in its UTF account to cover expected outlays during a recession. The maintenance of tax effort criteria indicate the adequacy of a State's tax structure. As both funding goals directly reflect State action(s), the Department has determined that the rule adequately accounts for State actions aimed at improving solvency.

One commenter also took issue with the Department's assertion, which the commenter found in the supporting and related materials (available at *http://www.regulations.gov/search/Regs/home.html#docketDetail?R=ETA-2009-0002)* that States have "misuse[d]" the system. The commenter appears to be referring to the sentence in the Impact Analysis that one advantage of this rule is "stemming the possibility of misuse of the current system by taking an interest-free advance and repaying it with funds from other sources, thereby avoiding the payment of interest on the use of federal funds." The commenter argues that since this is permitted under Federal law, it is not a misuse.

Although these actions are legally permissible, the SSA requires the Secretary to establish funding goals under regulations. To the extent that a State receives advances in the January to September period and repays by the September 30 deadline with funds from a non-UC source, but fails to actually improve its solvency, the system is not functioning in accordance with the obvious intent of section 1202(b)(2)(C) of the SSA. These funding goals will, of necessity, prevent a State from using the interest-free terms of the short-term advance to avoid confronting and addressing the underlying lack of solvency in the State's UTF account. It is a benefit that this rule may deter such behavior in the future, because a State will have to have made real efforts to obtain solvency to avoid interest.

Clarifying and Technical Corrections

We made several clerical and technical corrections to the regulations. These changes are intended to add clarity and accuracy but do not change the meaning or intent of the regulation.

We made several changes to § 606.3. Since the "Calculation of AHCM" and "Calculation of the AHCR" are definitions, they were moved from § 606.32(b)(3) and (4), where they respectively appeared in the NPRM, to § 606.3, "Definitions." The words, "Calculation of" were removed from the headings of those paragraphs and acronyms for these terms spelled out.

We added a definition for the reserve ratio to § 606.3. We also modified the definition of the AHCM to explain that it is calculated by dividing this reserve ratio by the AHCR and to include rounding to the nearest multiple of 0.01. Adding a definition for the "reserve ratio" to § 606.3 and using this term to describe the calculation of the AHCM is more accurate and consistent with the preamble discussion. In the NPRM, we described the AHCM as consisting of two ratios: The "reserve ratio" divided by the "average high cost rate (AHCR)." We described the "reserve ratio" as 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. However in § 606.32(b)(3) of the NPRM, we defined the calculation of the AHCM as: "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 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." The first ratio defined in § 606.32(b)(3)(i) was not identified as the "reserve ratio." In the NPRM, we noted that this rulemaking would "be based on established concepts and measures such as the reserve ratio and the average high cost multiple that are commonly used by DOL, State offices, and researchers to assess trust fund account adequacy." Adding a definition for the "reserve ratio" and referencing the "reserve ratio" as the first of the two ratios used to calculate the AHCM ensures that these established concepts and measures are reflected in this rulemaking. The reserve ratio is rounded to the nearest multiple of 0.01. The calculation of the AHCM remains unchanged. These revisions do not substantively change this rulemaking.

We also changed the definition for the Average High Cost Rate to ensure consistency with the preamble language that uses the term "average" instead of "mean" for the final calculation of the AHCR. In the NPRM, § 606.32(b)(4)(iii) read "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." This has been revised in § 606.3 to read "Average the three highest calendar year benefit cost ratios for the selected time period from paragraph (b) of this section. Final calculations are rounded to the nearest multiple of 0.01 percent." The calculation of the AHCR remains unchanged. This is not a substantive change to the rulemaking.

We removed the paragraph designations in § 606.3 (Definitions) and added, in alphabetical order, definitions for Average High Cost Multiple (AHCM), Average High Cost Rate (AHCR), and "Reserve Ratio". In subparts A and C of §§ 606.3 and 606.2 through 606.22, we removed the references of § 606.3(c), (f), (j), (k), and (l) and added in their place references to § 606.3.

