

**STATEMENT OF JANE OATES
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U.S. DEPARTMENT OF LABOR
BEFORE THE
COMMITTEE ON FINANCE
UNITED STATES SENATE**

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Good morning. Chairman Baucus, Ranking Member Grassley, and distinguished members of the Committee, thank you for this opportunity to discuss improper payments and the Administration's legislative proposals to improve integrity in the Unemployment Insurance (UI) program. Reducing improper payments and strengthening program integrity are priorities for the Administration government-wide. They are equally a priority within the Department of Labor with regard to the UI program. Given that Federal and state unemployment benefits being paid have dramatically increased during the course of this recession, focusing on this issue is both timely and necessary. I might also add that addressing improper payments relates to trust fund solvency. Particularly now, when trust funds are under extreme pressure and states are borrowing at near record levels, it is essential to ensure that UI benefit payments are made properly and that all employers pay their fair share of unemployment contributions.

I appreciate the Committee's interest in this critical issue.

BACKGROUND

I am pleased to report that the UI program has a longstanding commitment to ensuring its financial integrity. The program uses highly sophisticated sampling and audit methods to deter, detect, and recover overpayments. Every state operates a UI Benefit Payment Control unit that utilizes a wide variety of tools to prevent, detect, and collect overpayments. When potential overpayments are detected, individuals are given the opportunity to demonstrate that the payment was not made in error before collection efforts begin. All states also operate a quality control system to identify claims errors and support corrective action in the state's UI system. Benefit Accuracy Measurement (BAM) is a statistical survey of a sample of UI claims in each state that investigates the accuracy of benefit payments. For claims that were improperly paid, BAM determines the cause of, and the party responsible for, the error, and the amounts over (or under) paid. In fact, this UI statistical sampling program is often held up as a model for other Federal programs.

As you review improper payment statistics for the UI program, there are several things to keep in mind. States are required by the Social Security Act to pay benefits as soon as administratively feasible and states constantly struggle with getting timely, sufficient information from the individual's prior employer to make that determination. Many errors result from this structural issue. The Employment and Training Administration (ETA) routinely reports an annual improper payment rate based upon data collected from very thorough BAM audits that detect many errors that are not

within the control of the state agency. As a result, we report two rates for the UI program: the overall annual rate based on all sources of error and the operational rate, which represents those improper payments which could be more readily controlled – that is, identified and addressed- under normal state operations.

While benefit payments and improper payment dollar amounts have increased as a result of the recession and special Federal programs, during each of the last two fiscal years, both the annual rate and the operational overpayment rates have fallen. This phenomenon is due in part to the fact that during a recession there are more “clean claims” without issues that require more in-depth fact finding. (More people are laid off because of a lack of work rather than quit or are discharged for misconduct.) For fiscal year (FY) 2009, for regular unemployment benefits, the annual overpayment rate was 8.94% and the operational overpayment rate, for those root causes that were controllable, was 4.77%. These rates compare to 9.92% and 5.71%, respectively, in FY 2008. The underpayment rate in FYs 2008 and 2009 was 0.7%.

States also carry out integrity activities for state collection of UI contributions (taxes). Similar to the BAM survey, the Tax Performance System evaluates the quality of state UI tax operations. A sample of activity for each major tax function is examined including the collections operation and the field audit unit. Tax operations in the states employ a variety of tools including information sharing and audits to detect and recover unreported contributions. All states audit a sample of employers to determine if they are properly reporting their employees and paying correct amounts of contributions.

On November 20, 2009, President Obama signed Executive Order 13520: “Reducing Improper Payments and Eliminating Waste in Federal Programs”. This Executive Order requires identification of the Federal programs with the highest dollar value or majority of government-wide improper payments, which are called high-priority programs. Due to its size, the UI program has been identified as a high-priority program. While states strive to improve their integrity functions and the Department of Labor has several initiatives to support these state efforts, additional statutory authority and resources are needed to enhance our collaborative efforts and to continue to improve payment accuracy. To this end, the Department transmitted the Unemployment Compensation Program Integrity Act of 2010, or as we call it, the Integrity Act, to Congress on May 11, 2010. The Department estimates this bill would produce PAYGO savings of \$734 million over 5 years, and \$1.642 billion over 10 years. In addition, although not reflected in these estimates, the bill would also produce budgetary savings in the form of further reductions in improper UC payments and higher state unemployment tax collections.

UNEMPLOYMENT COMPENSATION PROGRAM INTEGRITY ACT OF 2010

The Integrity Act consists of several provisions that will reduce erroneous payments of UI, underpayment of employer taxes, and misclassification of employees as independent contractors; it will also improve the collection of overpayments and delinquent contributions.

