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DIRECTIVE : UNEMPLOYMENT INSURANCE PROGRAM LETTER NO. 29-83
CHANGE 2

TO : ALL STATE EMPLOYMENT SECURITY AGENCIES

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Unemployment Insurance Service

SUBJECT : Experience Rating - Permissible Secondary
Adjustments

1. Purpose. To provide States with additional guidance concerning those secondary adjustments which may be used in determining reduced rates for employers.

2. References. The Federal Unemployment Tax Act (FUTA); the Social Security Act (SSA); Unemployment Insurance Program Letter (UIPL) No. 29-83, dated June 23, 1983 and UIPL No. 29-83, Change 1, dated September 24, 1991 (both published at 56 Fed. Reg. 54891 (October 23, 1991)); and Employment Security Memorandum (ESM) No. 9, dated July 1940.

3. Background. Secondary adjustments are a part of many State experience rating plans. They are adjustments, permissible under limited conditions, to the measure of an employer's experience which bear no relation to the employer's experience. The most typical example of a secondary adjustment is the triggering of a particular rate schedule due to the unemployment fund's balance. Recently a question has been raised as to whether payments by employers to funds other than the State's unemployment fund may be used as secondary adjustments. This UIPL provides the Department's position.

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4. Discussion.

a. Federal law. As a condition of employers in a State receiving the additional credit, the State's law must be certified as meeting the requirements of Section 3303, FUTA, which provides, in pertinent part, as follows--

(a) STATE STANDARDS.--A taxpayer shall be allowed an additional credit under Section 3302(b) with respect to any reduced rate of contributions permitted by a State law, only if the Secretary of Labor finds that under such law--

(1) no reduced rate of contributions to a pooled fund or to a partially pooled account is permitted to a person (or group of persons) having individuals in his (or their) employ except on the basis of his (or their) experience with respect to unemployment or other factors bearing a direct relation to unemployment risk during not less than the 3 consecutive years immediately preceding the computation date

The term "pooled fund" is defined in Section 3303(c)(2), FUTA, as "an unemployment fund or any part thereof . . . into which the total contributions of persons contributing thereto are payable, in which all contributions are mingled and undivided, and from which compensation is payable to all individuals eligible for compensation from such fund." Similarly, Section 3303(c)(3), FUTA, defines "partially pooled account" as a "part of an unemployment fund" Section 3306(f), FUTA, defines "unemployment fund" as "a special fund . . . for the payment of compensation" These provisions establish an explicit linkage between experience rating and payments to the unemployment fund from which unemployment compensation (UC) is paid.

b. Secondary Adjustments. As noted in ESM No. 9 and UIPL No. 29-83, the Department and its predecessor agencies have approved experience rating plans using secondary adjustments which are not related to an employer's experience. The following explanation of secondary adjustments (derived in part from ESM No. 9) is from page 10 of the attachment to UIPL 29-83:

The requirement that a reduced rate must be based on the employer's experience makes it necessary to maintain the influence of that experience in the determination of the reduced rate granted to an employer. The measurement of experience may be subjected to adjustments by the application of other factors bearing no

relation to an employer's experience only if the basic experience factor has not been so impaired by combination with such other factors that the employer's own experience is no longer the basic determinant of his reduced rate.

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A secondary adjustment that results in a reduction of rates has been found not to be an unreasonable distortion of the experience factor if the reduction is the same for all rated employers and if the reduction is not applied to employers not otherwise entitled to a reduced rate based on their own experience. [Emphasis in original.]

Although UIPL 29-83 is broadly written, it should not be read to permit the introduction of any factor unrelated to an employer's experience. It is the position of the Department that, to meet the requirements of Section 3303(a)(1), FUTA, secondary adjustments must directly serve the purpose of the unemployment fund.

A secondary adjustment, by definition, involves the intrusion of a factor unrelated to experience into the State's experience rating system. It does not follow that any intrusion is permissible. In fact, these intrusions have in the past been limited as described in UIPL 29-83. As discussed in item 4.a. above, experience rating is explicitly linked to payments to the unemployment fund. Therefore, the introduction of a factor which does not directly serve the purpose of the unemployment fund (i.e., the payment of UC) is an unacceptable intrusion into experience rating.

A payment to fund other than the unemployment fund is not a factor directly serving the unemployment fund's purpose and may not be used in determining the rate of an individual employer. This applies to payments to State general funds (for example, income or sales tax payments) as well as to payments which could potentially be used for payments of UC.¹ Similarly, the balance

¹ The principal in certain State funds (often called reserve funds) may be used for any or all of the following purposes: the payment of UC, loans to the State's unemployment fund, or the payment of interest on advances made under Title XII, SSA. Reserve fund interest is used for non-UC purposes such as training or economic development activities. To date, all State reserve funds have been created with a concurrent reduction in the amount payable to the State's unemployment fund. Thus, the reserve funds have deprived the unemployment fund of assets and interest earnings. Moreover, there is no guarantee that the

in another State fund may not be used to trigger rate schedules for the unemployment fund since the other fund does not directly serve the purpose of the unemployment fund.

A review of previously approved secondary adjustments indicates that the Department has limited approval only to adjustments directly serving the purpose of the unemployment fund.² For example, the triggering of rate schedules generates sufficient revenues for the payment of UC. Factors related to socialized costs, including the experience factor in benefit-wage ratio States, serve to make the fund whole for costs which are not otherwise funded through experience rates. These costs include UC not charged to a specific employer or charged to an employer who has gone out of business.

5. Action Required. State agency administrators are requested to review existing State law provisions to ensure that Federal law requirements as set forth in this UIPL are met. Prompt action, including corrective legislation, should be taken to assure Federal requirements are met.

7. Inquiries. Direct questions to the appropriate Regional Office.

State will not amend its law to authorize use of reserve fund moneys for non-UC purposes. This is because, unlike unemployment funds, reserve funds are not subject to the "immediate deposit" and "withdrawal" standards of Sections 3304(a)(3) and (4), FUTA, and Section 303(a)(4) and (5), SSA, which assure unemployment fund moneys will be used for the payment of UC. Finally, payment of interest on advances made under Title XII, SSA, from the unemployment fund is prohibited by Section 303(c)(3), SSA, and Section 3304(a)(17), FUTA. Thus, payments of interest do not serve the purposes of the unemployment fund.

² Voluntary contributions were originally considered to be acceptable secondary adjustments since they are paid into the unemployment fund, thereby directly serving the fund's purpose. Since Section 3303(d), FUTA, now contains specific authorization for voluntary contributions, their status as secondary adjustments is moot. Section 3303(d) was added to FUTA in 1947 to "give express statutory sanction to the administrative interpretation which has permitted voluntary contributions . . ." and to "provide for a definite period within which voluntary contributions must be made . . ." (H. Rep. No. 759, 80th Cong., 1st Sess. (1947)).