In the NPRM, we changed the definition of "benefit-cost ratio" by removing the phrase "for cap purposes." The existing part 606 regulations, in addition to setting forth the conditions for interest-free advances, implement Federal provisions governing the "capping" of the reduction in the credits against the Federal unemployment tax where a State does not timely repay an advance. Eliminating this phrase makes clear that the definition applies to the funding goals provisions of part 606, in addition to the "cap purposes" of part 606. The benefit-cost ratio is also rounded to the nearest multiple of 0.01 percent when calculated for funding goal purposes; however, for cap purposes, final calculations are rounded to the nearest multiple of 0.1 percent as required by FUTA section 3302(f)(5)(E).

In the NPRM, we used the following heading for § 606.21(d), "State five-year benefit-cost ratio." In keeping with conventions governing Government printing, the heading now reads, "State 5-year average benefit-cost ratio." Similarly, we changed the reference within that section from "five preceding calendar years" to "5 preceding calendar years." We also added two hyphens to the section, each between "benefit" and "cost."

We made several technical changes to § 606.32. We moved the heading "Cash flow loans" from paragraph (b)(1)(i) to paragraph (b), and added the heading, "Availability of interest-free advances" to paragraph (b)(1). We moved to paragraph (b)(1) the first word and last phrase of the sentence that appeared in the NPRM in paragraph (b)(1)(i) so that paragraph (b)(1) now reads, "[a]dvances are deemed cash flow loans and shall be free of interest provided that:". For clarity, paragraphs (b)(1)(i)–(iii) have become explicit conditions a State must meet to avoid interest on the cash flow loan; the language for those paragraphs is drawn from what appeared in the NPRM as the first half of the sentence in paragraph (b)(1)(i), paragraphs (b)(1)(i)(A) and (B), and paragraph (b)(1)(ii).

We added the word "requirement" to paragraph (b)(2) of § 606.32, after the words, "funding goals," for clarity. In paragraph (b)(2)(i), we moved the words, "[t]he State" from the middle to the beginning of the sentence for clarity and to be consistent with paragraph (b)(2)(ii). Also in paragraph (b)(2)(i), we added the word, "consecutive" between the "5" and "years," again for clarity. In paragraph (b)(2)(ii), after the sentence begins with, "[t]he State maintained tax effort," we deleted the phrase, "with respect to the years between the last year the State had an AHCM of 1.00 and the year in which the advance or advances are made," because repeated information in the "maintenance of tax effort" paragraph (now paragraph (b)(4)).

We added the word, "criteria" after "[m]aintenance of tax effort" in the heading of what used to be paragraph (b)(5) but is now paragraph (b)(4). Also in paragraph (b)(4), we rephrased the opening sentence for clarity and accuracy. Most notably, we removed the word "not" which had appeared between "is" and "at least." The preamble to the NPRM correctly described the maintenance of tax effort criteria but the word "not" was inadvertently used in the NPRM regulatory text. Also, in the NPRM, we mistakenly included the word "any" between the words, "for" and "year;" that is corrected to now read, "for every year," which is consistent with how the preamble to the NPRM described the maintenance of tax effort criteria.

Due to these changes, we have renumbered and re-lettered the affected paragraphs of the rule. We also adjusted references to all relocated provisions throughout this rule.

Rounding Procedures

As we noted earlier in this preamble, we have changed the way we denote the AHCM to reflect the actual level of precision used to examine the proposed solvency goal in the NPRM. The simulation analysis, included in the NPRM and the rulemaking docket, assessed the solvency goal using an AHCM that was computed to the nearest hundredth (0.01). The simulation analysis, which examined the three possible solvency approaches outlined in the NPRM, used a set of annual State data from 1967 through 2007, and then examined borrowing over the period 1972 through 2007. The AHCM data used to determine eligibility for an interest-free advance in this analysis was calculated to the nearest hundredth (0.01).