Specifically, the legislation would provide flexibility to states that want to augment their resources for integrity activities by permitting them to use a portion of recovered overpayments and delinquent contributions specifically for integrity purposes. Under current Federal law, all overpayments of UI benefits and all delinquent payments of UI contributions by employers that are collected by a state must be deposited in the state's unemployment fund where they may be used only for the payment of UI benefits. The Integrity Act would permit states to use up to 5 percent of each overpayment recovered to augment administrative funding for preventing, detecting, and recovering benefit overpayments. Similarly, states would be permitted to use up to 5 percent of delinquent contributions collected for preventing, detecting, and recovering employer fraud and evasion of required employer contributions, including the misclassification of employees as independent contractors and the identification of employers who attempt to manipulate the taxing provisions to pay less than their fair share of contributions. Having dedicated resources to support integrity activities is critical, given that states are so often faced with difficult choices when deploying resources. When workloads are high, states often divert integrity resources to mission critical functions, such as timely benefit payments to unemployed workers.

Currently, every state assesses penalties on employers who are delinquent in tax payments. The Integrity Act would apply a similar penalty on UI claimants with outstanding fraudulent overpayments and boost resources for integrity activities. It would require states to assess a penalty of not less than 15 percent of the amount overpaid on any claim for benefits that is determined to be due to the claimant's fraud.

States would be required to place the penalties collected in a special state fund from which amounts may be withdrawn solely for integrity activities. This would ensure that individuals who have defrauded the system - who are frequently required to do no more than repay the fraudulently received benefits - will be penalized and that the penalty will be used in a way that will result in improved program integrity. While many states currently have these penalty provisions, the amounts received are often used for non-UI purposes. The Integrity Act would offer a state the option of transferring the penalty funds received into its account in the Unemployment Trust Fund for the payment of benefits if the state decides to use the funds for this purpose. With regard to penalty provisions related to claimants, the Department also plans to issue policy guidance and provide technical assistance to states to ensure that claimants are afforded appropriate due process.

The Integrity Act would help prevent overpayments as well by giving employers an incentive to respond timely and adequately to an agency request for information. Employers' state contributions to the fund from which benefits are paid are based in part on benefits paid to their former employees. Each time a payment is made, the benefits are "charged" to an individual employer's account, meaning that the benefits paid are used to calculate the employer's tax rate. Benefits may be "noncharged" when the employer is not at fault for causing the unemployment (e.g., the individual quit work for good personal cause) and thus the benefits paid are not used to calculate the employer's contribution rate. In determining whether an individual is eligible for UI, states rely on information provided by employers. When this information is not

received on a timely basis, is inaccurate, or is incomplete, an ineligible individual may receive benefits. States typically detect these improper payments when employers appeal their benefit charges. In many states, when benefit awards are reversed on appeal, contributing employers are non-charged regardless of whether or not the overpayments are recovered. To encourage employers to provide complete, timely, and accurate information about their former employees, this legislation would provide that if the state determines that an overpayment was the employer's fault due to failure to respond timely or adequately to an agency request for information, and that the employer has a pattern of failing to respond timely or adequately to such requests, the state may not relieve the employer's account of the benefit charges.

The Integrity Act would also give states better tools to recover overpayments. The Treasury Offset Program (TOP) is a government-wide debt matching and payment offset system that works by matching delinquent debts owed to various government agencies against Federal income tax refunds. In September 2008, Congress provided states the authority to use the TOP to recover certain UI debts (overpayments of UI benefits and uncollected employer contributions due to fraud), and associated penalties and interest, through offsets from Federal income tax refunds. The Integrity Act would expand the TOP authority to permit recovery of any overpayment incurred due to the individual's failure to report earnings to the UI agency. This addresses overpayments where the individual is at fault, because the individual fails to report earnings for the week of unemployment claimed, yet the state does not choose to classify it as a fraudulent overpayment. Since, in these cases, the individual clearly caused the

overpayment and should have known to report the earnings, the Department believes it is appropriate to use TOP to recover the debt. Additionally, the proposal repeals other limitations on TOP usage, including time limitations on the age of debts and the requirement that the state notify the person owing the debt by certified mail. It would also eliminate the restriction limiting recovery of a UI debt through TOP to when the address on the individual's tax form for a taxable year is an address within the state seeking the offset of the UI debt. In the UI program, many individuals receive UI benefits or employers pay UI taxes to one state while residing in another state. When this is the case, the state owed the UI debt would now be permitted to recover the debt via TOP.