In addition, quarterly financial reports on State-reported unemployment insurance data, which have been published by the Department on its Web site for more than a decade, reported a State's AHCM to the nearest multiple of 0.01. These quarterly reports can be found at *http://www.ows.doleta.gov/unemploy/content/data.asp.*

The AHCM as a measure of solvency was recommended by the Advisory Council. The Advisory Council recommended that States accumulate reserves sufficient to pay at least one year of benefits. This level of reserves was commonly described in the Advisory Council's 1996 report as an AHCM of 1.0. However, this description did not represent the level of precision the Advisory Council used to analyze the AHCM. The Advisory Council based its recommendation on a review of historical data that calculated the AHCM to the nearest hundredth (0.01). The Advisory Council used data provided by the Department to substantiate its AHCM recommendation and showed State AHCM data calculated to the nearest hundredth (0.01) in supporting tables in its 1996 report to Congress. Thus, an AHCM calculated to the nearest hundredth (0.01) also reflects a level of precision used by the Advisory Council to arrive at its recommendation that a State accumulate reserves sufficient to pay at least one year of benefits.

In addition, a majority of States that use an AHCM to assess trust fund solvency calculate the AHCM to the nearest hundredth (0.01).

An AHCM calculated to the nearest hundredth (0.01) reflects the long-standing and established procedure used by the Department to assess trust fund solvency. We calculate the AHCM to the nearest hundredth (0.01) because this level of precision more accurately measures a State's trust fund solvency than using an AHCM calculated to the nearest tenth (0.1).

Based upon a further review of data over a 40-year period, the Department determined that the use of a 1.00 AHCM, rather than a 1.0 AHCM, would have adversely affected only three States. Therefore, in § 606.3, we are revising the definition of the AHCM to include rounding it to the nearest multiple of 0.01.

The reserve ratio is rounded to the nearest multiple of 0.01 percent to conform to the rounding procedure for the AHCM. Also, the practice among a majority of States is to round the reserve ratio to the nearest multiple of 0.01.

The benefit-cost ratio is also rounded to the nearest multiple of 0.01 percent when calculated for funding goal purposes to conform to the procedures for rounding the AHCM and the reserve ratio; however, for cap purposes, final calculations are rounded to the nearest multiple of 0.1 percent as required by section 3302(f)(5)(E) of the FUTA.

III. Administrative Information

Executive Order 12866: Regulatory Planning and Review

This final 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 final 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 final rule is a significant regulatory action under Executive Order 12866 at section 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 final rule updates existing regulations in accordance with Congressional mandates. Therefore, the Department has submitted this final rule to the Office of Management and Budget (OMB) for review.

Paperwork Reduction Act

The purposes of the Paperwork Reduction Act of 1995 (PRA), 44 U.S.C. 3501 *et seq.,* include minimizing the paperwork burden on affected entities. The PRA requires certain actions before an agency can adopt or revise a collection of information, including publishing a summary of the collection of information and a brief description of the need for and proposed use of the information.

A Federal agency may not conduct or sponsor a collection of information unless it is approved by OMB under the PRA, and displays a currently valid OMB control number, and the public is not required to respond to a collection of information unless it displays a currently valid OMB control number. Also, notwithstanding any other provisions of law, no person shall be subject to penalty for failing to comply with a collection of information if the collection of information does not display a currently valid OMB control number (44 U.S.C. 3512).

The Department has determined that this rule does not contain 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 account balances in the UTF 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 Department received 11 unique comments during the public comment period for the NPRM. All but one of these comments were made by States. The Department's implementation of a phased-in approach for the AHCM levels is in response to feedback received from the States' through the NPRM. In addition, the Advisory Council's recommendation of using a 1.0 AHCM as a measure of solvency was developed through consultation with the States.

Moreover, the 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.

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 this final rule does not include any Federal mandate that may result in increased expenditure by State, local, and Tribal governments in the aggregate of more than $100 million, or increased expenditures by the private sector of more than $100 million.