Lastly, the Integrity Act would help states identify overpayments by requiring that the date the individual starts work (that is, the first day of earnings) be included in the information reported by all employers to the State Directory of New Hires, which transmits this information to the National Directory of New Hires (NDNH). State UI agencies have found the state and national directories of new hires to be extremely useful in identifying individuals who continue to claim UI benefits after they have returned to work. However, the effectiveness of this system is limited because not all employers currently report the date on which an individual actually started work, which is critical in determining whether the individual worked while claiming UI benefits. As a result, when reviewing UI claims that were identified via cross match with the new hire directories as potentially being improper payments, states must contact each employer directly to determine the date the individual actually started

work. Follow-up on all of these leads is an expensive, time consuming process. In some cases, overpayment investigations may not be pursued because of the lack of this start date. The Department's Office of Inspector General has recommended amending Federal law "to require employers to report a new hire's first day of earnings." The Integrity Act would implement that recommendation.

MISCLASSIFICATION OF WORKERS

Preventing misclassification of workers as independent contractors when they are actually employees is another priority for the Administration. Both ETA and the Department's Wage and Hour Division are currently working with the Vice President's Middle Class Task Force and the Department of Treasury on a multi-agency initiative to develop strategies to address this issue. To support this initiative, the Administration's budget request for FY 2011 includes \$25 million for the Department of Labor, including \$12 million for increased enforcement of wage and overtime laws in cases where employees have been misclassified, and almost \$11 million for ETA to increase the capacity of state UI programs to focus their audits on employers likely to misclassify their employees and to enhance information sharing activities with Federal and state agencies to detect worker misclassification. These funds would provide competitive grants and high performance bonuses to states to improve and reward improved worker misclassification efforts. The Department is actively engaged in exploring new alternatives for addressing worker misclassification as well.

STATE AND FEDERAL EFFORTS TO ADDRESS INTEGRITY

The provisions I have outlined above in the Integrity Act will bolster existing integrity efforts already in place at the state and Federal levels. Because the UI program has exceptionally good data as a result of the BAM sampling process, we can use that data to assess and analyze the root causes of UI improper payments and develop strategies that are targeted to those root causes.

The primary cause of improper payments, approximately 30 percent, is unreported earnings – individuals who return to work and continue to claim benefits. To assist in identifying this type of overpayment, states cross match their payment files with a variety of databases. The most effective cross match is with the NDNH database. The addition of employee start dates to the NDNH, among the Integrity Act provisions, will improve detection and reduce state costs.

The second highest cause of improper payments, approximately 20 percent, are errors related to state determinations concerning the reason an individual became unemployed. Ensuring the state UI agency receives sufficient and timely information from employers upon request would reduce this type of overpayment. To help address this issue, the Department worked with a group of states to pilot the State Information Data Exchange System (SIDES). SIDES will provide a secure electronic data exchange between states and employers with a standard format. This will help improve the quality and timely receipt of information by states. SIDES is now operational in one state with several more expected to join later this year. Several large employers and

third-party employer representatives are planning to use SIDES, and additional employers are being recruited.

Identity theft is another area of concern regarding proper benefit payments. To combat this issue, states cross match with databases from several agencies, such as the Social Security Administration and state departments of motor vehicles, to verify the identity of claimants.

States have multiple tools, including offsets from future UI benefits, wage garnishment, monthly payment plans, liens, other legal actions, and interception of lottery winnings or state income tax refunds to recover improper payments. As mentioned before, the Integrity Act would enable states to use TOP to offset additional UI debts against Federal income tax refunds.

With regard to integrity of state UI taxation, the Department has developed software for states to detect employers who try to pay less than their fair share by “dumping” some of their state unemployment tax act (SUTA) liability on the rest of the state’s employers, commonly referred to as “SUTA Dumping”. This “SUTA Dumping” software, including funds for installation, maintenance and support was provided to all states in FY 2005. The Department assists the states with maintenance and support of this software with available resources.

At Congress’ direction, we continue to provide states with resources to support integrity activities. In FY 2009, we issued \$13.5 million in response to supplemental budget requests from 24 states for integrity improvement and anticipate awarding an additional \$10 million in FY 2010. We are also working with the states by sponsoring

training conferences, sharing best practices and have provided \$50 million in FY 2010 for the Re-employment and Eligibility Assessment program and special integrity technology grants to address the root causes of UI improper payments.

CONCLUSION

Again, let me thank you for the opportunity to talk to you about the integrity of the UI program. I look forward to working further with the Committee as you consider ways to enhance Federal and state efforts to reduce improper payments in the UI program, including passage of the Integrity Act. I will be glad to respond to any questions you may have.