One commenter argued that this rule constitutes an unfunded Federal mandate. However, this rule is not a Federal mandate because States are not required to comply; this rule provides an incentive (in the form of access to interest-free advances) to achieve the funding goals requirement. The effect of this rulemaking is to encourage, but not require, States to build and maintain adequate balances in their UTF accounts.

Accordingly, it is unnecessary for the Department to prepare a budgetary impact statement. Further, as noted above, the impact is positive for State UTF accounts.

Plain Language

The Department drafted this rule in plain language.

Effect on Family Life

The Department certifies that this final rule has been assessed according to section 654 of the Treasury and General Government Appropriations Act, enacted as part of the Omnibus Consolidated and Emergency Supplemental Appropriations Act of 1999 (Pub. L. 105–277, 112 Stat. 2681), 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 final 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 final 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 final rule would directly impact States. The definition of small entity does not include States. Therefore, no RFA analysis is required.

In addition, this final rule is not a major rule as defined by the Small Business Regulatory Enforcement Act of 1996 (SBREFA). The Department provides the following analysis to support this certification.

This final 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 1.00 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. Although we cannot quantify the magnitude of any possible tax increases that might result from this final rule, we are confident that States would be unwilling to adopt tax increases of a size which would even approach $100 million in the aggregate as a condition for receiving interest-free advances. Therefore, the Department certifies that this final rule will not have a significant impact on a substantial number of small entities and, as a result, no regulatory flexibility analysis is required.

List of Subjects in 20 CFR Part 606

Employment and Training Administration, Labor, Unemployment compensation.

■ For the reasons stated in the preamble, the Department amends 20 CFR part 606 as set forth below:

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. Amend § 606.3 as follows:

■ a. Remove the paragraph designations and arrange definitions in alphabetical order;

■ b. Add in alphabetical order definitions for "Average High Cost Multiple (AHCM)", "Average High Cost Rate (AHCR)", and "Reserve Ratio";

■ c. Revise the introductory text and paragraph (2) and add a new paragraph (3) in the definition for "Benefit-cost ratio";

■ d. Amend paragraph (2) in the definition of "Benefit-cost ratio" by removing the reference "§ 606.3(l)" and adding in its place, the reference "§ 606.3"; and

■ e. Amend the definition of "Unemployment tax rate" by removing the reference "§ 606.3(l)" and adding in its place, the reference "§ 606.3".

The revisions and additions read as follows:

§ 606.3 Definitions.

* * * * *

Average High Cost Multiple (AHCM) for a State as of December 31 of a calendar year is calculated by dividing the State's reserve ratio, as defined in § 606.3, by the State's average high cost rate (AHCR), as defined in § 606.3, for the same year. Final calculations are rounded to the nearest multiple of 0.01.

Average High Cost Rate (AHCR) for a State is calculated as follows:

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

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

(ii) 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.

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

(3) Average the three highest calendar year benefit cost ratios for the selected time period from paragraph (2) of this definition. Final calculations are rounded to the nearest multiple of 0.01 percent.

* * * * *

Benefit-cost ratio for a calendar year is the percentage obtained by dividing—

(1) * * *

(2) The total wages (as defined in § 606.3) with respect to such calendar year.

(3) For cap purposes, if any percentage determined by this computation for a calendar year is not a multiple of 0.1 percent, such percentage shall be reduced to the nearest multiple of 0.1 percent. For funding goal purposes, if any percentage determined by this computation for a calendar year is not a multiple of 0.01 percent, such percentage is rounded to the nearest multiple of 0.01 percent.

* * * * *

Reserve Ratio is calculated by dividing the balance in the State's account in the unemployment trust fund (UTF) as of December 31 of such year by the total wages paid workers covered by the unemployment compensation (UC) program during the 12 months ending on December 31 of such year. Final calculations are rounded to the nearest multiple of 0.01 percent.

* * * * *

§ 606.20 [Amended]

■ 3. In § 606.20, amend paragraph (a)(3) by removing the reference "§ 606.3(c)" and adding in its place, the reference "§ 606.3" and by removing the reference § 606.3(j)" and adding in its place, the reference "§ 606.3".

■ 4. In § 606.21, amend paragraph (c) by removing the reference "606.3(j)" and adding in its place, the reference "§ 606.3" and amend paragraph (d) by revising the first sentence to read as follows:

§ 606.21 Criteria for cap.

* * * * *

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

§ 606.22 [Amended]

■ 5. In § 606.22, amend paragraph (b)(4) by removing the reference "§ 606.3(f)" and adding in its place, the reference "§ 606.3"; and amend paragraphs (c)(1) and (c)(3) by removing the reference "§ 606.3(k)" and adding in its place, the reference "§ 606.3": and by amending paragraphs (c)(2) and (d)(3) by removing the reference "§ 606.3(l)" and adding in its place, the reference "§ 606.3"

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

§ 606.32 Types of advances subject to interest.

* * * * *

(b) *Cash flow loans.* (1) *Availability of interest-free advances.* Advances are deemed cash flow loans and shall be free of interest provided that:

(i) The advances are repaid in full prior to October 1 of the calendar year in which the advances are made;

(ii) The State does not receive an additional advance after September 30 of the same calendar year in which the advance is made. If the State receives an additional advance after September 30 of the same calendar year in which earlier advances were made, interest on the fully repaid earlier advance(s) is due and payable not later than the day following the date of the first such additional advance. The administrator of the State agency must notify the Secretary of Labor no later than September 10 of the same calendar year of those loans deemed to be cash flow loans and not subject to interest. This notification must include the date and amount of each loan made beginning January 01 through September 30 of the same calendar year, and a copy of documentation sent to the Secretary of the Treasury requesting loan repayment transfer(s) from the State's account in the UTF to the Federal unemployment account in the UTF; and

(iii) The State has met the funding goals described in paragraph (b)(2) or (b)(3) of this section.

(2) *Funding goals.* This paragraph (b)(2) is applicable to all States as of January 1, 2019. A State has met the funding goals requirement if:

(i) The State, as of December 31 of any of the 5 consecutive calendar years preceding the calendar year in which such advances are made, had an AHCM of at least 1.00, as determined under § 606.3; and

(ii) The State maintained tax effort as determined under paragraph (b)(4) of this section.

(3) *Phasing in funding goals.* This paragraph (b)(3) applies for calendar years 2014 through 2018. A State has met the funding goals requirement if it has satisfied the solvency criterion in paragraph (i), and the maintenance of tax effort criteria in paragraph (ii), of this § 606.32(b)(3).

(i) A State has met the solvency criterion if:

(A) For calendar year 2014, as of December 31 of any of the 5 consecutively preceding calendar years, the State had an AHCM of at least 0.50, as determined under § 606.3;

(B) For calendar year 2015, as of December 31 of any of the 5 consecutively preceding calendar years, the State had an AHCM of at least 0.60, as determined under § 606.3;

(C) For calendar year 2016, as of December 31 of any of the 5 consecutively preceding calendar years, the State had an AHCM of at least 0.70, as determined under § 606.3;

(D) For calendar year 2017, as of December 31 of any of the 5 consecutively preceding calendar years, the State had an AHCM of at least 0.80, as determined under § 606.3;

(E) For calendar year 2018, as of December 31 of any of the 5 consecutively preceding calendar years, the State had an AHCM of at least 0.90, as determined under § 606.3;

(ii) A State has met the maintenance of tax effort criteria if it maintained tax effort as determined under paragraph (b)(4) of this section.

(4) *Maintenance of tax effort criteria.* A State has maintained tax effort if, for every year between the last calendar year in which it met the solvency criterion in paragraph (b)(2)(i) or (b)(3)(i) of this section and the calendar year in which an interest-free advance is taken, the State's unemployment tax rate as defined in § 606.3 for the calendar year is 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).

Signed at Washington, DC, this 8th day of September, 2010.

Jane Oates,

Assistant Secretary, Employment and Training Administration.

[FR Doc. 2010–22926 Filed 9–16–10; 8:45 am]

BILLING CODE 4510–FW–P